

Franklin High Yield Tax-Free Income Fund

Advisor Class: FHYVX Class A: FHYQX

Commentary | as of March 31, 2025

Key Takeaways

- **Markets:** The municipal (muni) bond market, as measured by the Bloomberg Municipal Bond Index, posted a slightly negative result for the first quarter of 2025 (Q1). January and February saw positive returns supported by healthy inflows of funds and steady demand, while returns posted in March reversed those gains.
- **Contributors:** Overweight allocation to muni bonds with no external credit rating and overweight allocation to muni bonds rated below investment grade.
- **Detractors:** Overweight allocation to muni bonds with 20 or more years to maturity, security selection in BBB rated bonds and underweight allocation to A rated bonds.
- **Outlook:** Potential policy changes under US President Donald Trump's administration, such as the possible elimination of tax exemptions for certain bonds and the cancellation of federal leases, are adding uncertainty to the muni market outlook, alongside broader concerns about how federal decisions may impact local economies.

Performance Review

- Over the quarter, Franklin High Yield Tax-Free Income Fund fared better than its benchmark, the Bloomberg Municipal Bond Index.
- Rating allocations benefited the fund's relative returns for the period, led by our overweights to bonds with no external credit rating and bonds rated below investment grade. Conversely, our underweight to A rated bonds partially mitigated some of those gains. Security selection detracted from relative results, particularly due to selection in BBB and AA rated securities.
- The fund's yield curve positioning detracted from relative performance during the quarter, primarily driven by our overweight to muni bonds with 20 or more years to maturity and underweight to muni bonds with two to five years to maturity.

Outlook

- There was a significant swing in market sentiment across Q1 as participants digested the first few months of the new Trump administration. January saw positive excess returns across a number of sectors as market sentiment moved higher in anticipation of new business friendly initiatives. This was replaced by a negative shift in risk appetite during February and March as unclear tariff policies became the market's focus. Throughout the quarter, investment-grade munis underperformed US Treasuries. Despite modest outflows in March, muni funds overall benefited from steady inflows earlier in the quarter.
- Muni credit fundamentals remain broadly stable, with signs of improvement even in sectors that struggled post-pandemic, though revenue growth is moderating, and economic tailwinds are slowing. High reserves and fiscal flexibility continue to support most issuers, and credit ratings are expected to remain steady over the next six months, though sector-specific challenges persist.
- Potential policy changes under the Trump administration, such as the possible elimination of tax exemptions for certain bonds and the cancellation of federal leases, are adding uncertainty to the muni market outlook, alongside broader concerns about how federal decisions may impact local economies. At the same time, US consumer sentiment is softening, and overall uncertainty around the economic growth outlook has increased in response to the administration's proposed reforms and policy direction.

Morningstar Rating™

Overall Rating as of March 31, 2025



(4-Star) Advisor Class



(3-Star) Class A

As of 03/31/2025 the fund's Advisor Class shares received a 4 star and Class A shares received a 3 star overall Morningstar rating™, measuring risk-adjusted returns against 180, 174 and 118 High Yield Muni funds over the 3-, 5- and 10- year periods, respectively. A fund's overall rating is derived from a weighted average of the performance figures associated with its 3-, 5- and 10-year (if applicable) rating metrics.

Fund Characteristics

| | Fund |
|---|-------------|
| Distribution Frequency | Monthly |
| Effective Duration | 7.61 Years |
| 30-Day SEC Yield (Advisor Class)—With Waiver | 4.43% |
| 30-Day SEC Yield (Advisor Class)—Without Waiver | 4.43% |
| Taxable Equivalent Yield (Advisor Class)—With Waiver | 7.48% |
| Taxable Equivalent Yield (Advisor Class)—Without Waiver | 7.48% |

State / U.S. Territory Allocation (% of Total)

| State | Fund |
|-------------------------|-------------|
| California | 20.54 |
| Florida | 18.43 |
| Texas | 11.56 |
| Puerto Rico | 7.76 |
| Colorado | 5.05 |
| N/A | 4.31 |
| Arizona | 3.84 |
| New York | 3.17 |
| Other | 26.02 |
| Cash & Cash Equivalents | -0.68 |

Average annual total returns and fund expenses (%)

| Class | CUSIP | Ticker | Without Sales Charge | | | | | | | With Maximum Sales Charge | | | | | | | Expenses | | Sales Charges | | Inception Date |
|---------------|-----------|--------|----------------------|-------|------|------|------|-------|-----------|---------------------------|-------|------|------|------|-------|-----------|----------|------|----------------|------|----------------|
| | | | 3-Mo | YTD | 1-Yr | 3-Yr | 5-Yr | 10-Yr | Inception | 3-Mo | YTD | 1-Yr | 3-Yr | 5-Yr | 10-Yr | Inception | Gross | Net | Initial Charge | CDSC | |
| Advisor Class | 354723272 | FHYVX | 0.01 | 0.01 | 4.35 | 1.68 | 2.31 | 2.48 | 5.45 | 0.01 | 0.01 | 4.35 | 1.68 | 2.31 | 2.48 | 5.45 | 0.57 | 0.57 | — | — | 3/18/1986 |
| Class A | 354726887 | FHYQX | -0.05 | -0.05 | 4.11 | 1.47 | 2.07 | 2.29 | 5.36 | -3.80 | -3.80 | 0.21 | 0.19 | 1.29 | 1.90 | 5.26 | 0.83 | 0.83 | 3.75 | — | 3/18/1986 |
| Benchmark | — | — | -0.22 | -0.22 | 1.22 | 1.53 | 1.07 | 2.13 | — | -0.22 | -0.22 | 1.22 | 1.53 | 1.07 | 2.13 | — | — | — | — | — | — |

Benchmark(s)

Benchmark = Bloomberg Municipal Bond Index

Performance data quoted represents past performance, which does not guarantee future results. Current performance may be lower or higher than the figures shown. Principal value and investment returns will fluctuate, and investors' shares, when redeemed, may be worth more or less than the original cost. Performance would have been lower if fees had not been waived in various periods. Total returns assume the reinvestment of all distributions and the deduction of all fund expenses. Returns with sales charge reflect a deduction of the stated maximum sales charge. An investor cannot invest directly in an index, and unmanaged index returns do not reflect any fees, expenses or sales charges. Returns for periods of less than one year are not annualized. All classes of shares may not be available to all investors or through all distribution channels. For current month-end performance, please visit franklintempleton.com.

The fund began offering Advisor Class shares on 1/3/2006 and the fund began offering A Class shares on 9/10/2018. Performance quotations have been calculated as follows: (a) for Advisor Class periods prior to 1/3/2006, a restated figure is used based on the fund's Class A1 performance; for A Class periods prior to 9/10/2018, a restated figure is used based on the fund's Class A1 performance. The performance was adjusted to take into account differences in class-specific operating expenses and maximum sales charges. (b) For periods after share class offering, performance for the specific share class is used, reflecting the expenses and maximum sales charges applicable to that class.

The total annual operating expenses are as of the fund's prospectus available at the time of publication. Actual expenses may be higher and may impact portfolio returns.

What are the Risks?

All investments involve risks, including possible loss of principal. Fixed income securities involve interest rate, credit, inflation and reinvestment risks, and possible loss of principal. As interest rates rise, the value of fixed income securities falls. Changes in the credit rating of a bond, or in the credit rating or financial strength of a bond's issuer, insurer or guarantor, may affect the bond's value. Low-rated, high-yield bonds are subject to greater price volatility, illiquidity and possibility of default. An investor may be subject to the federal Alternative Minimum Tax, and state and local taxes may apply. These and other risks are discussed in the fund's prospectus.

Glossary

Investment grade is a rating that indicates that a municipal or corporate bond has a relatively low risk of default. BBB is medium credit quality rating.

The **yield curve** shows the relationship between yields and maturity dates for a similar class of bonds.

Important Information

The information provided is not a complete analysis of every material fact regarding any country, market, industry, security or fund. Because market and economic conditions are subject to change, comments, opinions and analyses are rendered as of the date of this material and may change without notice. A portfolio manager's assessment of a particular security, investment or strategy is not intended as individual investment advice or a recommendation or solicitation to buy, sell or hold any security or to adopt any investment strategy; it is intended only to provide insight into the fund's portfolio selection process. Holdings are subject to change.

The **Bloomberg Municipal Bond Index** is a broad measure of the municipal bond market with maturities of at least one year. Source: Bloomberg Indices.

Important data provider notices and terms available at www.franklintempletondatasources.com. All data is subject to change.

Effective Duration is a duration calculation for bonds with embedded options. Effective duration takes into account that expected cash flows will fluctuate as interest rates change. Duration measures the sensitivity of price (the value of principal) of a fixed-income investment to a change in interest rates. The higher the duration number, the more sensitive a fixed-income investment will be to interest rate changes. The **30-day SEC yield** is calculated using the net income (interest and dividends) per share earned over a trailing 30-day period (annualized), divided by the fund's share price at the end of that period. It may not equal the fund's actual income distribution rate, which reflects the fund's past dividends paid to shareholders.

Morningstar Rating™: Source: Morningstar®, 03/31/2025. For each mutual fund and ETF with at least a 3-year history, Morningstar calculates a Morningstar Rating™ based on how a fund ranks on a Morningstar Risk-Adjusted Return measure against other funds in the same category. This measure takes into account variations in a fund's monthly performance, and does not take into account the effects of sales charges and loads, placing more emphasis on downward variations and rewarding consistent performance. The top 10% of funds in each category receive 5 stars, the next 22.5% receive 4 stars, the next 35% receive 3 stars, the next 22.5% receive 2 stars and the bottom 10% receive 1 star. The weights are: 100% 3-year rating for 36-59 months of total returns, 60% 5-year rating/40% 3-year rating for 60-119 months of total returns, and 50% 10-year rating/30% 5-year rating/20% 3-year rating for 120 or more months of total returns. While the 10-year overall star rating formula seems to give the most weight to the 10-year period, the most recent 3-year period actually has the greatest impact because it is included in all three rating periods. The fund's Advisor Class shares received a Morningstar Rating of 4, 4 and 3 and fund's Class A shares received a Morningstar Rating of 3, 3 and 3 star(s) for the 3-, 5- and 10-year periods, respectively. Franklin Templeton provides this fund's Morningstar Rating™ for Advisor Class and Class A shares only. Other share classes may have different Morningstar ratings.

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Before investing, carefully consider a fund's investment objectives, risks, charges and expenses. You can find this and other information in each prospectus, or summary prospectus, if available, at www.franklintempleton.com. Please read it carefully.