

FRANKLIN LTD DURATION INCOME TRUST  
Form N-2  
June 14, 2018

As filed with the Securities and Exchange Commission on June 14, 2018

Securities Act File No. 333-[ ]

Investment Company Act File No. 811-21357

**U.S. SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

**FORM N-2**

**Registration Statement Under the Securities Act of 1933**

**Pre-Effective Amendment No.**

**Post-Effective Amendment No.**

and/or

**Registration Statement Under the Investment Company Act of 1940**

**Amendment No. 7**

**Franklin Limited Duration Income Trust**

(Exact Name of Registrant as Specified In Charter)

**c/o Franklin Advisers, Inc.**

**One Franklin Parkway, San Mateo, CA 94403-1906**

(Address of Principal Executive Offices)

Registrant's Telephone Number, including Area Code: **(650) 312-2000**

**Craig S. Tyle, One Franklin Parkway**

**San Mateo, CA 94403-1906**

(Name and Address of Agent For Service)

**Copies of information to:**

**Rose F. DiMartino, Esq.**

**Willkie Farr & Gallagher LLP**

**787 Seventh Avenue**

**New York, New York 10019**

**Approximate Date of Proposed Public Offering:** From time to time after the effective date of this Registration Statement.

If any securities being registered on this form will be offered on a delayed or continuous basis in reliance on Rule 415 under the Securities Act of 1933, other than securities offered in connection with a dividend reinvestment plan, check the following box.

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It is proposed that this filing will become effective (check appropriate box)

when declared effective pursuant to section 8(c).

**CALCULATION OF REGISTRATION FEE UNDER THE SECURITIES ACT OF 1933**

<b>Title of Securities Being Registered</b>	<b>Amount Being Registered(1)</b>	<b>Proposed Maximum Offering Price Per Unit</b>	<b>Proposed Maximum Aggregate Offering Price(2)</b>	<b>Amount of Registration Fee</b>
Common Shares, no par value per share Rights to Purchase Common Shares (3)			\$200,000,000	\$24,900
	Total		\$200,000,000	\$24,900

- (1) There is being registered hereunder an indeterminate principal amount of Common Shares as may be sold, from time to time, including rights to purchase Common Shares.
- (2) Estimated pursuant to Rule 457(o) solely for the purpose of determining the registration fee. The proposed maximum offering price per security will be determined, from time to time, by the Registrant in connection with the sale by the Registrant of the securities registered under this registration statement.
- (3) No separate consideration will be received by the Registrant. Any shares issued pursuant to an offering of rights to purchase Common Shares, including any shares issued pursuant to an over-subscription privilege or a secondary over-subscription privilege, will be shares registered under this Registration Statement.

THE REGISTRANT HEREBY AMENDS THIS REGISTRATION STATEMENT ON SUCH DATE OR DATES AS MAY BE NECESSARY TO DELAY ITS EFFECTIVE DATE UNTIL THE REGISTRANT SHALL FILE A FURTHER AMENDMENT WHICH SPECIFICALLY STATES THAT THIS REGISTRATION STATEMENT SHALL THEREAFTER BECOME EFFECTIVE IN ACCORDANCE WITH SECTION 8(a) OF THE SECURITIES ACT OF 1933 OR UNTIL THE REGISTRATION STATEMENT SHALL BECOME EFFECTIVE ON SUCH DATE AS THE SECURITIES AND EXCHANGE COMMISSION, ACTING PURSUANT TO SAID SECTION 8(a), MAY DETERMINE.

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The information in this Prospectus is not complete and may be changed. Franklin Limited Duration Income Trust may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and it is not soliciting an offer to buy these securities in any jurisdiction where the offer or sale is not permitted.

**SUBJECT TO COMPLETION, DATED JUNE 14, 2018**

**PRELIMINARY BASE PROSPECTUS**

**\$200,000,000**

**FRANKLIN LIMITED DURATION INCOME TRUST**

**Common Shares**

**Rights to Purchase Common Shares**

The Franklin Limited Duration Income Trust, a Delaware statutory trust (“Fund,” “we,” “us” or “our”), is a diversified, closed-end management investment company. The Fund seeks to provide high current income, with a secondary objective of capital appreciation to the extent possible and consistent with the Fund’s primary objective.

We may offer, from time to time, in one or more offerings, our common shares, no par value (“Common Shares”), or subscription rights to purchase our Common Shares. Common Shares may be offered at prices and on terms to be set forth in one or more supplements to this Prospectus (each, a “Prospectus Supplement”). You should read this Prospectus and the applicable Prospectus Supplement carefully before you invest in our Common Shares.

Our Common Shares may be offered directly to one or more purchasers, including existing shareholders in a rights offering, through agents designated from time to time by us, or to or through underwriters or dealers. The Prospectus Supplement relating to the offering will identify any agents or underwriters involved in the sale of our Common Shares, and will set forth any applicable purchase price, fee, commission or discount arrangement between us and our agents or underwriters, or among our underwriters, or the basis upon which such amount may be calculated. The Prospectus Supplement relating to any offering of rights will set forth the number of Common Shares issuable upon the exercise of each right (or number of rights) and the other terms of such rights offering. We may not sell any of our Common Shares through agents, underwriters or dealers without delivery of a Prospectus Supplement describing the method and terms of the particular offering of our Common Shares.

Our Common Shares are listed on the NYSE American under the symbol “FTF”. The last reported sale price of our Common Shares, as reported by the NYSE American on June 13, 2018 was \$10.94 per Common Share. The net asset value of our Common Shares at the close of business on June 13, 2018 was \$11.73 per Common Share. Rights issued by the Fund may also be listed on a securities exchange.

As of June 13, 2018, the Fund has outstanding 1,200 Series M Auction Preferred Shares, 1,200 Series W Auction Preferred Shares and 1,200 Series F Auction Preferred Shares, each with a \$25,000 liquidation preference totaling \$90,000,000 (collectively, the “Preferred Shares”). The Preferred Shares are not listed on an exchange. The Fund’s Board of Trustees has authorized the redemption of all the Fund’s outstanding Preferred Shares, which is currently anticipated to take place in August 2018. The Fund will use other forms of leverage, including by purchasing mortgage dollar rolls and/or borrowing from a financial institution, following the redemption of the Preferred Shares.

**An investment in the Common Shares involves certain risks and special considerations. For a discussion of these and other risks, see “Risks and Special Considerations.”**

**Shares of closed-end investment companies frequently trade at a discount to their net asset value. The Fund’s Common Shares have traded at a discount to net asset value, including during recent periods. If the Fund’s Common Shares trade at a discount to its net asset value, the risk of loss may increase for purchasers in a public offering. See “Risks and Special Considerations—Net Asset Value Discount Risk.”**

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**Neither the Securities and Exchange Commission (“SEC”) nor any state securities commission has approved or disapproved these securities or passed upon the adequacy of this Prospectus. Any representation to the contrary is a criminal offense.**

This Prospectus, together with any Prospectus Supplement, sets forth concisely the information about the Fund that a prospective investor should know before investing. You should read this Prospectus and applicable Prospectus Supplement, which contain important information, before deciding whether to invest in the Common Shares. You should retain the Prospectus and Prospectus Supplement for future reference. A Statement of Additional Information (“SAI”), dated [ ], 2018, containing additional information about the Fund, has been filed with the SEC and is incorporated by reference in its entirety into this Prospectus. The table of contents for the SAI is on page 65 of the Prospectus. You may call (800) DIAL BEN/342-5236, visit the Fund’s website at [www.franklintempleton.com](http://www.franklintempleton.com) or forward a written request to Franklin Templeton Investor Services, LLC, P.O. Box 997151, Sacramento, CA 95899-9983 to obtain, free of charge, copies of the SAI and the Fund’s annual and semi-annual reports to shareholders, as well as to obtain other information about the Fund and to make shareholder inquiries.

The Fund’s SAI, as well as the annual and semi-annual reports to shareholders, are also available on the Fund’s website at [www.franklintempleton.com](http://www.franklintempleton.com). The SEC maintains a website at [www.sec.gov](http://www.sec.gov) that contains the SAI, material incorporated by reference into the Fund’s registration statement and other information about the Fund.

Our Common Shares do not represent a deposit or obligation of, and are not guaranteed or endorsed by, any bank or other insured depository institution, and are not federally insured by the Federal Deposit Insurance Corporation, the Federal Reserve Board or any other government agency.

Prospectus dated [ ], 2018

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**You should rely only on the information contained in, or incorporated by reference into, this Prospectus and any related Prospectus Supplement in making your investment decisions. The Fund has not authorized any person to provide you with different information. If anyone provides you with different or inconsistent information, you should not rely on it. The Fund is not making an offer to sell the Common Shares in any jurisdiction where the offer or sale is not permitted. You should assume that the information in this Prospectus and any Prospectus Supplement is accurate only as of the dates on their covers. The Fund’s business, financial condition and prospects may have changed since the date of its description in this Prospectus or the date of its description in any Prospectus Supplement.**



## PROSPECTUS SUMMARY

*The following information is only a summary. You should consider the more detailed information contained in the Prospectus and in any related Prospectus Supplement and in the SAI before purchasing Common Shares, especially the information under “Risks and Special Considerations” on page 39 of the Prospectus.*

### **The Fund**

The Fund is a diversified, closed-end management investment company organized under the laws of the State of Delaware. See “The Fund.”

The Fund’s Common Shares are listed for trading on the NYSE American under the symbol “FTF”. As of May 31, 2018, the net assets of the Fund were \$264,804,387, the total assets of the Fund were \$420,117,184 and the Fund had outstanding 22,604,126 Common Shares. The last reported sale price of the Fund’s Common Shares, as reported by the NYSE American on June 13, 2018 was \$10.94 per Common Share. The net asset value of the Fund’s Common Shares at the close of business on June 13, 2018 was \$11.73 per Common Share. See “Description of Shares.” Rights issued by the Fund may also be listed on a securities exchange.

### **The Offering**

We may offer, from time to time, in one or more offerings, up to \$200,000,000 of our Common Shares on terms to be determined at the time of the offering. We may also offer subscription rights to purchase our Common Shares. The Common Shares may be offered at prices and on terms to be set forth in one or more Prospectus Supplements. You should read this Prospectus and the applicable Prospectus Supplement carefully before you invest in our Common Shares. Our Common Shares may be offered directly to one or more purchasers, through agents designated from time to time by us, or to or through underwriters or dealers. The offering price per Common Share will not be less than the net asset value per Common Share at the time we make the offering, exclusive of any underwriting commissions or discounts, provided that rights offerings that meet certain conditions may be offered at a price below the then current net asset value. See “Rights Offerings.” The Prospectus Supplement relating to the offering will identify any agents, underwriters or dealers involved in the sale of our Common Shares, and will set forth any applicable purchase price, fee, commission or discount arrangement between us and our agents or underwriters, or among our underwriters, or the basis upon which such amount may be calculated. See “Plan of Distribution.” The Prospectus Supplement relating to any offering of rights will set

forth the number of Common Shares issuable upon the exercise of each right (or number of rights) and the other terms of such rights offering. We may not sell any of our Common Shares through agents, underwriters or dealers without delivery of a Prospectus Supplement describing the method and terms of the particular offering of our Common Shares.

**Use of Proceeds**

We intend to use the net proceeds from the offering primarily to invest in accordance with our investment objectives and policies as appropriate investment opportunities are identified, which is expected to be substantially completed in approximately three months from the conclusion of the offering; however, the identification of appropriate investment opportunities pursuant to the Fund's investment style or changes in market conditions could result in the Fund's anticipated investment period extending to as long as six months. See "Use of Proceeds."

**Investment Objectives**

1  
The Fund seeks to provide high current income, with a secondary objective of capital appreciation to the extent possible and consistent with the Fund's primary objective.

**Investment Policies**

Under normal market conditions, the Fund will seek to achieve its investment objectives by investing in debt securities and other income-producing instruments, allocated primarily among three distinct investment categories: (1) mortgage-backed securities and other asset-backed securities; (2) bank loans made to corporate and other business entities; and (3) below "investment grade" debt securities and other income-producing instruments. There is no limitation on the percentage of the Fund's assets that may be allocated to each of these investment categories; provided that, under normal market conditions, the Fund will invest at least [25]% of its total assets in each category. Under normal circumstances, the Fund's allocation to the investment category of mortgage-backed and other asset-backed securities will be primarily composed of investments in mortgage-backed securities. See "Investment Objectives and Strategies."

**Limited Duration**

Under normal market conditions, the Investment Manager (as defined below) expects the Fund to maintain an estimated average portfolio duration of between two and five years (including the effect of anticipated leverage). This duration policy may only be changed following provision of 60 days' prior notice to holders of Common Shares ("Common Shareholders"). In comparison to maturity (which is the date on which a debt instrument ceases and the issuer is obligated to

repay the principal amount), duration is a measure of the price volatility of a debt instrument as a result of changes in market rates of interest, based on the weighted average timing of the instrument's expected principal and interest payments. Duration differs from maturity in that it considers a security's yield, coupon payments, principal payments and call features in addition to the amount of time until the security finally matures. As the value of a security changes over time, so will its duration. Prices of securities with longer durations tend to be more sensitive to interest rate changes than securities with shorter durations. In general, a portfolio of securities with a longer duration can be expected to be more sensitive to interest rate changes than a portfolio with a shorter duration.

### **Sector Allocation Strategy**

The Fund uses an active sector allocation strategy to try to achieve its goals of income and capital appreciation. This means the Fund allocates its assets among securities in various market sectors based on the Investment Manager's assessment of changing economic, global market, industry, and issuer conditions. Consequently, the Fund, from time to time, may have significant positions in particular sectors. There can be no assurance that the Investment Manager's assessments will be correct. See "Investment Objectives and Strategies—Portfolio Management Strategies."

### **Credit Quality**

Under normal market conditions, the Fund will invest at least [25]% of its assets in debt securities or other instruments rated below investment grade, sometimes called "junk bonds." The Fund may also invest in investment grade debt securities. Investment grade debt securities are rated in one of the top four ratings categories by a nationally-recognized statistical rating organization (a "Rating Agency") such as S&P, Moody's or Fitch. A debt security rated below the top four ratings categories by each Rating Agency rating the security will be considered below investment grade. The Fund may also buy unrated debt securities or other income-producing instruments.

The Investment Manager monitors the credit quality and price of the Fund's holdings, as well as other investments that are available to the Fund. Under normal market conditions, the Fund expects to maintain a weighted average portfolio credit quality of investment grade, as determined by the Investment Manager based on the credit quality of the Fund's portfolio holdings (as rated by the Rating Agencies or, if unrated, as determined by the Investment Manager). For this purpose, when a portfolio holding is rated by

more than one of these rating agencies, the Investment Manager generally will use the highest rating.

[The Fund will not invest more than 10% of its total assets in securities that are, at the time of purchase, rated CCC/Caa or lower by each Rating Agency rating the security or that are unrated but judged by the portfolio managers to be of comparable quality.] The Fund may invest in securities or other instruments whose issuers are in default or bankruptcy. Under normal conditions, the Fund will not invest more than 5% of its total assets in debt securities or other obligations whose issuers are in default at the time of purchase.

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The Investment Manager will rely heavily on its own analysis of the credit quality and risks associated with individual debt obligations considered for the Fund, rather than relying exclusively on rating agencies or third-party research. The Investment Manager will use this information in an attempt to minimize credit risk and identify issuers, industries or sectors that are undervalued or that offer attractive yields relative to the Investment Manager's assessment of their credit characteristics. The Fund's success in achieving its investment objectives may depend more heavily on the Investment Manager's credit analysis than if the Fund invested solely in higher-quality and rated securities. Subject to the availability of suitable investment opportunities, the Investment Manager will seek to diversify the Fund's investments broadly in an attempt to minimize the portfolio's sensitivity to credit and other risks associated with a particular issuer, industry or sector, or to the impact of a single economic, political or regulatory event.

The Fund's portfolio may include bonds, debentures, notes and other similar types of debt instruments, such as asset-backed securities, as well as bank loans and loan participations, commercial and agency-issued mortgage securities, payment-in-kind securities, zero-coupon securities, bank certificates of deposit, fixed time deposits and bankers' acceptances, structured notes and other hybrid instruments, preferred shares, municipal or U.S. government securities, debt securities issued by foreign corporations or supra-national government agencies, mortgage-backed securities issued on a public or private basis, and other types of asset-backed securities. The rate of interest on an income-producing security may be fixed, floating or variable. The Fund may use swaps and other derivative instruments. The Fund will not invest in inverse

### **Independent Credit Analysis**

### **Diversification**

### **Portfolio Contents**

floating rate instruments or interest-only or principal-only mortgage securities.

The Fund may hold equity securities; however, under ordinary circumstances, such investments will be limited to convertible securities, dividend-paying common or preferred stocks, or equity securities acquired in connection with a restructuring, bankruptcy, default, or the exercise of a conversion or purchase right.

Since the Fund is diversified, with respect to 75% of its investment portfolio, the Fund generally may not hold more than 5% of its assets in the securities of a single issuer or hold more than 10% of the outstanding voting securities of an issuer. The Fund generally will not invest more than 25% of its total assets in securities of issuers in any one industry. See “How the Fund Manages Risk—Investment Limitations.”

3

The Fund has certain investment restrictions that may not be changed without approval by a majority of the Fund’s outstanding voting securities. These restrictions concern issuance of senior securities, borrowing, lending and other matters. See “Investment Restrictions and Additional Investment Information” in the SAI. The value of the Fund’s assets, as well as the market price of its shares, will fluctuate. You can lose money on your investment. Investing in the Fund involves other risks, including the risks set out below. See “Risks and Special Considerations” for more information on these and other risks).

*General.* The Fund is a diversified, closed-end investment company designed primarily as a long-term investment and not as a trading tool. An investment in the Fund’s Common Shares may be speculative and involves a high degree of risk. The Fund should not be considered a complete investment program. Due to the uncertainty in all investments, there can be no assurance that the Fund will achieve its investment objective.

*Investment and Market Risk.* An investment in the Fund’s Common Shares is subject to investment risk, including the possible loss of the entire principal amount that you invest. Your investment in Shares represents an indirect investment in the securities owned by the Fund. The value of these securities, like other market investments, may move up or down, sometimes rapidly and unpredictably. The value of the securities in which the Fund invests will affect the value of the Common Shares. Your Common Shares at

## Investment Restrictions

## Risks

any point in time may be worth less than your original investment, even after taking into account the reinvestment of Fund dividends and distributions.

*Net Asset Value Discount Risk.* As with any stock, the price of the Common Shares will fluctuate with market conditions and other factors. If Common Shares are sold, the price received may be more or less than the original investment. The Common Shares may trade at a price that is less than the offering price or at a discount from their net asset value. This risk may be greater for investors who sell their shares relatively shortly after completion of the offering. The Common Shares are designed for long-term investors.

*Credit Risk.* An issuer of a debt security may be unable to make interest payments and repay principal. Changes in an issuer's financial strength or in a security's credit rating may affect a security's value and, thus, impact Fund performance. See "Risks and Special Considerations—Credit Risk."

*Mortgage-Related Risk.* Rising interest rates tend to extend the duration of mortgage-related securities, which in turn could lengthen the average duration of the Fund's portfolio, making the portfolio more sensitive to changes in interest rates, and may reduce the market value of the portfolio's mortgage-related securities. This possibility is often referred to as extension risk. In addition, mortgage-related securities are subject to prepayment risk – the risk that borrowers may pay off their mortgages sooner than expected, particularly when interest rates decline. See "Risks and Special Considerations—Mortgage-Related Risk."

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*Loan Risk.* Bank loans, loan participations and assignments involve credit risk, interest rate risk, liquidity risk, and the risks of being a lender, as well as other risks. If the Fund purchases a loan, it may be able to enforce its rights only through the lender, and may assume the credit risk of both the lender and the borrower.

Corporate loans in which the Fund may invest may be unrated and generally will not be registered with the SEC or listed on a securities exchange. Because the amount of public information available with respect to corporate loans generally is less extensive than that available for more widely rated, registered and exchange-listed securities, corporate loans can be more difficult to value. See "Risks and Special Considerations—Loan Risk."

*High Yield Risk.* The Fund may invest in debt securities and other income-producing instruments that

are rated below investment grade or unrated. These securities and instruments generally have more credit risk than higher-rated securities. The issuers of such securities or instruments typically do not have the track record needed to receive an investment grade rating, have borrowed to finance acquisitions or to expand their operations, are seeking to refinance their debt at lower rates, or have been downgraded due to financial difficulties. Due to the risks involved in investing in high yield debt securities and other income-producing instruments, an investment in the Fund should be considered speculative.

Companies issuing high yield, fixed-income securities are not as strong financially as those issuing securities with higher credit ratings. These companies are more likely to encounter financial difficulties and are more vulnerable to changes in the economy, such as a recession or a sustained period of rising interest rates, that could affect their ability to make interest and principal payments. The high yield market has experienced a large number of defaults in recent years. If a company defaults because it stops making interest and/or principal payments, payments on the securities may never resume because such securities are generally unsecured and are often subordinated to other creditors of the issuer. These securities may be worthless and the Fund could lose its entire investment.

High yield securities generally are less liquid than higher-quality securities. Many of these securities do not trade frequently, and when they do their prices may be significantly higher or lower than expected. See “Risks and Special Considerations—High Yield Risk.” *Interest Rate Risk.* Changes in interest rates may present risks to the Fund. When interest rates rise, debt security prices generally fall. The opposite is also true: debt security prices generally rise when interest rates fall. Because market interest rates are currently near their lowest levels in many years, there is a great risk that the Fund’s investments will decline in value.

The prices of fixed-rate securities with longer durations tend to be more sensitive to changes in interest rates than securities with shorter durations, usually making them more volatile. Because the Fund will normally have an estimated average portfolio duration of between two and five years (including the effects of anticipated leverage), the Common Shares’ net asset value and market price will tend to fluctuate more in response to changes in market interest rates than if the

Fund invested mainly in short-term debt securities and less than if the Fund invested mainly in longer-term debt securities.

The cost of leverage employed by the Fund is based on certain interest rates. If the cost of leverage exceeds the rate of return on the debt obligations and other investments held by the Fund that were acquired during periods of generally lower interest rates, the returns to Common Shareholders may be reduced. The Fund's use of leverage, as described in the Prospectus, will tend to increase Common Share interest rate risk.

The Fund may employ certain strategies for the purpose of reducing the interest rate sensitivity of the portfolio and decreasing the Fund's exposure to interest rate risk, although there is no assurance that it will do so or that such strategies will be successful. See "Risks and Special Considerations—Interest Rate Risk."

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*Inflation Risk.* Inflation risk is the risk that the value of assets or income from the Fund's investments will be worth less in the future as inflation decreases the value of money.

*Leverage Risk.* The Fund's use of leverage creates the opportunity for increased Common Share net income, but also creates special risks for Common Shareholders. The Fund uses leverage through the purchase of mortgage dollar rolls. The Fund may use leverage through the issuance of senior securities such as preferred shares or the borrowing of funds from financial institutions (including committed financing arrangements). The Fund may also use leverage through the purchase of the lending of portfolio securities, and the use of swaps, other derivatives, reverse repurchase agreements, and when-issued, delayed delivery or forward commitment transactions. To mitigate leverage risk from such transactions, the Fund may segregate liquid assets against or otherwise cover its future obligations under such transactions.

So long as the Fund's securities portfolio provides a higher rate of return (net of Fund expenses) than the cost of its leverage (e.g., the interest rate on any borrowings or the preferred share dividend rate), the leverage will allow Common Shareholders to receive a higher current rate of return than if the Fund were not leveraged. If, however, interest rates rise, which may be likely because interest rates are currently near their lowest levels in many years, the Fund's cost of leverage could exceed the rate of return on the debt obligations



and other investments held by the Fund that were acquired during periods of generally lower interest rates, reducing return to Common Shareholders. If the Fund leverages with preferred shares that pay cumulative dividends, the Fund's leverage risk may be increased.

The Fund's use of leverage may, during periods of rising interest rates, adversely affect the Fund's income, distributions and total returns to Common Shareholders. Leverage creates two major types of risks for Common Shareholders:

- the likelihood of greater volatility of net asset value and market price of Common Shares, because changes in the value of the Fund's portfolio of income-producing securities (including securities bought with the proceeds of leverage) are borne entirely by the Common Shareholders; and
- the possibility either that Common Share income will fall if the Fund's cost of leverage rises, or that Common Share income will fluctuate because the cost of leverage varies. Because the fees received by the Investment Manager are based on the Managed Assets (as defined below) of the Fund (including the aggregate liquidation preference of any preferred shares or the outstanding amount of any borrowing or short-term debt securities), the Investment Manager has a financial incentive for the Fund to use leverage, which may create a conflict of interest between the Investment Manager and the Common Shareholders.

By using leverage, the Fund will seek to obtain a higher return for holders of Common Shares than if the Fund did not use leverage. Leveraging is a speculative technique and there are special risks involved. There can be no assurance that a leveraging strategy will be successful during any period in which it is employed. The Fund's use of leverage strategies could result in larger losses than if the strategies were not used.

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*Portfolio Security Issuer Risk.* The value of the Fund's investments may decline for a number of reasons that directly relate to the issuer, such as management performance, financial leverage and performance and factors affecting the issuer's industry

*Management Risk.* The Fund is subject to management risk because it is an actively managed portfolio. The Investment Manager will apply investment techniques and risk analyses in making investment decisions for

the Fund, but there can be no guarantee that they will produce the desired results.

*Foreign (Non-U.S.) Investment Risk.* Investing in foreign securities, including securities of foreign governments, typically involves more risks than investing in U.S. securities. These risks can increase the potential for losses in the Fund and may include, among others, currency risks, country risks (political, diplomatic, regional conflicts, terrorism, war, social and economic instability, currency devaluations and policies that have the effect of limiting or restricting foreign investment or the movement of assets), different trading practices, less government supervision, less publicly available information, limited trading markets and greater volatility. See “Risks and Special Considerations—Foreign (Non-U.S.) Investment Risk.” Investing in securities of issuers based in developing or emerging markets entails all of the risks of investing in securities of foreign issuers to a heightened degree as well as other risks. See “Risks and Special Considerations—Foreign (Non-U.S.) Investment Risk—Developing Countries and Emerging Markets.”

Debt issued by foreign governments, their agencies or instrumentalities, or other government-related entities, is subject to several risks, such as the fact that there are generally no bankruptcy proceedings similar to those in the United States by which defaulted sovereign debt may be collected. Other risks include: potential limits on the flow of capital; political and economic risk; the extent and quality of financial regulations; tax risk; and the potential expropriation or nationalization of foreign issuers. See “Risks and Special Considerations— Foreign (Non-U.S.) Investment Risk—Sovereign Issuers.”

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*Derivatives Risk.* The performance of derivatives depends largely on the performance of an underlying asset, interest rate or index, and such instruments often have risks similar to their underlying asset. Derivatives (such as futures contracts and options thereon, options, swaps and short sales) are also subject to a number of risks such as liquidity risk, interest rate risk, credit risk, leverage risk, volatility risk and management risk. They also involve the risk of mispricing or improper valuation, the risk of ambiguous documentation, and the risk that changes in the value of a derivative may not correlate perfectly with an underlying asset, interest rate or index. With over-the-counter derivatives, there is a risk that the other party to the transaction will fail to perform (known as counterparty risk). There can be no assurance that the Fund will engage in suitable

derivative transactions to reduce exposure to other risks when that would be beneficial. See “Risks and Special Considerations—Derivatives Risk.”

*Counterparty Risk.* The Fund will be subject to credit risk with respect to the counterparties to any derivative contracts purchased by the Fund. If a counterparty becomes bankrupt or otherwise fails to perform its obligations under a derivative contract due to financial difficulties, the Fund may experience significant delays in obtaining any recovery under the derivative contract. See “Risks and Special Considerations—Counterparty Risk.”

*Volatility Risk.* The market values for some or all of the Fund’s holdings may be volatile. The Fund’s investment grade or long-term debt securities, will generally be more sensitive to changing interest rates and less sensitive to changes in the economic environment. The Fund’s investments may also be subject to liquidity constraints and as a result, higher price volatility. The Fund’s use of leverage may increase the volatility of the Fund’s investment portfolio. See “Risks and Special Considerations—Volatility Risk.”

*Reinvestment Risk.* The Fund may distribute or reinvest the proceeds from matured, traded or called debt obligations. If the Fund reinvests such proceeds at lower interest rates, the market price or the overall return of the Common Shares may decline. See “Risks and Special Considerations—Reinvestment Risk.”

*Call Risk.* A debt security may be prepaid (called) before maturity. An issuer is more likely to call its securities when interest rates are falling, because the issuer can issue new securities with lower interest payments. If a debt security is called, the Fund may have to replace it with a lower-yielding security. At any time, the Fund may have a large amount of its assets invested in securities subject to call risk. A call of some or all of these securities may lower the Fund’s income and yield and its distributions to shareholders. See “Risks and Special Considerations—Call Risk.”

*Liquidity Risk.* The Fund may invest up to 15% of its total assets in securities (excluding swaps) which are illiquid at the time of investment (*i.e.*, securities that cannot be disposed of within seven days in the ordinary course of business at approximately the value at which the Fund has valued the securities). Illiquid securities may trade at a discount from comparable, more liquid investments, and may be subject to wide fluctuations in market value. Also, the Fund may not be able to dispose of illiquid securities when that would be beneficial at a favorable time or price. See “Risks and Special Considerations—Liquidity Risk.”

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*Income Risk.* Because the Fund can distribute only what it earns, the Fund's distributions to shareholders may decline. See "Risks and Special Considerations—Income Risk."

*Zero-Coupon Securities Risk.* Zero-coupon securities are especially sensitive to changes in interest rates, and their prices generally are more volatile than debt securities that pay interest periodically. Lower quality zero-coupon bonds are generally subject to the same risks as high yield debt securities. The Fund typically will not receive any interest payments on these securities until maturity. If the issuer defaults, the Fund may lose its entire investment, which will affect the Fund's share price. See "Risks and Special Considerations—Zero-Coupon Securities Risk."

*Smaller Company Risk.* Although the Fund does not presently intend to invest a significant portion of its assets in smaller companies, the Fund may invest some of its assets in such companies. These companies may be subject to greater levels of credit, market and issuer risk than companies with larger market capitalizations. Also, securities of smaller companies may trade less frequently and in lesser volume than more widely held securities and their values may fluctuate more sharply than other securities. See "Risks and Special Considerations—Smaller Company Risk."

*Real Estate Risk.* Since the Fund may invest in real estate investment trusts and mortgage securities secured by real estate, the Fund may be subject to risks similar to those associated with the direct ownership of real estate. These risks include declines in the value of real estate, general and local economic risk, management risk, interest rate risk, possible lack of availability of mortgage funds, overbuilding, extended vacancies of properties, increased competition, increases in property taxes and operating expenses, changes in zoning laws, environmental risk, casualty or condemnation losses, and rent controls. See "Risks and Special Considerations—Real Estate Risk."

*Market Disruption and Geopolitical Risk.* The occurrence of events similar to those in recent years, such as the aftermath of the war in Iraq, instability in Afghanistan, Pakistan, Libya, Syria and other countries in the Middle East and North Africa, terrorist attacks in the U.S., Europe and elsewhere around the world, social and political discord and uncertainty, debt crises (such as the recent Greek crisis), sovereign debt downgrades, or the exit or potential exit of one or more countries from the EMU or the European Union (such as the United Kingdom), among others, may result in market

volatility, may have long term effects on the U.S. and worldwide financial markets, and may cause further economic uncertainties in the U.S. and worldwide. Any such event(s) could have a significant adverse impact on the value and risk profile of the Fund's portfolio. The Fund does not know how long the securities markets may be affected by similar events and cannot predict the effects of similar events in the future on the U.S. economy and securities markets. There can be no assurance that similar events and other market disruptions will not have other material and adverse implications. See "Risks and Special Considerations—Market Disruption and Geopolitical Risk."

*Anti-Takeover Provisions.* The Fund's Amended and Restated Agreement and Declaration of Trust, dated June 19, 2003, as amended (the "Declaration"), includes provisions that could limit the ability of other entities or persons to acquire control of the Fund or convert the Fund to open-end status. Also, these provisions could have the effect of depriving the Common Shareholders of opportunities to sell their Common Shares at a premium over the then-current market price of the Common Shares. See "Anti-Takeover and Other Provisions in the Declaration of Trust."

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*Conflicts of Interest Risk.* The Investment Manager's advisory fees are based on Managed Assets. Consequently, the Investment Manager will benefit from an increase in the Fund's Managed Assets resulting from an offering. In addition, a Director who is an "interested person" (as such term is defined under the Investment Company Act of 1940 ("1940 Act")) of the Fund or a portfolio manager of the Fund could benefit indirectly from an offering because of such affiliations.

*Distribution Rate.* There can be no assurance that the Fund's Board of Trustees (the "Board" or the "Board of Trustees") will maintain the Fund's distribution rate at a particular level, or that the Board will continue a managed distribution policy. Additionally, distributions may include return of capital as well as net investment income and capital gains. A return of capital is a return to investors of a portion of their original investment in the Fund. In general terms, a return of capital would involve a situation in which a Fund distribution (or a portion thereof) represents a return of a portion of a shareholder's investment in the Fund, rather than making a distribution that is funded from the Fund's earned income or other profits. Although return of capital distributions may not be currently taxable, such distributions would decrease the

basis of a shareholder's shares, and therefore, may increase a shareholder's tax liability for capital gains upon a sale of shares, even if sold at a loss to the shareholder's original investments. If the Fund's investments do not generate sufficient income, the Fund may be required to liquidate a portion of its portfolio to fund these distributions. See "Dividends and Distributions."

*Share Repurchases.* When the Fund repurchases its shares pursuant to the Fund's share repurchase program, the resulting decrease in shares outstanding may increase the Fund's expense ratio; any borrowing to finance repurchases would reduce net income; and any sales of portfolio securities to finance repurchases may not be at a preferred time from a portfolio management perspective and would increase portfolio turnover and related expenses.

*Rights.* There is a risk that performance of the Fund may result in the underlying Shares purchasable upon exercise of the rights being less attractive to investors at the conclusion of the subscription period. This may reduce or eliminate the value of rights. Investors who receive rights may find that there is no market to sell rights they do not wish to exercise. If investors exercise only a portion of the rights, the number of Common Shares issued may be reduced, and the Common Shares may trade at less favorable prices than larger offerings for similar securities.

**Investment Manager**

Franklin Advisers, Inc. (the "Investment Manager") serves as the investment manager of the Fund. Subject to the supervision of the Board of Trustees, the Investment Manager is responsible for managing the investment activities of the Fund for which it receives an annual fee, payable monthly, in an amount equal to 0.70% of the average daily value of the Fund's Managed Assets. "Managed Assets" means the total assets of the Fund (including any assets attributable to leverage) minus the sum of accrued liabilities (other than the aggregate liquidation preference of any outstanding preferred shares or the outstanding amount of any borrowing or short-term debt securities). The Investment Manager and its affiliates (collectively known as "Franklin Templeton Investments") provide investment management and advisory services to closed-end and open-end investment company clients, as well as private accounts. As of May 31, 2018, Franklin Templeton Investments had approximately \$732 billion in assets under management for more than three million U.S. based mutual fund shareholder and other accounts.

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**Administrator**

The administrator of the Fund is Franklin Templeton Services, LLC ("FT Services"), whose principal address is also One Franklin Parkway, San Mateo, CA 94403. Under an agreement with the Investment Manager, FT Services performs certain administrative services, such as portfolio recordkeeping, for the Fund. FT Services is an indirect wholly owned subsidiary of Franklin Resources, Inc. The administrative fee is paid by the Investment Manager based on the Fund's average daily net assets, and is not an additional expense of the Fund.

**Portfolio Management Team**

Roger A. Bayston, CFA, Christopher J. Molumphy, CFA, Glenn I. Voyles, CFA, Madeline Lam and Justin Ma, CFA, have responsibility for the day-to-day management of the Fund's portfolio. See "Management of the Fund—Portfolio Management Team."

**Leverage**

The Fund expects to use financial leverage on an ongoing basis for investment purposes, including through borrowing funds from financial institutions, the issuance of preferred shares and/or the purchase of mortgage dollar rolls. The Fund may enter into transactions that may give rise to a form of leverage, including among others: loans of portfolio securities, swap

**Distributions**

contracts and other derivative instruments, reverse repurchase agreements, as well as when-issued, delayed delivery or forward commitment transactions. The Fund will segregate liquid assets against or otherwise cover its future obligations under such transactions. The Fund's entry into leverage transactions will not exceed the limits in the 1940 Act. As of May 31, 2018, the Fund had leverage in the amount of 34.95% of the Fund's Managed Assets. The Board of Trustees adopted a managed distribution plan (the "Plan") whereby the Fund began, in January 2017, making monthly distributions to common shareholders at an annual minimum fixed rate of 10% based on average monthly NAV of the Fund's Common Shares. The primary purpose of the Plan is to provide the Fund's Common Shareholders with a constant, but not guaranteed, fixed minimum rate of distribution each month. The Plan is intended to narrow the discount between the market price and the NAV of the Fund's common shares, but there is no assurance that the Plan will be successful in doing so.

Under the Plan, to the extent that sufficient investment income is not available on a monthly basis, the Fund will distribute long-term capital gains and/or return of capital in order to maintain its managed distribution level. The Board may amend the terms of the Plan or terminate the Plan at any time without prior notice to the Fund's shareholders. The amendment or termination of the Plan could have an adverse effect on the market price of the Fund's Common Shares. The Plan is subject to periodic review by the Board, including a yearly review of the annual minimum fixed rate to determine if an adjustment should be made.

The Fund calculates the average NAV from the previous month based on the number of business days in that month on which the NAV is calculated. The distribution is calculated as 10% of the previous month's average NAV, divided by 12. The payment date for the distribution will typically be during the middle of the next month.

Unless you elect to receive distributions in cash, all of your distributions under the Plan will be automatically reinvested in additional Common Shares under the Fund's Dividend Reinvestment Plan. See "Dividends and Distributions" and "Dividend Reinvestment Plan."

**Dividend Reinvestment Plan**

Under the Fund's Dividend Reinvestment Plan, all Common Shareholders whose shares are registered in their own names will have all dividends, including any capital gain distributions, reinvested automatically in additional Common Shares by American Stock Transfer & Trust Company, LLC, unless the Common Shareholder "opts out" of the plan and elects to receive cash. See "Dividend Reinvestment Plan."

**Custodian**

The Bank of New York Mellon, Corporate Trust Dealing & Trading-Auctions, 101 Barclay Street, 7W, New York, NY 10286, acts as custodian of the Fund's securities and other assets.

**Shareholder Servicing Agent and Transfer Agent Share Repurchase Program**

The shareholder servicing agent, transfer agent and dividend disbursement agent for the Common Shares is American Stock Transfer & Trust Company, LLC, 6201 15th Avenue, Brooklyn, NY 11219.

Under the Fund's open-market share repurchase program which commenced on June 1, 2016, the Fund may purchase, from time to time, up to 10% of the Fund's Common Shares in open-market transactions, at the discretion of management. Since the inception of the program, the Fund has repurchased a total of 242,561 Common Shares. Applicable law may prevent such repurchases during the offering of the Common Shares described herein. See "Description of Shares—Common Shares—Share Repurchase Program."

**Market Price of Common Shares**

Shares of closed-end investment companies frequently trade at prices lower than net asset value. The Fund cannot assure you that the Common Shares will trade at a price higher than net asset value in the future. Market price may be affected by such factors relating to the Fund or its portfolio holdings as dividend levels (which are in turn affected by expenses, including the costs of leverage), dividend stability, portfolio credit quality and liquidity and call

protection and market supply and demand. See “Leverage,” “Risks and Special Considerations,” “Description of Shares,” and “Repurchase of Common Shares; Conversion to Open-End Fund” in this Prospectus. The Common Shares are designed primarily for long-term investors, and you should not view the Fund as a vehicle for trading purposes.



## SUMMARY OF FUND EXPENSES

### Shareholder Transaction Expenses

Record Date Sales Load (as a percentage of offering price) <sup>(1)</sup>	[ ]%
Offering Expenses (as a percentage of offering price) <sup>(1)</sup>	[ ]%
Dividend Reinvestment Plan Fees <sup>(2)</sup>	None

### Annual Operating Expenses

	<b>Percentage of Managed Assets Attributable to Common Shares</b>
Management Fees <sup>(3)</sup>	[ ]%
Other Expenses <sup>(4)</sup>	[ ]%
Total Annual Fund Operating Expenses	[ ]%

- (1) Estimated maximum amount based on offering of \$200 million in Common Shares. Actual sales loads and offering expenses may be higher or lower than these estimates and will be set forth in the Prospectus Supplement if applicable. If the Common Shares are sold to or through underwriters, the Prospectus Supplement will set forth any applicable sales load and the estimated offering expenses. Fund shareholders will pay all offering expenses involved with an offering.
- (2) You will pay brokerage charges if you direct the plan agent to sell your Common Shares held in a dividend reinvestment account.
- (3) The Investment Manager is entitled to receive an investment management fee of 0.70% per year of the Fund's average daily managed assets. Managed assets are defined as the total assets of the Fund (including any assets attributable to leverage) minus the sum of accrued liabilities (other than the aggregate liquidation preference of any outstanding preferred shares or the outstanding amount of any borrowing or short-term debt securities). If the Fund uses leverage, the amount of fees paid to the Investment Manager for investment management services will be higher than if the Fund does not use leverage because the fees paid are calculated on the Fund's managed assets, which include assets purchased with leverage. The management fee for the Fund reflects the leverage used by the Fund as of its December 31, 2017 fiscal year end.
- (4) "Other Expenses" have been estimated assuming the issuance of \$200 million in Common Shares.

#### Example

An investor would pay the following expenses on a \$1,000 investment in the Fund, assuming a 5% annual return:

<b>One Year</b>	<b>Three Years</b>	<b>Five Years</b>	<b>Ten Years</b>
\$[ ]	\$[ ]	\$[ ]	\$[ ]

The above table and example are intended to assist investors in understanding the various costs and expenses directly or indirectly associated with investing in Shares of the Fund. The "Example" assumes that all dividends and other distributions are reinvested at net asset value and that the percentage amounts listed in the table above under Total Annual Operating Expenses remain the same in the years shown. The above table and example and the assumption in

the example of a 5% annual return are required by regulations of the SEC that are applicable to all investment companies; the assumed 5% annual return is not a prediction of, and does not represent, the projected or actual performance of the Fund's Common Shares. For more complete descriptions of certain of the Fund's costs and expenses, see "Management of the Fund."

**The example should not be considered a representation of past or future expenses, and the Fund's actual expenses may be greater than or less than those shown. Moreover, the Fund's actual rate of return may be greater or less than the hypothetical 5% return shown in the example.**

## FINANCIAL HIGHLIGHTS

The financial highlights table is intended to help you understand the Fund's financial performance. Information is shown for the Fund's last ten fiscal years and for the fiscal period ended December 31, 2017. Certain information reflects financial results for a single Fund Share. The information for the fiscal years ended December 31, 2017 and March 31, 2017, 2016, 2015, 2014 and 2013, has been audited by [ ], independent registered public accounting firm for the Fund, whose reports thereon were unqualified. The report of [ ] is included in the Fund's December 31, 2017 Annual Report, and is incorporated by reference into the SAI. The Fund's financial statements are included in the Fund's Annual and are incorporated by reference into the SAI.

	Year Ended					
	December 31, 2017 <sup>a</sup>	2017	Year Ended March 31, 2016	2015	2014	2013
<b>Per Common Share operating performance</b> (for a Common Share outstanding throughout the year)						
Net asset value, beginning of year	\$12.91	\$12.38	\$13.87	\$14.36	\$14.30	\$13.82
Income from investment operations:						
Net investment income <sup>b</sup>	0.48	0.62	0.72	0.73	0.80	0.90
Net realized and unrealized gains (losses)	(0.03)	0.85	(1.41)	(0.33)	0.20	0.62
Dividends to preferred shareholders from net investment income	(0.08)	(0.07)	(0.06)	(0.06)	(0.06)	(0.05)
Total from investment operations	0.37	1.40	(0.75)	0.34	0.94	1.47
Less distributions to Common Shareholders from:						
Net investment income	(0.43)	(0.57)	(0.74)	(0.83)	(0.88)	(0.99)
Tax return of capital	(0.53)	(0.36)	—	—	—	—
Total distributions.	(0.96)	(0.93)	(0.74)	(0.83)	(0.88)	(0.99)
Repurchase of shares	—	0.06	—	—	—	—

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Net asset value, end of year	\$12.32	\$12.91	\$12.38	\$13.87	\$14.36	\$14.30
Market value, end of year <sup>c</sup>	\$11.83	\$11.97	\$11.34	\$12.17	\$13.05	\$14.82
Total return (based on market value per share) <sup>d</sup>	7.08%	14.07%	(0.44)%	(0.35)%	(5.85)%	13.41%

**Ratios to average net assets applicable to Common Shares<sup>e,f</sup>**

Expenses before waiver and payments by affiliates and expense reduction	1.25%	1.35%	1.16%	1.14%	1.12%	1.13%
Expenses net of waiver and payments by affiliates and expense reduction	1.23% <sup>g</sup>	1.32% <sup>g</sup>	1.16% <sup>g,h</sup>	1.14% <sup>g,h</sup>	1.12% <sup>g,h</sup>	1.13%
Net investment income	5.04%	4.83%	5.52%	5.14%	5.65%	6.44%

**Supplemental data**

Net assets applicable to Common Shares, end of period (000's)

	\$278,489	\$291,875	\$332,132	\$372,080	\$385,388	\$383,632
Portfolio turnover rate	168.28%	265.00%	270.16%	289.67%	318.57%	295.39%
Portfolio turnover rate excluding mortgage dollar rolls <sup>i</sup>	46.49%	93.00%	81.78%	92.15%	137.85%	106.42%
Asset coverage per preferred share	\$72,311	\$74,809	\$75,991	\$76,665	\$78,686	\$79,157
Liquidation preference per preferred share	\$25,000	\$25,000	\$25,000	\$25,000	\$25,000	\$25,000

<sup>a</sup> For the period April 1, 2017 to December 31, 2017.

<sup>b</sup> Based on average daily Common Shares outstanding.

<sup>c</sup> Based on the last sale on the NYSE American.

<sup>d</sup> Total return is not annualized for periods less than one year.

<sup>e</sup> Based on income and expenses applicable to both common and preferred shares.

<sup>f</sup> Ratios are annualized for periods less than one year.

<sup>g</sup> Benefit of expense reduction rounds to less than 0.01%.

<sup>h</sup> Benefit of waiver and payments by affiliates rounds to less than 0.01%.

<sup>l</sup> See Note 1(e) regarding mortgage dollar rolls.

	<b>Year Ended March 31,</b>				
	<b>2012</b>	<b>2011</b>	<b>2010</b>	<b>2009</b>	<b>2008</b>
<b>Per Common Share operating performance</b>					
(for a Common Share outstanding throughout the year)					
Net asset value, beginning of year.....	\$14.01	\$13.48	\$10.15	\$12.85	\$14.24
Income from investment operations:					
Net investment income <sup>a</sup> .....	0.92	0.98	0.93	0.93	1.28
Net realized and unrealized gains (losses).....	(0.04)	0.65	3.40	(2.56)	(1.29)
Dividends to preferred shareholders from net investment income.....	(0.05)	(0.05)	(0.05)	(0.14)	(0.37)
Total from investment operations.....	0.83	1.58	4.28	(1.77)	(0.38)
Less distributions to Common Shareholders from net investment income.....	(1.02)	(1.05)	(0.95)	(0.93)	(1.01)
Net asset value, end of year.....	\$13.82	\$14.01	\$13.48	\$10.15	\$12.85
Market value, end of year <sup>b</sup> .....	\$14.01	\$13.14	\$13.40	\$ 8.92	\$10.94
Total return (based on market value per share).....	15.03%	6.25%	63.14%	(9.97%)	(16.64%)
<b>Ratios to average net assets applicable to Common Shares<sup>c</sup></b>					
Expenses before expense reduction.....	1.15%	1.14%	1.15%	1.33%	1.28%

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Expenses net of expense reduction.....	1.15%	1.14%	1.15% <sup>d</sup>	1.33% <sup>d</sup>	1.28% <sup>d</sup>
Net investment income.....	6.73%	7.15%	7.47%	8.16%	9.38%

**Supplemental data**

Net assets applicable to Common Shares, end of year (000's).....	\$370,095	\$375,016	\$360,798	\$271,679	\$344,010
Portfolio turnover rate.....	302.18%	262.57%	220.09%	203.31%	47.48%
Portfolio turnover rate excluding mortgage dollar rolls <sup>e</sup> .....	106.49%	115.51%	66.07%	42.58%	47.48%
Asset coverage per preferred share.....	\$77,796	\$76,096	\$78,092	\$72,571 <sup>f</sup>	\$70,264
Liquidation preference per preferred share.....	\$25,000	\$25,000	\$25,000	\$25,000	\$25,000

- 
- <sup>a</sup> Based on average daily Common Shares outstanding.
- <sup>b</sup> Based on the last sale on the NYSE Amex.
- <sup>c</sup> Based on income and expenses applicable to both Common Shares and any Preferred Shares outstanding during the relevant year.
- <sup>d</sup> Benefit of expense reduction rounds to less than 0.01%.
- <sup>e</sup> See Note 1(e) regarding mortgage dollar rolls.
- <sup>f</sup> Prior amount of \$115,173 has been corrected to include the impact of mortgage dollar rolls.

## USE OF PROCEEDS

The Fund will invest the net proceeds of the offering in accordance with the Fund's investment objectives and policies as stated below. It is presently anticipated that the Fund will be able to invest substantially all of the net proceeds in debt obligations and other investments that meet its investment objectives and policies within three months after the completion of the offering; however, the identification of appropriate investment opportunities pursuant to the Fund's investment style or changes in market conditions could result in the Fund's anticipated investment period extending to as long as six months. Pending such investment, the Fund anticipates investing the proceeds in short-term securities issued by the U.S. government or its agencies or instrumentalities or in high quality, short-term or long-term debt obligations or money market instruments.

## THE FUND

The Fund is a diversified, closed-end management investment company registered under the Investment Company Act of 1940, as amended, and the rules and regulations thereunder (the "1940 Act"). The Fund was organized as a Delaware statutory trust on May 8, 2003, pursuant to the Declaration, which is governed by the laws of the State of Delaware. On June 30, 2014, the Fund was renamed from "Franklin Templeton Limited Duration Income Trust" to "Franklin Limited Duration Income Trust." The Fund's principal office is located at One Franklin Parkway, San Mateo, California 94403-1906, and its telephone number is 1-800-DIAL-BEN (1-800-342-5236).

The Fund commenced operations on August 26, 2003, upon the initiation of an initial public offering of 24,600,000 of its Common Shares. The proceeds of such offering were approximately \$351.7 million after the payment of organizational and offering expenses. On September 25, 2003, the Fund issued an additional 1,000,000 of its Common Shares, and on October 14, 2003, the Fund issued an additional 960,000 of its Common Shares in connection with the exercise by the underwriters of the over-allotment option. The Fund's Common Shares are traded on the NYSE American under the symbol "FTF". On November 5, 2003, the Fund issued the Preferred Shares. As of December 31, 2017, the Fund had Preferred Shares outstanding with an aggregate liquidation preference totaling \$90,000,000. The Fund's Board of Trustees has authorized the redemption of all the Fund's outstanding Preferred Shares, which is currently anticipated to take place in August 2018.

## DESCRIPTION OF SHARES

### Common Shares

The Declaration authorizes the issuance of an unlimited number of Common Shares. All Common Shares have equal rights to the payment of dividends and the distribution of assets upon liquidation. Common Shares will, when issued, be fully paid and, subject to matters discussed in “Anti-Takeover and Other Provisions in the Declaration of Trust,” non-assessable, and will have no pre-emptive or conversion rights or rights to cumulative voting. Whenever preferred shares and/or borrowings are outstanding, the Fund will not have the power to pay distributions on Common Shares unless all accrued dividends on the preferred shares and interest and principal payments on borrowings have been paid, and unless the applicable asset coverage requirements under the 1940 Act would be satisfied after giving effect to the distribution.



The Common Shares are listed on the NYSE American. The Fund intends to hold annual meetings of shareholders so long as the Common Shares are listed on a national securities exchange and such meetings are required as a condition to such listing.

The Fund's net asset value per share generally increases when interest rates decline, and generally decreases when interest rates rise, and these changes are likely to be greater because the Fund has a leveraged capital structure.

Unlike open-end funds, closed-end funds like the Fund do not continuously offer shares and do not provide daily redemptions. Rather, if a shareholder determines to buy additional Common Shares or sell shares already held, the shareholder may do so by trading on the exchange through a broker or otherwise. Shares of closed-end investment companies may frequently trade on an exchange at prices lower than net asset value. Shares of closed-end investment companies, like the Fund, that invest predominantly in debt obligations have during some periods traded at prices higher than net asset value and during other periods have traded at prices lower than net asset value. See "Risks and Special Considerations—Net Asset Value Discount Risk." The Fund's Declaration limits the ability of the Fund to convert to open-end status. See "Anti-Takeover and Other Provisions in the Declaration of Trust."

The Fund's Common Shares have traded in the market below, at and above net asset value since the commencement of the Fund's operations. However, it has recently been the case that the Fund's Common Shares have traded at a discount from net asset value. The Fund cannot determine the reasons why the Fund's Common Shares trade at a premium to or discount from net asset value, nor can the Fund predict whether its Shares will trade in the future at a premium to or discount from net asset value, or the level of any premium or discount. Shares of closed-end investment companies frequently trade at a discount from net asset value. Because the market value of the Common Shares may be influenced by such factors as dividend levels (which are in turn affected by expenses), call protection, dividend stability, portfolio credit quality, net asset value, relative demand for and supply of such shares in the market, general market and economic conditions, and other factors beyond the control of the Fund, the Fund cannot assure you that the Common Shares will trade at a price equal to or higher than net asset value in the future. The Common Shares are designed primarily for long-term investors, and investors in the Common Shares should not view the Fund as a vehicle for trading purposes. See "Leverage" and "Repurchase of Common Shares; Conversion to Open-End Fund."

The Fund's outstanding Common Shares are, and when issued, the Common Shares offered by this Prospectus will be, publicly held and listed and traded on the NYSE American. The Fund determines its net asset value on a daily basis. The following table sets forth, for the quarters indicated, the highest and lowest daily closing prices on the NYSE American per Common Share, and the net asset value per Common Share and the premium to or discount from net asset value, on the date of each of the high and low market prices. The table also sets forth the number of Common Shares traded on the NYSE American during the respective quarters.

During Quarter Ended	NAV per Common Share on Date of		NYSE American Market Price		Premium/ (Discount) on Date of Market Price		Trading Volume
	Market Price <sup>(1)</sup>		per Common Share <sup>(2)</sup>		Price <sup>(3)</sup>		
	High	Low	High	Low	High	Low	
March 31, 2016	12.43	12.03	11.36	10.18	-8.608%	-15.378	% 4,540,300
June 30, 2016	12.75	12.36	11.85	11.18	-7.059%	-9.547	% 2,794,800
September 30, 2016	13.11	12.72	12.16	11.53	-7.250%	-9.355	% 3,049,600
December 31, 2016	13.23	12.89	12.42	11.61	-6.122%	-9.930	% 3,696,100
March 31, 2017	13.07	12.95	12.27	11.88	-6.121%	-8.263	% 9,197,300
June 30, 2017	12.92	12.93	12.07	11.83	-6.579%	-7.502	% 9,192,600
September 30, 2017	12.70	12.75	12.07	11.66	-4.961%	-8.549	% 8,247,900
December 31, 2017	12.64	12.41	12.13	11.52	-4.035%	-7.172	% 6,683,600
March 31, 2018	12.39	11.88	12.02	11.13	-2.986	-6.313	6,150,700
April 1, 2018 through May 31, 2018	11.94	11.77	11.25	10.94	-5.779	-7.052	3,168,700

(1) Based on the Fund's computations.

(2) Source: NYSE American.

(3) Based on the Fund's computations.

(4) Source: Bloomberg.

The net asset value per Common Share on June 13, 2018 was \$11.73 and the market price per Common Share at the close of business on June 13, 2018 was \$10.94, representing a 6.73% discount from such net asset value.

The Fund has an unlimited amount of authorized shares. As of May 31, 2018, the Fund has outstanding 22,604,126 Common Shares.

**Share Repurchase Program.** Under the Board-approved open-market share repurchase program which commenced on June 1, 2016, the Fund may purchase, from time to time, up to 10% of the Fund's Common Shares in open-market transactions, at the discretion of management. Since the inception of the program, the Fund has repurchased a total of 242,561 Common Shares.

**Tender Offer.** In accordance with its offer to purchase for cash up to 15% of its issued and outstanding Common Shares (3,988,963 shares), each without par value, which offer expired on Friday, March 3, 2017 and was oversubscribed, the Fund accepted the maximum allowed by the offer of 3,988,963 Common Shares for cash payment at a price equal to \$12.73 per Common Share. This purchase price was 98% of the Fund's net asset value per Common Share of \$12.99 as of the close of regular trading on the NYSE American on March 6, 2017.

### Preferred Shares

Under the Declaration, the Fund is authorized to issue preferred shares having such par value and such preferences, voting powers, terms of redemption, if any, and special or relative rights or privileges (including conversion rights, if any) as determined by the Board of Trustees, without the approval of Common Shareholders.

Series of preferred shares may be issued in one or more classes or series, with such par value and rights as determined by the Board of Trustees, by action of the Board of Trustees without the approval of the Common Shareholders. Any decision by the Board to authorize an offering of preferred shares is subject to market conditions and to the Board's belief that leveraging the Fund's capital structure through the issuance of preferred shares is likely to achieve the benefits to the Common Shareholders. The terms of any series of preferred shares will be determined by the Board of Trustees (subject to applicable law and the Fund's Declaration) if and when it authorizes a preferred shares offering.

The Fund offered the three outstanding series of Preferred Shares in 2003. The remaining outstanding Preferred Shares are currently anticipated to be redeemed in August 2018.

### Authorized Shares

The following tables provides the Fund's authorized shares and Common Shares and Preferred Shares outstanding as of May 31, 2018.

<b>Title of Class</b>	<b>Amount</b>	<b>Amount Outstanding Exclusive of Amount held by Fund</b>
Common Shares	Unlimited	22,604,126
Series M Preferred Shares	Unlimited	1,200
Series W Preferred Shares	Unlimited	1,200
Series F Preferred Shares	Unlimited	1,200

## INVESTMENT OBJECTIVES AND STRATEGIES

### Investment Objectives

The Fund seeks to provide high current income, with a secondary objective of capital appreciation to the extent possible and consistent with the Fund's primary objective. Under normal market conditions, the Fund will seek to achieve its investment objectives by investing in debt securities and other income-producing instruments, allocated primarily among three distinct investment categories: (1) mortgage-backed and other asset-backed securities; (2) bank loans made to corporate and other business entities; and (3) below investment grade debt securities and other income-producing instruments, as described under "Portfolio Contents and Other Information." The Investment Manager has broad discretion to allocate the Fund's assets among the three principal investment categories. There is no limitation on the percentage of the Fund's assets that may be allocated to each of these investment categories; provided that, under normal market conditions, the Fund will invest at least [25]% of its total assets in each category. Under normal circumstances, the Fund's allocation to the investment category of mortgage-backed and other asset-backed securities will be primarily composed of investments in mortgage-backed securities. The Fund cannot assure you that it will achieve its investment objectives.

Under normal market conditions, the Fund expects to maintain a weighted average portfolio credit quality of investment grade, which will be determined by the Investment Manager based on the credit quality of the Fund's portfolio holdings (as rated by the Rating Agencies, or if unrated, as determined by the Investment Manager). For this purpose, when a portfolio holding is rated by more than one of these rating agencies, the Investment Manager

generally will use the highest rating.

Under normal market conditions, the Investment Manager expects the Fund to maintain an estimated average portfolio duration of between two and five years (including the effect of anticipated leverage). This duration policy may only be changed following provision of 60 days' prior notice to Common Shareholders. In comparison to maturity (which is the date on which a debt instrument ceases and the issuer is obligated to repay the principal amount), duration is a measure of the price volatility of a debt instrument as a result of changes in market rates of interest, based on the weighted average timing of the instrument's expected principal and interest payments. Duration differs from maturity in that it considers a security's yield, coupon payments, principal payments and call features in addition to the amount of time until the security finally matures. As the value of a security changes over time, so will its duration. Prices of securities with longer durations tend to be more sensitive to interest rate changes than securities with shorter durations. In general, a portfolio of securities with a longer duration can be expected to be more sensitive to interest rate changes than a portfolio with a shorter duration.

The Fund cannot change its investment objectives without the approval of the holders of a "majority of the outstanding" Common Shares and any preferred shares voting together as a single class, and, if the Fund has preferred shares are outstanding, of the holders of a "majority of the outstanding" preferred shares voting as a separate class. A "majority of the outstanding" shares (whether voting together as a single class or voting as a separate class) means (i) 67% or more of such shares present at a meeting, if the holders of more than 50% of those shares are present or represented by proxy, or (ii) more than 50% of such shares, whichever is less.

The Fund may not necessarily be leveraged at all times and the amount of borrowing or leverage, if any, may vary depending upon a variety of factors, including the Investment Manager's outlook for the market for debt securities and other income-producing instruments and the costs that the Fund would incur as a result of such leverage.

The Fund employs leverage through the purchase of mortgage dollar rolls. The Fund may use leverage through the issuance of senior securities such as preferred shares or the borrowing of funds from financial institutions (including committed financing arrangements). The Fund may also use leverage through the lending of portfolio securities, and the use of swaps, other derivatives, reverse repurchase agreements, and when-issued, delayed delivery or forward commitment transactions. To mitigate leverage risk from such transactions, the Fund may segregate liquid assets against or otherwise cover its future obligations under such transactions. See "Leverage." The Fund's use of derivative instruments (other than swaps) will be limited by the Fund's 15% limit on illiquid investments to the extent they are determined to be illiquid. See "Risks and Special Considerations—Liquidity Risk."

By using leverage, the Fund will seek to obtain a higher return for holders of Common Shares than if the Fund did not use leverage. Leveraging is a speculative technique and there are special risks involved. There can be no assurance that a leveraging strategy will be used or that it will be successful during any period in which it is employed.

### **Portfolio Management Strategies**

The ability of the Fund to use some of the strategies discussed below and in the SAI, such as derivatives, is limited by the rating agency guidelines. See "Leverage."

The Fund uses an active sector allocation strategy to try to achieve its goals of income and capital appreciation. This means the Fund allocates its assets among securities in various market sectors based on the Investment Manager's assessment of changing economic, global market, industry, and issuer conditions. Consequently, the Fund, from time to time, may have significant positions in particular sectors. The Investment Manager uses a "top-down" analysis of macroeconomic trends combined with a "bottom-up" fundamental analysis of market sectors, industries, and issuers to try to take advantage of varying sector reactions to economic events. The Investment Manager evaluates business cycles, yield curves, and values between and within markets, as well as country risk and currency risk. The Fund's ability to achieve its investment goals depends in part upon the Investment Manager's skill in determining the Fund's

asset allocation mix and sector weightings. There can be no assurance that the Investment Manager's analysis of the outlook for the economy and the business cycle will be correct.

The Investment Manager also uses a research driven, fundamental strategy that relies on a team of analysts to provide in-depth industry expertise and that use both qualitative and quantitative analysis to evaluate companies. Employing a “bottom-up” investment strategy, the Investment Manager intends to focus on individual securities. In selecting securities for the Fund’s investment portfolio, the Investment Manager will not rely principally on the ratings assigned by rating agencies, but will perform its own independent investment analysis to evaluate the creditworthiness of the issuer. The Investment Manager considers a variety of factors, including the issuer’s experience and managerial strength, its sensitivity to economic conditions, and its current financial condition.

At the same time, the Investment Manager uses a variety of techniques, described below and elsewhere in the Prospectus, designed to evaluate risk and manage the Fund’s exposure to investments that the Investment Manager believes are more likely to default or otherwise depreciate in value over time and detract from the Fund’s overall return to investors. The Fund cannot assure you that such securities will ultimately continue to pay current income or be paid in full at maturity.

When the Investment Manager believes market or economic conditions are unfavorable for investors, the Investment Manager may invest up to 100% of the Fund’s assets in a temporary defensive manner by holding all or a substantial portion of its assets in cash, cash equivalents or other high quality short-term investments. Temporary defensive investments generally may include U.S. government securities, commercial paper, repurchase agreements and other money market securities. The Investment Manager also may invest in these types of securities or hold cash while looking for suitable investment opportunities or to maintain liquidity. In these circumstances, the Fund may be unable to achieve its investment goals.

## **PORTFOLIO CONTENTS AND OTHER INFORMATION**

This section provides additional information regarding the types of securities and other instruments in which the Fund will ordinarily invest. A more detailed discussion of these and other instruments and investment techniques that may be used by the Fund is provided under “Investment Objectives and Policies” and “Investment Restrictions and Additional Investment Information” in the Statement of Additional Information.

The Fund invests in a diversified portfolio of debt securities and other income-producing instruments of varying maturities. These may include bonds, debentures, notes and other similar types of debt instruments, such as asset-backed securities, as well as convertible securities, bank loans and loan participations, commercial and agency-issued mortgage securities, payment-in-kind securities, zero-coupon securities, bank certificates of deposit, fixed time deposits and bankers’ acceptances, structured notes and other hybrid instruments, real estate investment trusts, preferred shares, U.S. government securities, municipal securities, debt securities issued by foreign corporations or supra-national government agencies, mortgage-backed securities issued on a public or private basis, and other types of asset-backed securities. The Fund will not invest in inverse floaters or interest-only or principal-only mortgage securities.

Certain debt instruments, such as convertible bonds, also may include the right to participate in equity appreciation, and the Investment Manager will generally evaluate those instruments based primarily on their debt characteristics. The Fund may hold equity securities; however, under ordinary circumstances, such investments will be limited to convertible securities, dividend-paying common or preferred stocks, or equity securities acquired in connection with a restructuring, a bankruptcy, a default, or the exercise of a conversion or purchase right. See “—Additional Investment Practices—Equity Securities.”

The rate of interest on an income-producing security may be fixed, floating or variable. The principal and/or interest rate on some debt instruments may be determined by reference to the performance of a benchmark asset or market,

such as an index of securities, or the differential performance of two assets or markets, such as the level of exchange rates between the U.S. dollar and a foreign currency or currencies.



The Fund may invest in debt securities and other income-producing instruments that are rated below investment grade. The Fund may invest up to 15% of its total assets in securities or other income-producing instruments issued by companies and governments in any foreign country, including developed or developing countries.

The Fund also may invest up to 5% of its total assets in securities or other income-producing instruments denominated in foreign currencies, including obligations of non-U.S. governments and their respective sub-divisions, agencies and government-sponsored enterprises. The Fund also may use a variety of derivative instruments for hedging, duration management, investment and risk management purposes, such as options, futures contracts, swap agreements and short sales, and may seek to obtain market exposure to the securities in which it primarily invests by entering into a series of purchase and sales contracts.

The Fund may invest up to 15% of its total assets in illiquid securities (*i.e.*, securities that cannot be disposed of within seven days in the ordinary course of business at approximately the value at which the Fund has valued the securities). Given the current structure of the markets for Rule 144A securities, the Fund may treat some of these securities as illiquid, except that Rule 144A securities may be deemed liquid by the Investment Manager under guidelines adopted by the Board of Trustees. Although structured notes, bank loans and loan participations are not necessarily illiquid, to the extent such investments are deemed to be illiquid by the Investment Manager, they will be subject to the Fund's restrictions on investments in illiquid securities. The Fund's investment in swaps will not be included as illiquid investments for purposes of determining compliance with the 15% limit on illiquid investments. Accordingly, the Fund may invest more than 15% of its total assets in swaps. However, the Fund's use of derivative instruments (other than swaps) will be limited by the Fund's 15% limit on illiquid investments to the extent such derivatives are determined to be illiquid.

### **Commercial and Other Mortgage-Related and Asset-Backed Securities**

Under normal market conditions, the Fund will invest at least [25]% of its assets in mortgage-backed and other asset-backed securities. Mortgage-related securities are debt instruments which provide periodic payments consisting of interest and/or principal that are derived from or related to payments of interest and/or principal on underlying mortgages. Additional payments on mortgage-related securities may be made out of unscheduled prepayments of principal resulting from the sale of the underlying property, refinancing or foreclosure, net of fees or costs that may be incurred. Under normal conditions, the Fund's allocation to the investment category of mortgage-backed and other asset-backed securities will be primarily composed of investments in mortgage-backed securities.

The Fund may invest a significant portion of its assets in commercial mortgage-related securities issued by corporations. These are securities that represent an interest in, or are secured by, mortgage loans secured by commercial property, such as industrial and warehouse properties, office buildings, retail space and shopping malls, multifamily properties and cooperative apartments, hotels and motels, nursing homes, hospitals, and senior living centers. They may pay fixed or adjustable rates of interest. The commercial mortgage loans that underlie commercial mortgage-related securities have certain distinct risk characteristics. Commercial mortgage loans generally lack standardized terms, which may complicate their structure. Commercial properties themselves tend to be unique and difficult to value. Commercial mortgage loans tend to have shorter maturities than residential mortgage loans, and may not be fully amortizing, meaning that they may have a significant principal balance, or "balloon" payment, due on maturity. In addition, commercial properties, particularly industrial and warehouse properties, are subject to environmental risks and the burdens and costs of compliance with environmental laws and regulations.

Other mortgage-related securities in which the Fund may invest include mortgage pass-through securities, mortgage dollar rolls, and other securities that directly or indirectly represent a participation in, or are secured by and payable from, mortgage loans on real property. The Fund will not invest in interest-only or principal-only mortgage securities.



The Fund may invest in securities issued by trusts and special purpose corporations with principal and interest payouts backed by, or supported by, any of various types of assets. These assets typically include receivables related to the purchase of manufactured housing, automobiles, credit card loans, and home equity loans. These securities generally take the form of a structured type of security, including pass-through, pay-through and senior subordinated payout structures.

The Fund may invest in other types of asset-backed securities that are offered in the marketplace, including Enhanced Equipment Trust Certificates (“EETCs”). Although any entity may issue EETCs, to date, U.S. airlines are the primary issuers. An airline EETC is an obligation secured directly by aircraft or aircraft engines as collateral. EETCs tend to be less liquid than bonds. Other asset-backed securities may be collateralized by the fees earned by service providers. The value of asset-backed securities may be substantially dependent on the servicing of the underlying asset pools and are therefore subject to risks associated with the negligence of, or defalcation by, their servicers. In certain circumstances, the mishandling of related documentation may also affect the rights of the security holders in and to the underlying collateral. The insolvency of entities that generate receivables or that use the assets may result in added costs and delays in addition to losses associated with a decline in the value of the underlying assets.

Please see “Investment Restrictions and Additional Investment Information—Mortgage-Related and Other Asset-Backed Securities” in the SAI and “Risks and Special Considerations—Mortgage-Related Risk” in this Prospectus for a more detailed description of the types of mortgage-related and other asset-backed securities in which the Fund may invest and their related risks.

### **Bank Loans and Loan Participations**

Under normal market conditions, the Fund will invest at least [25]% of its total assets in bank loans made to corporate and other business entities. Such bank loans typically pay interest at rates which are re-determined periodically on the basis of a floating base lending rate such as the London Interbank Offered Rate (“LIBOR”) plus a premium. The Fund may acquire loan participations and other related direct or indirect bank debt obligations (bank loans or loan participations), in which the Fund will buy from a lender a portion of a larger loan that the lender has made to a borrower. The Investment Manager generally considers loan participations to be liquid. To the extent loan participations are deemed to be liquid by the Investment Manager, they will not be subject to the Fund’s restrictions on investments in illiquid securities.

Generally, loan participations are sold without guarantee or recourse to the lending institution and are subject to the credit risks of both the borrower and the lending institution. Loan participations, however, may enable the Fund to acquire an interest in a loan from a financially strong borrower which it could not do directly. While loan participations generally trade at par value, the Fund may be permitted to buy loan participations that sell at a discount because of the borrower’s credit problems or other issues associated with the credit risk of the loan. To the extent the credit problems are resolved, loan participations may appreciate in value.

Indebtedness of companies whose creditworthiness is poor involves substantially greater risks, and may be highly speculative. Some companies may never pay off their indebtedness, or may pay only a small fraction of the amount owed. Consequently, when investing in indebtedness of companies with poor credit, the Fund bears a substantial risk of losing the entire amount invested. If the Fund purchases a loan, it may only be able to enforce its rights through the lender, and may assume the credit risk of both the lender and the borrower.

Bank loans and other floating-rate debt instruments are subject to the risk of non-payment of scheduled interest or principal. Such non-payment would result in a reduction of income to the Fund, a reduction in the value of the investment and a potential decrease in the net asset value of the Fund. Some bank loans may be secured by collateral; however, there can be no assurance that the liquidation of any collateral securing a bank loan would satisfy the

borrower's obligation in the event of non-payment of scheduled interest or principal payments, or that such collateral could be readily liquidated. In the event of bankruptcy of a borrower, the Fund could experience delays or limitations with respect to its ability to realize the benefits of any collateral securing a bank loan. Collateral securing a bank loan may lose all or substantially all of its value in the event of bankruptcy of a borrower. Some bank loans are subject to the risk that a court, pursuant to fraudulent conveyance or other similar laws, could subordinate the bank loans to presently existing or future indebtedness of the borrower or take other action detrimental to the holders of the bank loans including, in certain circumstances, invalidating such bank loans or causing interest previously paid to be refunded to the borrower. If interest were required to be refunded, it could negatively affect the Fund's performance.

Many bank loans in which the Fund will invest may not be rated by a Rating Agency, will not be registered with the SEC or any state securities commission and will not be listed on any national securities exchange. The amount of public information available with respect to bank loans will generally be less extensive than that available for registered or exchange listed securities. In evaluating the creditworthiness of borrowers, the Investment Manager will consider, and may rely in part, on analyses performed by others. Borrowers may have outstanding debt obligations that are rated below investment grade by a Rating Agency. A portion, and potentially all, of the bank loans in the Fund may be assigned ratings below investment grade by a Rating Agency, or unrated but judged by the Investment Manager to be of comparable quality.

No active trading market may exist for some bank loans and some loans may be subject to restrictions on resale. A secondary market may be subject to irregular trading activity, wide bid/ask spreads and extended trade settlement periods, which may impair the ability to realize full value and thus cause a material decline in the Fund's net asset value. In addition, the Fund may not be able to readily dispose of its bank loans at prices that approximate those at which the Fund could sell such loans if they were more widely-traded and, as a result of such illiquidity, the Fund may have to sell other investments or engage in borrowing transactions if necessary to raise cash to meet its obligations. During periods of limited supply and liquidity of bank loans, the Fund's yield may be lower. See "Risks and Special Considerations—Liquidity Risk."

### **High Yield Investments**

Under normal market conditions, the Fund will invest at least [25]% of its total assets in debt securities and other income-producing instruments that are rated below investment grade by Moody's, S&P or Fitch (below Baa by Moody's, below BBB by S&P or Fitch) or that are unrated but judged by the portfolio managers to be of comparable quality. These debt securities are sometimes referred to as "high yield" securities or "junk bonds." Investing in high yield securities and instruments involves greater risks (in particular, greater risk of default) and special risks in addition to the risks associated with investments in investment grade debt obligations. While offering a greater potential opportunity for capital appreciation and higher yields, high yield investments typically entail greater potential price volatility and default risk and may be less liquid than higher-rated securities. Compared to issuers of higher-rated securities, issuers of high yield securities or other income-producing instruments may be perceived to have greater difficulty meeting principal and interest payments. They also may be more susceptible to real or perceived adverse economic and competitive conditions related to the issuer's industry than higher-rated securities. High yield investments may be less liquid than higher rated securities. The Fund may also invest in debt securities or other obligations whose issuers are in bankruptcy. See "Risks and Special Considerations—Liquidity Risk."

The market values of high yield investments tend to reflect individual developments of the issuer to a greater extent than do higher-quality securities, which tend to react mainly to fluctuations in the general level of interest rates. In addition, lower-quality debt securities tend to be more sensitive to economic conditions. Certain "emerging market" governments that issue high yield securities are among the largest debtors to commercial banks, foreign governments and supra-national organizations such as the World Bank, and may not be able or willing to make principal and/or interest payments as they come due.

The Fund may purchase unrated securities (which are not rated by a rating agency) if the Investment Manager determines that the securities are of comparable quality to rated securities that the Fund may purchase. Unrated securities may be less liquid than comparable rated securities and involve the risk that the Investment Manager may not accurately evaluate the security's comparative credit rating.

[The Fund will not invest more than 10% of its total assets in securities that are, at the time of purchase, rated CCC/Caa or lower by each Rating Agency rating the security or that are unrated but judged by the portfolio managers to be of comparable quality.] Lower rated securities generally provide higher yields than more highly rated securities to compensate investors for the higher risk. The Fund will seek to invest in securities offering the highest yield and expected total return without taking on an excessive amount of risk. These lower rated securities may also include defaulted securities for which payments of interest or principal or both are unpaid and overdue or for which other defaults have occurred. Under normal conditions, the Fund will not invest more than 5% of its total assets in debt securities or other obligations whose issuers are in default at the time of purchase.

Because the securities the Fund holds fluctuate in price, the value of your investment in the Fund will go up and down. This means you could lose money over short or even extended periods.

### ***Credit Ratings and Unrated Securities***

Rating Agencies are private services that provide ratings of the credit quality of debt obligations, including convertible securities, based on an assessment of default risk. Appendix A to the SAI describes the various ratings assigned to debt obligations by Moody's, S&P and Fitch. Ratings assigned by a Rating Agency are the individual agency's opinion of credit quality and do not evaluate market risks. Rating Agencies may fail to make timely changes in credit ratings or may make an inaccurate assessment of the factors affecting credit quality, and an issuer's current financial condition may be better or worse than a rating indicates. The Fund will not necessarily sell a security when its rating is reduced below its rating at the time of purchase. As described below under "—Independent Credit Analysis," the Investment Manager does not rely solely on credit ratings, and develops its own analysis of issuer credit quality. The ratings of a debt security may change over time. The Rating Agencies monitor and evaluate the ratings assigned to securities on an ongoing basis. As a result, debt instruments held by the Fund could receive a higher rating (which would tend to increase their value) or a lower rating (which would tend to decrease their value) during the period in which they are held.

### ***Independent Credit Analysis***

The Investment Manager relies heavily on its own analysis of the credit quality and risks associated with individual debt obligations considered for the Fund, rather than relying exclusively on rating agencies or third-party research. The Investment Manager uses this information in an attempt to minimize credit risk and identify issuers, industries or sectors that are undervalued or that offer attractive yields relative to the Investment Manager's assessment of their credit characteristics. The Investment Manager monitors the creditworthiness of the Fund's portfolio. Analysis of the creditworthiness of issuers of high yield securities may be more complex than for issuers of higher-quality debt obligations. The Fund's success in achieving its investment objectives may depend more heavily on the Investment Manager's credit analysis than if the Fund invested solely in higher-quality and rated securities.

### **Additional Investment Practices**

#### ***Commercial Paper***

Commercial paper represents short-term unsecured promissory notes issued in bearer form by corporations such as banks or bank holding companies and finance companies. The rate of return on commercial paper may be linked or

indexed to the level of exchange rates between the U.S. dollar and a foreign currency or currencies.

### ***Bank Obligations***

The Fund may invest in certain bank obligations, including certificates of deposit, bankers' acceptances, and fixed time deposits. Certificates of deposit are negotiable certificates issued against funds deposited in a commercial bank for a definite period of time and earning a specified return. Bankers' acceptances are negotiable drafts or bills of exchange, normally drawn by an importer or exporter to pay for specific merchandise, which are "accepted" by a bank, meaning, in effect, that the bank unconditionally agrees to pay the face value of the instrument on maturity. Fixed time deposits are bank obligations payable at a stated maturity date and bearing interest at a fixed rate. Fixed time deposits may be withdrawn on demand by the investor, but may be subject to early withdrawal penalties, which vary depending upon market conditions and the remaining maturity of the obligation.

### ***Zero-Coupon Securities***

Zero-coupon or deferred interest securities are debt obligations that make no periodic interest payments before maturity or a specified date when the securities begin paying current interest (the cash payment date), and therefore are generally issued and traded at a discount from their face amount or par value. The discount varies depending on the time remaining until maturity or the cash payment date, as well as prevailing interest rates, liquidity of the security, and the perceived credit quality of the issuer. The discount, in the absence of financial difficulties of the issuer, typically decreases as the final maturity or cash payment date approaches.

Because of the lack of current income, the value of zero-coupon or deferred interest securities is generally more volatile than the value of other fixed-income securities that pay interest periodically. Zero-coupon or deferred interest securities are also likely to respond to changes in interest rates to a greater degree than other fixed-income securities having similar maturities and credit quality. For federal income tax purposes, holders of these bonds, such as the Fund, are deemed to receive interest over the life of the bonds and are taxed as if interest were paid on a current basis although the holder does not receive cash interest payments until the bonds mature or the specified date. Accordingly, during times when the Fund does not receive any cash interest payments on its zero-coupon or deferred interest securities, it may have to sell portfolio securities to meet distribution requirements and these sales may be subject to the risk factors discussed above. The Fund is not limited in the amount of its assets that may be invested in these types of securities.

### ***Pay-in-kind Securities***

Pay-in-kind securities pay interest by issuing more bonds. The Fund is deemed to receive interest over the life of these bonds and is treated as if the interest were paid on a current basis for federal income tax purposes, although the Fund does not receive any cash interest payments until maturity or the cash payment date. Accordingly, during times when the Fund does not receive any cash interest payments on its pay-in-kind securities, it may have to sell portfolio securities to meet distribution requirements and these sales may be subject to the risk factors discussed above. The Fund is not limited in the amount of its assets that may be invested in pay-in-kind securities.

### ***Foreign (Non-U.S.) Investments and Currencies***

The Fund may invest up to 15% of its total assets in securities or other income-producing instruments issued by companies and governments in any foreign country, developed or developing. Foreign investments held by the Fund generally will be traded on U.S. markets.

The Fund also may invest up to 5% of its total assets in securities or other income-producing instruments denominated in foreign currencies, including obligations of non-U.S. governments and their respective sub-divisions, agencies and government-sponsored enterprises. Investing in foreign securities involves special risks and considerations not



typically associated with investing in U.S. securities. See “Risks and Special Considerations—Foreign (Non-U.S.) Investment Risk.”

***Foreign Currencies and Related Transactions.*** The Fund’s investments in securities that trade in, or receive revenues in, foreign currencies will be subject to currency risk, which is the risk that fluctuations in the exchange rates between the U.S. dollar and foreign currencies may negatively affect any investment. The Fund may engage in a variety of transactions involving foreign currencies in order to hedge against foreign currency risk, to increase exposure to a foreign currency, or to shift exposure to foreign currency fluctuations from one currency to another. For instance, the Fund may purchase foreign currencies on a spot (cash) basis and enter into forward foreign currency exchange contracts, foreign currency futures contracts and options on foreign currencies and futures. Suitable hedging transactions may not be available in all circumstances and there can be no assurance that the Fund will engage in such transactions at any given time or from time to time. Also, these transactions may not be successful and may eliminate any chance for the Fund to benefit from favorable fluctuations in relevant foreign currencies. The Fund will normally seek to hedge at least 75% of its exposure to foreign currencies.

Please see “Investment Restrictions and Additional Investment Information—Foreign (Non-U.S.) Investments and Currencies” in the SAI for a more detailed description of the types of foreign investments and foreign currency transactions in which the Fund may invest and their related risks.

### ***Derivatives***

The Fund may invest in a variety of derivatives without limit for hedging purposes, and may invest up to 25% of its total assets in derivatives for non-hedging purposes. Generally, derivatives are financial contracts whose value depends upon, or is derived from, the value of an underlying asset, reference rate or index, and may relate to individual debt instruments, interest rates, currencies or currency exchange rates, commodities, and related indexes. Examples of derivative instruments that the Fund may use include options contracts, futures contracts, options on futures contracts and swap agreements. The Fund’s use of derivative instruments will be limited by the Fund’s 15% limit on illiquid investments to the extent they are determined to be illiquid. The Fund’s use of derivative instruments involves risks different from, or possibly greater than, the risks associated with investment directly in securities and other more traditional investments. See “Risks and Special Considerations—Derivatives Risk.” Certain types of derivative instruments that the Fund may use with some frequency are described elsewhere in this section, including those described under “—Structured Notes and Other Related Instruments” and “—Swaps.” Please see “Investment Restrictions and Additional Investment Information—Derivative Instruments” in the SAI for additional information about these and other derivative instruments that the Fund may use and the risks associated with such instruments. There is no assurance that these derivative strategies will be available at any time or that the Investment Manager will determine to use them for the Fund or, if used, that the strategies will be successful. In addition, the Fund may be subject to certain restrictions on its use of derivative strategies imposed by guidelines of one or more Rating Agencies that may issue ratings for preferred shares or debt issued by the Fund.

The performance of derivative instruments (including currency-related derivatives) depends largely on the performance of an underlying currency, security or index and such instruments often have risks similar to their underlying instrument in addition to other risks. Derivative instruments involve costs and can create economic leverage in the Fund’s portfolio that may result in significant volatility and cause the Fund to participate in losses (as well as gains) in an amount that significantly exceeds the Fund’s initial investment. Certain derivatives have the potential for unlimited loss, regardless of the size of the initial investment. Other risks include illiquidity, mispricing or improper valuation of the derivative instrument, and imperfect correlation between the value of the derivative and the underlying instrument so that the Fund may not realize the intended benefits. Their successful use will usually depend on the investment manager’s ability to accurately forecast movements in the market relating to the underlying instrument. Should a market or markets, or prices of particular classes of investments, move in an unexpected manner, especially in unusual or extreme market conditions, the Fund may not achieve the anticipated benefits of the transaction, and it may realize losses, which could be significant. If the investment manager is not successful in using such derivative instruments, the Fund’s performance may be worse than if the investment manager did not use such

derivative instruments at all. To the extent that the Fund uses such instruments for hedging purposes, there is the risk of imperfect correlation between movements in the value of the derivative instrument and the value of the underlying investment or other asset being hedged. There is also the risk, especially under extreme market conditions, that an instrument, which usually would operate as a hedge, provides no hedging benefits at all.

Use of these instruments could also result in a loss if the counterparty to the transaction (particularly with respect to swap agreements, forward currency contracts and other OTC derivatives) does not perform as promised, including because of such counterparty's bankruptcy or insolvency. This risk may be heightened during volatile market conditions. Other risks include the inability to close out a position because the trading market becomes illiquid (particularly in the OTC markets) or the availability of counterparties becomes limited for a period of time. In addition, the presence of speculators in a particular market could lead to price distortions. To the extent that the Fund is unable to close out a position because of market illiquidity, the Fund may not be able to prevent further losses of value in its derivatives holdings and the Fund's liquidity may be impaired to the extent that it has a substantial portion of its otherwise liquid assets marked as segregated to cover its obligations under such derivative instruments. The Fund may also be required to take or make delivery of an underlying instrument that the investment manager would otherwise have attempted to avoid. Some derivatives can be particularly sensitive to changes in interest rates or other market prices. Investors should bear in mind that, while the Fund intends to use derivative strategies on a regular basis, it is not obligated to actively engage in these transactions, generally or in any particular kind of derivative, if the investment manager elects not to do so due to availability, cost or other factors.

The use of derivative strategies may also have a tax impact on the Fund. The timing and character of income, gains or losses from these strategies could impair the ability of the Investment Manager to use derivatives when it wishes to do so.

**Swaps.** The Fund may enter into swap contracts for hedging purposes, to change the duration of the overall portfolio, to mitigate default risk, or to add leverage to the portfolio; such swaps may include but are not limited to interest rate swaps, credit default swaps, inflation index swaps or currency swaps. When used for hedging purposes, the Fund would be the buyer of a swap contract. When the Fund is the seller of a swap contract, the Fund will segregate assets in the form of cash and cash equivalents in an amount equal to the aggregate market value of such swaps, marked to market on a daily basis. The Fund's use of derivative instruments will be limited by the Fund's 15% limit on illiquid investments to the extent such derivatives are determined to be illiquid.

Generally, swap agreements are contracts between the Fund and another party (the swap counterparty) for periods ranging from a few days to multiple years. A swap agreement may be negotiated bilaterally and traded over-the-counter (OTC) between two parties (for an uncleared swap) or, in some instances, must be transacted through a futures commission merchant (FCM) and cleared through a clearinghouse that serves as a central counterparty (for a cleared swap). In a basic swap transaction, the Fund agrees with the swap counterparty to exchange the returns (or differentials in rates of return) and/or cash flows earned or realized on a particular "notional amount" or value of predetermined underlying reference instruments. The notional amount is the set dollar or other value selected by the parties to use as the basis on which to calculate the obligations that the parties to a swap agreement have agreed to exchange. The parties typically do not actually exchange the notional amount. Instead they agree to exchange the returns that would be earned or realized if the notional amount were invested in given investments or at given interest rates. Examples of returns that may be exchanged in a swap agreement are those of a particular security, a particular fixed or variable interest rate, a particular non-U.S. currency, or a "basket" of securities representing a particular index. The Fund customarily enters into swap agreements that are based on the standard terms and conditions of an International Swaps and Derivatives Association ("ISDA") Master Agreement. ISDA is a voluntary industry association of participants in the over-the-counter ("OTC") derivatives markets that has developed standardized contracts used by such participants that have agreed to be bound by such standardized contracts.

The Fund will generally enter into swap agreements on a net basis, which means that the two payment streams that are to be made by the Fund and its counter-party are netted out, with the Fund receiving or paying, as the case may be, only the net difference in the two payments. The Fund's obligations (or rights) under a swap agreement that is entered into on a net basis will generally be the net amount to be paid or received under the agreement based on the relative values of the obligations of each party upon termination of the agreement or at set valuation dates. The Fund will accrue its obligations under a swap agreement daily (offset by any amounts the counterparty owes the Fund). If the swap agreement does not provide for that type of netting, the full amount of the Fund's obligations will be accrued on a daily basis.

During the term of an uncleared swap agreement, the Fund will be required to pledge to the swap counterparty, from time to time, an amount of cash and/or other assets equal to the total net amount (if any) that would be payable by the Fund to the counterparty if all outstanding swaps between the parties were terminated on the date in question, including any early termination payments (variation margin). Periodically, changes in the amount pledged are made to recognize changes in value of the contract resulting from, among other things, interest on the notional value of the contract, market value changes in the underlying investment, and/or dividends paid by the issuer of the underlying instrument. Likewise, the counterparty will be required to pledge cash or other assets to cover its obligations to the Fund. However, the amount pledged may not always be equal to or more than the amount due to the other party. Therefore, if a counterparty defaults on its obligations to the Fund, the amount pledged by the counterparty and available to the Fund may not be sufficient to cover all the amounts due to the Fund and the Fund may sustain a loss.

Many swaps currently are, and others eventually are expected to be, required to be cleared through a central counterparty. Central clearing is designed to reduce counterparty credit risk and increase liquidity compared to OTC swaps, but it does not eliminate those risks completely. With cleared swaps, there is also a risk of loss by the Fund of its initial and variation margin deposits in the event of bankruptcy of the FCM with which the Fund has an open position in a swap contract. The assets of the Fund may not be fully protected in the event of the bankruptcy of the FCM or central counterparty because the Fund might be limited to recovering only a pro rata share of all available funds and margin segregated on behalf of an FCM's customers. Credit risk of cleared swap participants is concentrated in a few clearinghouses, and the consequences of insolvency of a clearinghouse are not clear. With cleared swaps, the Fund may not be able to obtain as terms as favorable it would be able to negotiate for a bilateral, uncleared swap. In addition, an FCM may unilaterally amend the terms of its agreement with the Fund, which may include the imposition of position limits or additional margin requirements with respect to the Fund's investment in certain types of swaps. The regulation of cleared and uncleared swaps, as well as other derivatives, is a rapidly changing area of law and is subject to modification by government and judicial action. In addition, the SEC, Commodity Futures Trading Commission ("CFTC") and the exchanges are authorized to take extraordinary actions in the event of a market emergency. It is not possible to predict fully the effects of current or future regulation.

Cleared swaps are submitted for clearing through each party's FCM, which must be a member of the clearinghouse that serves as the central counterparty. Transactions executed on a swap execution facility (SEF) may increase market transparency and liquidity but may require the Fund to incur increased expenses to access the same types of swaps that it has used in the past. When the Fund enters into a cleared swap, it must deliver to the central counterparty (via the FCM) an amount referred to as "initial margin." Initial margin requirements are determined by the central counterparty, and are typically calculated as an amount equal to the volatility in market value of the cleared swap over a fixed period, but an FCM may require additional initial margin above the amount required by the central counterparty. During the term of the swap agreement, a "variation margin" amount may also be required to be paid by the Fund or may be received by the Fund in accordance with margin controls set for such accounts. If the value of the Fund's cleared swap declines, the Fund will be required to make additional "variation margin" payments to the FCM to settle the change in value. Conversely, if the market value of the Fund's position increases, the FCM will post additional "variation margin" to the Fund's account. At the conclusion of the term of the swap agreement, if the Fund has a loss equal to or greater than the margin amount, the margin amount is paid to the FCM along with any loss in excess of the

margin amount. If the Fund has a loss of less than the margin amount, the excess margin is returned to the Fund. If the Fund has a gain, the full margin amount and the amount of the gain is paid to the Fund.

**Interest Rate Swaps.** An interest rate swap is an agreement between two parties to exchange interest rate payment obligations. Typically, one party's obligation is based on an interest rate fixed to maturity while the other party's obligation is based on an interest rate that changes in accordance with changes in a designated benchmark (for example, LIBOR, prime rate, commercial paper rate, or other benchmarks). Alternatively, both payment obligations may be based on an interest rate that changes in accordance with changes in a designated benchmark (also known as a "basis swap"). In a basis swap, the rates may be based on different benchmarks (for example, LIBOR versus commercial paper) or on different terms of the same benchmark (for example, one-month LIBOR versus three-month LIBOR). In a basis swap, the rates may be based on different benchmarks (for example, LIBOR versus commercial paper) or on different terms of the same benchmark (for example, one-month LIBOR versus three-month LIBOR). Each party's payment obligation under an interest rate swap is determined by reference to a specified "notional" amount of money. Therefore, interest rate swaps generally do not involve the delivery of securities, other underlying instruments, or principal amounts; rather they entail the exchange of cash payments based on the application of the designated interest rates to the notional amount. Accordingly, barring swap counterparty or FCM default, the risk of loss in an interest rate swap is limited to the net amount of interest payments that the Fund is obligated to make or receive (as applicable), as well as any early termination payment payable by or to the Fund upon early termination of the swap. To the extent the Fund does not own the underlying obligation, the Fund will maintain, in a segregated account with its custodian bank, cash or liquid debt securities with an aggregate value equal to the amount of the Fund's outstanding swap obligation.

By swapping fixed interest rate payments for floating payments, an interest rate swap can be used to increase or decrease the Fund's exposure to various interest rates, including to hedge interest rate risk. Interest rate swaps are generally used to permit the party seeking a floating rate obligation the opportunity to acquire such obligation at a rate lower than is directly available in the credit markets, while permitting the party desiring a fixed-rate obligation the opportunity to acquire such a fixed-rate obligation, also frequently at a rate lower than is directly available in the credit markets. The success of such a transaction depends in large part on the availability of fixed-rate obligations at interest (or coupon) rates low enough to cover the costs involved. Similarly, a basis swap can be used to increase or decrease the Fund's exposure to various interest rates, including to hedge against or speculate on the spread between the two indexes, or to manage duration. An interest rate swap transaction is affected by changes in interest rates, which, in turn, may affect the prepayment rate of any underlying debt obligations upon which the interest rate swap is based.

**Credit Default Swaps.** The Fund may purchase and sell credit default swaps. In that case, the Fund would be entitled to receive the par (or other agreed-upon) value of a referenced debt obligation from the counterparty to the contract in the event of a default by a third party, such as a U.S. or foreign issuer, on the debt obligation. In return, the Fund would pay to the counterparty a periodic stream of payments over the term of the contract provided that no event of default has occurred. If no default occurs, the Fund would have spent the stream of payments and received no benefit from the contract. When the Fund is the seller of a swap contract, it receives the stream of payments but is obligated to pay upon default of the referenced debt obligation. As the seller, the Fund would effectively add leverage to its portfolio because, in addition to its total assets, the Fund would be subject to investment exposure on the notional amount of the swap.

**Inflation Index Swaps.** An inflation index swap is a contract between two parties, whereby one party makes payments based on the cumulative percentage increase in an index that serves as a measure of inflation (typically, the Consumer Price Index) and the other party makes a regular payment based on a compounded fixed rate. Each party's payment obligation is determined by reference to a specified "notional" amount of money. Typically, an inflation index swap has payment obligations netted and exchanged upon maturity. The value of an inflation index swap is expected to change in response to changes in the rate of inflation. If inflation increases at a faster rate than anticipated at the time the swap is entered into, the swap will increase in value. Similarly, if inflation increases at a rate slower than anticipated at the time the swap is entered into, the swap will decrease in value.

**Total Return Swaps.** A total return swap is an agreement between two parties, pursuant to which one pays (and the other receives) an amount equal to the total return (including, typically, income and capital gains distributions, principal prepayment or credit losses) of an underlying reference asset (e.g., a note, bond or securities index) in exchange for a regular payment, at a floating rate based on LIBOR, or alternatively at a fixed rate or the total rate of return on another financial instrument. The Fund may take either position in a total return swap (i.e., the Fund may receive or pay the total return on the underlying reference asset).



**Currency Swaps.** A currency swap is generally a contract between two parties to exchange one currency for another currency at the start of the contract and then exchange periodic floating or fixed rates during the term of the contract based upon the relative value differential between the two currencies. Unlike other types of swaps, currency swaps typically involve the delivery of the entire principal (notional) amounts of the two currencies at the time the swap is entered into. At the end of the swap contract, the parties receive back the principal amounts of the two currencies.

### ***Options on Swap Agreements***

Generally, the Fund may purchase options on credit default swaps, options on interest rate swaps, commonly known as swaptions and options on fixed income total return swaps. For example, the Fund may buy options on interest rate swaps to help hedge the Fund's risk of potentially rising interest rates or options on credit default swaps to help hedge the Fund's risk of a credit rating decline in one or more of the debt securities held by the Fund. An option on a swap agreement generally is an over-the-counter option that gives the buyer of the option the right, but not the obligation, to enter into a previously negotiated swap agreement, or to extend, terminate, or otherwise modify the terms of an existing swap agreement, in exchange for the payment of a premium to the writer (seller) of the option. The writer (seller) of an option receives premium payments from the buyer and, in exchange, becomes obligated to enter into or modify an underlying swap agreement upon the exercise of the option by the buyer. A pay fixed option on an interest rate swap gives the buyer the right to establish a position in an interest rate swap where the buyer will pay (and the writer will receive) the fixed-rate cash flows and receive (and the writer will pay) the floating-rate cash flows. In general, most options on interest rate swaps are "European" exercise, which means that they can only be exercised at the end of the option term.

When the Fund purchases an option on a swap, it risks losing the amount of premium it has paid, should it elect not to exercise the option, plus any related transaction costs. Such options also involve other risks associated with both OTC options and swap agreements, such as counterparty risk (the risk that the counterparty defaults on its obligation), market risk, credit risk, and interest rate risk. With respect to the Fund's purchase of options on interest rate swaps, depending on the movement of interest rates between the time of purchase and expiration of the swaption, the value of the underlying interest rate swap and therefore the value of the swaption will change. With respect to the Fund's purchase of options on credit default swaps, depending on the movement of market spreads with respect to the particular referenced debt securities between the time of purchase and expiration of the option, the value of the underlying credit default swap and therefore the value of the option will change.

### ***Exclusion of Investment Manager from Commodity Pool Operator Definition***

With respect to the Fund, the investment manager has claimed an exclusion from the definition of "commodity pool operator" ("CPO") under the Commodity Exchange Act ("CEA") and the rules of the CFTC and, therefore, is not subject to CFTC registration or regulation as a CPO. In addition, with respect to the Fund, the investment manager is relying upon a related exclusion from the definition of "commodity trading advisor" ("CTA") under the CEA and the rules of the CFTC.

The terms of the CPO exclusion require the Fund, among other things, to adhere to certain limits on its investments in commodity futures, commodity options and swaps, which in turn include non-deliverable currency forward contracts, as further described in the Fund's Statement of Additional Information ("SAI"). Because the investment manager and the Fund intend to comply with the terms of the CPO exclusion, the Fund may, in the future, need to adjust its investment strategies, consistent with its investment goal, to limit its investments in these types of instruments. The Fund is not intended as a vehicle for trading in the commodity futures, commodity options, or swaps markets. The CFTC has neither reviewed nor approved the investment manager's reliance on these exclusions, or the Fund, its investment strategies or this prospectus.



### ***Currency Forwards***

A currency forward contract is an obligation to purchase or sell a specific foreign currency in exchange for another currency, which may be U.S. dollars, at an agreed exchange rate (price) at a future date. Currency forwards are typically individually negotiated and privately traded by currency traders and their customers in the interbank market. A cross currency forward is a forward contract to sell a specific foreign currency in exchange for another foreign currency and may be used when the Fund believes that the price of one of those foreign currencies will experience a substantial movement against the other foreign currency. A currency forward will tend to reduce or eliminate exposure to the currency that is sold, and increase exposure to the currency that is purchased, similar to when the Fund sells a security denominated in one currency and purchases a security denominated in another currency. When used for hedging purposes, a currency forward should protect the Fund against losses resulting from a decline in the hedged currency, but will cause the Fund to assume the risk of fluctuations in the value of the currency it purchases.

### ***Equity Securities***

The Fund may invest in equity securities. The purchaser of an equity security typically receives an ownership interest in the company as well as certain voting rights. The owner of an equity security may participate in a company's success through the receipt of dividends which are distributions of earnings by the company to its owners; however, the Fund may hold equity securities that do not issue dividends. Equity security owners may also participate in a company's success or lack of success through increases or decreases in the value of the company's shares as traded in the public trading market for such shares. Equity securities generally take the form of common stock or preferred stock. Preferred stockholders typically receive greater dividends but may receive less appreciation than common stockholders and may have greater voting rights as well. Equity securities may also include convertible securities, warrants or rights. Warrants or rights give the holder the right to purchase a common stock at a given time for a specified price.

The Fund's equity investments generally will be limited to convertible securities and dividend-paying common or preferred stocks. The Fund may also acquire equity securities in connection with the Fund's other investment activities, including through: the restructuring of loans or other debt securities; the resolution of a bankruptcy or a default; the entry of an issuer into receivership, a corporate or securities transaction by the issuer that affects securities held by the Fund; or the exercise by the Fund of conversion or purchase rights associated with a convertible or other fixed-income security purchased by the Fund. These equity securities may have risk and other characteristics of stocks or of both stocks and bonds. By holding and investing in equity securities, the Fund may expose an investor to certain risks that could cause the investor to lose money, particularly if there is a sudden decline in a holding's share price or an overall decline in the stock market. The value of an investment in the Fund could decline because of equity securities held by the Fund based on the day-to-day fluctuation or the decline in their value related to movements in the stock market, as well as in response to the activities of individual companies. In addition, some of the equity securities that the Fund would obtain as a result of the special circumstances described above could be subject to restrictions on transfer or sale that may reduce their market value compared to freely tradable securities.

***Preferred Stocks.*** Preferred stock represents an equity interest in a company that generally entitles the holder to receive, in preference to the holders of other stocks such as common stocks, dividends and a fixed share of the proceeds resulting from liquidation of the company. Some preferred stocks also entitle their holders to receive additional liquidation proceeds on the same basis as holders of a company's common stock, and thus also represent an ownership interest in the company. Some preferred stocks offer a fixed rate of return with no maturity date. Because they never mature, these preferred stocks act like long-term bonds and can be more volatile than other types of preferred stocks and may have heightened sensitivity to changes in interest rates. Other preferred stocks have a variable dividend, generally determined on a quarterly or other periodic basis, either according to a formula based upon a specified premium or discount to the yield on particular U.S. Treasury securities or based on an auction

process, involving bids submitted by holders and prospective purchasers of such stocks. Because preferred stocks represent an equity ownership interest in a company, their value usually will react more strongly than bonds and other debt instruments to actual or perceived changes in a company's financial condition or prospects, or to fluctuations in the equity markets.

***Convertible Securities and Synthetic Convertible Securities.*** The Fund may invest in convertible securities, which are generally a debt obligation or preferred stock that may be converted within a specified period of time into a certain amount of common stock of the same or a different issuer. A convertible security provides a fixed income stream and the opportunity, through its conversion feature, to participate in the capital appreciation resulting from a market price advance in its underlying common stock. As with a straight fixed-income security, a convertible security tends to increase in market value when interest rates decline and decrease in value when interest rates rise. Like a common stock, the value of a convertible security also tends to increase as the market value of the underlying stock rises, and it tends to decrease as the market value of the underlying stock declines. Because both interest rate and market movements can influence its value, a convertible security is not as sensitive to interest rates as a similar fixed-income security, nor is it as sensitive to changes in share price as its underlying stock.

### ***Collateralized Obligations***

The Fund may invest in any tranche (other than the equity tranche) of collateralized debt obligations. Collateralized debt obligations and similarly structured securities, sometimes known generally as CDOs, are interests in a trust or other special purpose entity (“SPE”) and are typically backed by a diversified pool of bonds, loans or other debt obligations. CDOs are not limited to investments in one type of debt and, accordingly, a CDO may be collateralized by corporate bonds, commercial loans, asset-backed securities, residential mortgage-backed securities, real estate investment trusts (“REITs”), commercial mortgage-backed securities, emerging market debt, and municipal bonds. Certain CDOs may use derivatives contracts, such as credit default swaps, to create “synthetic” exposure to assets rather than holding such assets directly, which entails the risks of derivative instruments.

Common varieties of CDOs include the following:

**Collateralized loan obligations.** Collateralized loan obligations (“CLOs”) are interests in a trust typically collateralized substantially by a pool of loans, which may include, among others, domestic and foreign senior secured loans, senior unsecured loans, and subordinate corporate loans made to domestic and foreign borrowers, including loans that may be rated below investment grade or equivalent unrated loans.

**Collateralized bond obligations.** Collateralized bond obligations (“CBOs”) are interests in a trust typically backed substantially by a diversified pool of high risk, below investment grade fixed income securities.

**Structured finance CDOs.** Structured finance CDOs are interests in a trust typically backed substantially by structured investment products such as asset-backed securities and commercial mortgage-backed securities.

***Synthetic CDOs.*** In contrast to CDOs that directly own the underlying debt obligations, referred to as cash CDOs, synthetic CDOs are typically collateralized substantially by derivatives contracts, such as credit default swaps, to create “synthetic” exposure to assets rather than holding such assets directly, which entails the risks of derivative instruments, principally counterparty risk.

CDOs are similar in structure to collateralized mortgage obligations. Unless the context indicates otherwise, the discussion of CDOs below also applies to CLOs, CBOs and other similarly structured securities.

In CDOs, the cash flows from the SPE are split into two or more portions, called tranches (or classes), that vary in risk and yield. The riskiest portion is the “equity” tranche, which bears the first loss from defaults on the bonds or loans in the SPE and is intended to protect the other, more senior tranches from severe, and potentially unforeseen, defaults or delinquent collateral payments (though such protection is not complete). Because they may be partially protected from defaults, senior tranches from a CDO typically have higher ratings and lower yields than the underlying collateral securities held by the trust, and may be rated investment grade. Despite protection from the equity tranche,

more senior tranches can experience, and may have experienced in the past, substantial losses due to actual defaults, increased sensitivity to defaults due to collateral default, downgrades of the underlying collateral by rating agencies, forced liquidation of a collateral pool due to a failure of coverage tests, disappearance of protecting tranches, market anticipation of defaults, as well as a market aversion to CDO securities as a class.

The risks of an investment in a CDO depend largely on the type of collateral held by the SPE and the tranche of the CDO in which the Fund invests. Investment risk may also be affected by the performance of a CDO's collateral manager (the entity responsible for selecting and managing the pool of collateral securities held by the SPE trust), especially during a period of market volatility like that experienced in 2007-2008. Normally, CDOs are privately offered and sold, and thus, are not registered under the securities laws and traded in a public market. As a result, investments in CDOs may be characterized by the Fund as illiquid securities. However, an active dealer market may exist for CDOs allowing the Fund to trade CDOs with other qualified institutional investors under Rule 144A. To the extent such investments are characterized as illiquid, they will be subject to the Fund's restrictions on investments in illiquid securities. The Fund's investment in unregistered securities such as CDOs will not receive the same investor protection as an investment in registered securities.

All tranches of CDOs, including senior tranches with high credit ratings, can experience, and many have recently experienced, substantial losses due to actual defaults, increased sensitivity to future defaults due to the disappearance of protecting tranches, market anticipation of defaults, as well as market aversion to CDO securities as a class. Prices of CDO tranches have declined considerably. The drop in prices was initially triggered by the subprime mortgage crisis. Subprime mortgages make up a significant portion of the mortgage securities that collateralize many CDOs. As floating interest rates and mortgage default rates increased, the rating agencies that had rated the mortgage securities and CDO transactions backed by such mortgages realized their default assumptions were too low and began to downgrade the credit rating of these transactions. There can be no assurance that additional losses of equal or greater magnitude will not occur in the future.

In addition to the normal risks associated with debt securities and asset-backed securities (e.g., interest rate risk, credit risk and default risk), CDOs carry additional risks including, but not limited to: (i) the possibility that distributions from collateral securities will not be adequate to make interest or other payments; (ii) the quality of the collateral may decline in value or quality or go into default or be downgraded; (iii) the Fund may invest in tranches of a CDO that are subordinate to other classes; and (iv) the complex structure of the security may not be fully understood at the time of investment and may produce disputes with the issuer, difficulty in valuing the security or unexpected investment results.

Certain issuers of CDOs may be deemed to be "investment companies" as defined in the 1940 Act. As a result, the Fund's investment in these structured investments from these issuers may be limited by the restrictions contained in the 1940 Act. CDOs generally charge management fees and administrative expenses that the shareholders of the Fund would pay indirectly.

### ***Repurchase Agreements***

The Fund generally will have a portion of its assets in cash or cash equivalents for a variety of reasons, such as waiting for a suitable investment opportunity or taking a defensive position. To earn income on this portion of its assets, the Fund may enter into repurchase agreements. Under a repurchase agreement, the Fund agrees to buy securities guaranteed as to payment of principal and interest by the U.S. government or its agencies from a qualified bank or broker-dealer and then to sell the securities back to the bank or broker-dealer after a short period of time (generally, less than seven days) at a higher price. The bank or broker-dealer must transfer to the Fund's custodian securities with an initial market value of at least 102% of the dollar amount invested by the Fund in each repurchase agreement. The Investment Manager will monitor the value of such securities daily to determine that the value equals or exceeds the repurchase price. Repurchase agreements maturing in more than seven days are considered to be illiquid securities.





Repurchase agreements may involve risks in the event of default or insolvency of the bank or broker-dealer, including possible delays or restrictions upon the Fund's ability to sell the underlying securities. The Fund will enter into repurchase agreements only with parties who meet certain creditworthiness standards, *i.e.*, banks or broker-dealers that the Investment Manager has determined present no serious risk of becoming involved in bankruptcy proceedings within the time frame contemplated by the repurchase transaction.

### ***Reverse Repurchase Agreements***

The Fund may use reverse repurchase agreements in order to add leverage to the portfolio. In a reverse repurchase agreement, the Fund sells securities to a bank or broker-dealer and agrees to repurchase the securities at a mutually agreed date and price. Generally, the effect of such a transaction is that the Fund can recover and reinvest all or most of the cash invested in the portfolio securities involved during the term of the reverse repurchase agreement and still be entitled to the returns associated with those portfolio securities. Such transactions are advantageous if the interest cost to the Fund of the reverse repurchase transaction is less than the returns it obtains on investments purchased with the cash.

Unless the Fund covers its positions in reverse repurchase agreements (by segregating liquid assets at least equal in amount to the forward purchase commitment), its obligations under the agreements will be subject to the Fund's limitations on borrowings. Reverse repurchase agreements involve leverage risk and also the market risk based on the value of the securities that the Fund is obligated to repurchase. In the event the buyer of securities under a reverse repurchase agreement files for bankruptcy or becomes insolvent, the Fund's use of the proceeds of the agreement may be restricted pending a determination by the other party, or its trustee or receiver, whether to enforce the Fund's obligation to repurchase the securities.

### ***U.S. Government Securities***

The Fund may invest in U.S. Government securities, which are obligations of, or guaranteed by, the U.S. Government, its agencies or government-sponsored enterprises. U.S. Government securities include a variety of securities that differ in their interest rates, maturities and dates of issue. Securities issued or guaranteed by agencies or instrumentalities of the U.S. Government may or may not be supported by the full faith and credit of the United States or by the right of the issuer to borrow from the U.S. Treasury.

### ***Municipal Bonds***

Municipal bonds are generally issued by states, municipalities and other political subdivisions, agencies, authorities and instrumentalities of states and multi-state agencies or authorities. Like other debt obligations, municipal bonds are subject to interest rate, credit and market risk. The ability of a municipal issuer to make payments could be affected by litigation, legislation or other political events or the bankruptcy of the issuer. Municipal bonds are either general obligation or revenue bonds and typically are issued to finance public projects (such as roads or public buildings), to pay general operating expenses or to refinance outstanding debt. General obligation bonds are backed by the full faith and credit, or taxing authority, of the issuer and may be repaid from any revenue source; revenue bonds may be repaid only from the revenues of a specific facility or source. The Fund also may purchase municipal bonds that represent lease obligations. These carry special risks because the issuer of the bonds may not be obligated to appropriate money annually to make payments under the lease. The Fund also may invest in securities issued by entities whose underlying assets are municipal bonds.

### ***When Issued, Delayed Delivery and Forward Commitment Transactions***

The Fund may buy debt securities on a “when-issued” or “delayed delivery” basis. These transactions are arrangements under which the Fund buys securities with payment and delivery scheduled for a future time. Purchases of debt securities on a when-issued or delayed delivery basis are subject to market fluctuation and to the risk that the value or yields at delivery may be more or less than the purchase price or the yields available when the transaction was entered into. Although the Fund will generally buy debt securities on a when-issued basis with the intention of acquiring such securities, it may sell them before the settlement date if it deems the sale to be advisable. The Fund will not enter into these transactions for investment leverage. When the Fund is the buyer in such a transaction, it will maintain, in a segregated account with its custodian bank, cash or high-grade marketable securities having an aggregate value equal to the amount of its purchase commitments until payment is made.

In when-issued and delayed delivery transactions, the Fund relies on the seller to complete the transaction. The other party’s failure may cause the Fund to miss a price or yield considered advantageous. Securities purchased on a when-issued or delayed delivery basis do not generally earn interest until their scheduled delivery date. The Fund is not subject to any percentage limit on the amount of its assets which may be invested in when-issued debt securities.

### ***Structured Notes and Related Instruments***

The Fund may invest in “structured” notes and other related instruments, which are privately negotiated debt obligations where the principal and/or interest is determined by reference to the performance of a benchmark asset, market or interest rate (an “embedded index”), such as selected securities, an index of securities or specified interest rates, or the differential performance of two assets or markets, such as indexes reflecting bonds. Structured instruments may be issued by corporations, including banks, as well as by governmental agencies. Structured instruments frequently are assembled in the form of medium-term notes, but a variety of forms are available and may be used in particular circumstances. The terms of such structured instruments normally provide that their principal and/or interest payments are to be adjusted upwards or downwards (but ordinarily not below zero) to reflect changes in the embedded index while the structured instruments are outstanding. As a result, the interest and/or principal payments that may be made on a structured product may vary widely, depending on a variety of factors, including the volatility of the embedded index and the effect of changes in the embedded index on principal and/or interest payments. The rate of return on structured notes may be determined by applying a multiplier to the performance or differential performance of the referenced index(es) or other asset(s). Application of a multiplier involves leverage that will serve to magnify the potential for gain and the risk of loss.

The Investment Manager may use structured instruments for investment purposes and also for risk management purposes, such as to reduce the duration and interest rate sensitivity of the Fund’s portfolio. While structured instruments may offer the potential for a favorable rate of return from time to time, they also entail certain risks. Structured instruments may be less liquid than other debt securities, and the price of structured instruments may be more volatile. In some cases, depending on the terms of the embedded index, a structured instrument may provide that the principal and/or interest payments may be adjusted below zero. Structured instruments also may involve significant credit risk and risk of default by the counterparty. Certain issuers of structured instruments may be deemed to be “investment companies” as defined in the 1940 Act. As a result, the Fund’s investment in these structured instruments may be limited by the restrictions contained in the 1940 Act. Although structured notes, bank loans and loan participations are not necessarily illiquid, to the extent such investments are deemed to be illiquid by the Investment Manager, they will be subject to the Fund’s restrictions on investments in illiquid securities. Like other sophisticated strategies, the Fund’s use of structured instruments may not work as intended. If the value of the embedded index changes in a manner other than that expected by the Investment Manager, principal and/or interest payments received on the structured instrument may be substantially less than expected. Also, if the Investment Manager uses structured instruments to reduce the duration of the Fund’s portfolio, this may limit the Fund’s return

when having a longer duration would be beneficial (for instance, when interest rates decline).

### ***Short Sales***

A short sale is a transaction in which the Fund sells an instrument that it does not own in anticipation that the market price will decline. The Fund may use short sales for investment and risk management purposes. When the Fund engages in a short sale, it must borrow the security sold short and deliver it to the counterparty. The Fund may have to pay a fee to borrow particular securities and would often be obligated to pay over any payments received on such borrowed securities. The Fund's obligation to replace the borrowed security will be secured by collateral deposited with the lender, which is usually a broker-dealer, and/or with the Fund's custodian. The Fund may not receive any payments (including interest) on its collateral. Short sales expose the Fund to the risk that it will be required to cover its short position at a time when the securities have appreciated in value, thus resulting in a loss to the Fund. The Fund may engage in so-called "naked" short sales where it does not own or have the immediate right to acquire the security sold short at no additional cost, in which case the Fund's losses could theoretically be unlimited, provided that the Fund will not engage in such naked short sales in excess of 5% of the Fund's total assets.

### ***Dollar Roll Transactions***

The Fund enters into mortgage dollar roll transactions as a form of borrowing. In a mortgage dollar roll, the Fund sells mortgage-backed securities for delivery in the current month and simultaneously contracts to repurchase substantially similar (name, type, coupon, and maturity) securities on a specified future date. During the period between the sale and repurchase (the "roll period"), the Fund forgoes principal and interest paid on the mortgage-backed securities. The Fund is compensated by the difference between the current sales price and the lower forward price for the future purchase (often referred to as the "drop"), as well as by the interest earned on the cash proceeds of the initial sale. The cash received by the Fund for the sale in a dollar roll is used to purchase additional investments. The Fund then continues to engage in forward dollar roll transactions, continually "rolling" them forward as existing transactions move toward their settlement dates. The cost of borrowing associated with the mortgage dollar roll strategy is an implied rate, calculated from the difference between the lower forward settlement price at which the Fund is purchasing agency mortgage-backed securities and the higher current price at which the Fund is selling the securities.

As a matter of non-fundamental policy, the Fund considers the purchase and/or sale of a mortgage dollar roll to be a borrowing for purposes of the Fund's fundamental restrictions.

### ***Real Estate Investment Trusts***

The Fund may invest in the equity or debt securities of publicly traded and private real estate investment trusts ("REITs"). A REIT is an entity that concentrates its assets in investments related to equity real estate and/or interests in mortgages on real estate. The shares of publicly traded REITs are traded on a national securities exchange or in the OTC market. Shares of private REITs are not publicly traded, and will be treated as illiquid securities. The Fund will limit its investments in illiquid securities, including private REITs, to 15% of its total assets.

### ***Other Investment Companies***

The Fund may invest in the securities of other investment companies to the extent that such investments are consistent with the Fund's investment objective and policies and permissible under the 1940 Act. Under the 1940 Act, the Fund may not acquire the securities of other domestic or non-U.S. investment companies if, as a result, (i) more than 10% of the Fund's total assets would be invested in securities of other investment companies, (ii) such purchase would result in more than 3% of the total outstanding voting securities of any one investment company being held by the Fund, or (iii) more than 5% of the Fund's total assets would be invested in any one investment company. These limitations do not apply to the purchase of shares of any investment company in connection with a merger, consolidation, reorganization or acquisition of substantially all the assets of another investment company.

Notwithstanding the foregoing, to the extent permitted by exemptive orders received from the SEC, the Fund may invest cash balances in shares of other money market funds advised by the Investment Manager or its affiliates in amounts up to 25% of the Fund's total assets. The Fund, as a holder of the securities of other investment companies, will bear its pro rata portion of the other investment companies' expenses, including advisory fees. These expenses are in addition to the direct expenses of the Fund's own operations.

**Rating Agency Requirements; Financing Restrictions.** If any debt or preferred shares issued by the Fund are rated, the relevant rating agencies impose asset coverage tests and other restrictions that may limit the Fund's ability to engage in certain of the transactions described above. Similarly, financial institutions that lend or make margin loans to the Fund impose restrictions that may limit the Fund's ability to make investments or engage in certain transactions. See "Leverage."

Please see "Investment Objectives and Policies" and "Investment Restrictions and Additional Investment Information" in the SAI for additional information regarding the investments of the Fund and their related risks.

## LEVERAGE

The Fund uses financial leverage on an ongoing basis for investment purposes, including through the purchase of mortgage dollar rolls. From 2003 through August 2018, the Fund also leveraged through preferred shares. In addition to mortgage dollar rolls, the Fund may from time to time use leverage through the issuance of senior securities such as preferred shares or the borrowing of funds from financial institutions (including committed financing arrangements). The Fund may also use leverage through the lending of portfolio securities, and the use of swaps, other derivatives, reverse repurchase agreements, and when-issued, delayed delivery or forward commitment transactions. To mitigate leverage risk from such transactions, the Fund may segregate liquid assets against or otherwise cover its future obligations under such transactions. By adding additional leverage, these strategies have the potential to increase returns to Common Shareholders, but also involve additional risks. Additional leverage will increase the volatility of the Fund's investment portfolio and could result in larger losses than if the strategies were not used. The Fund may engage in additional transactions of the type described above and similar investment management techniques which provide leverage. The Fund may use leverage for investment purposes, in order to repurchase its shares or as a temporary measure for extraordinary or emergency purposes, including for the payment of dividends or the settlement of securities transactions which otherwise might require untimely dispositions of Fund securities.

By using leverage, the Fund will seek to obtain a higher return for holders of Common Shares than if the Fund did not use leverage. Leveraging is a speculative technique and there are special risks involved. There can be no assurance that a leveraging strategy will be used or that it will be successful during any period in which it is employed. See "Risks and Special Considerations—Leverage Risk."

For each mortgage dollar roll transaction, the Fund will segregate on its books an offsetting cash position or a position of liquid securities of equivalent value. The Investment Manager will monitor the value of such securities daily to determine that the value equals or exceeds the mortgage dollar roll contract price.

The Fund could suffer a loss in a mortgage dollar roll transaction if the contracting party fails to perform the future transaction and the Fund is therefore unable to buy back the mortgage-backed securities it initially sold. The Fund intends to enter into mortgage dollar rolls only with high quality government securities dealers and member banks of the Federal Reserve System as approved by the Fund's Board of Trustees. In addition to counterparty risk, the use of dollar rolls is subject to the continued availability of these transactions at favorable rates. If mortgage dollar rolls cease to be available, have limited availability or are unavailable at favorable rates, the Fund may be unable to maintain this form of leverage and could be forced to make actual settlement on mortgage-backed securities purchased on the forward basis and possibly to seek alternative forms of borrowing. In addition, by entering into mortgage dollar rolls as a means of financing, the Fund is committed to acquiring the types of mortgage-backed securities upon which counterparties are willing to enter into mortgage dollar rolls. This could result in the Fund entering into mortgage dollar rolls for securities which the Investment Manager would not otherwise purchase for the Fund, or be required to reduce leverage through dollar rolls or find alternative forms of leverage, which may not be available at all or available on equally favorable terms.



As of May 31, 2018, the Fund had leverage in the amount of 34.95% of the Fund's Managed Assets.

The Fund may borrow pursuant to a committed financing arrangement. Such borrowings may be done on a secured basis, which means the Fund would be required to pledge portfolio securities as collateral in an amount up to the loan balance outstanding or as otherwise required by financing arrangements and grant a security interest in the securities pledged to, and in favor of, the counterparty as security for the loan balance outstanding. The Fund may permit re-hypothecation of portfolio securities pledged by the Fund up to the amount of the loan balance outstanding. Such re-hypothecation would allow the Fund to retain ownership of the re-hypothecated securities and to continue to receive payments in lieu of dividends and interest on such re-hypothecated securities. The Fund also would have the right under the committed financing arrangement to recall the re-hypothecated securities on demand. If the counterparty fails to deliver the recalled security in a timely manner, the counterparty will compensate the Fund for any fees or losses related to the failed delivery or, in the event a recalled security is not returned by the counterparty, the Fund, upon notice to the provider of the facility, may reduce the loan balance outstanding by the value of the recalled security failed to be returned.

The Fund's senior securities, including any preferred shares or borrowings, have complete priority upon distribution of assets over the Common Shares. The issuance of preferred shares or incurrence of indebtedness leverages the Common Shares. So long as the Fund's portfolio is invested in securities that provide a higher rate of return than the Fund's cost of leverage (after taking expenses into consideration), the leverage will allow Common Shareholders to receive a higher current rate of return than if the Fund were not leveraged.

Changes in the value of the Fund's portfolio (including investments bought with the proceeds of any preferred shares issued or indebtedness incurred) will be borne entirely by the Common Shareholders. If there is a net decrease (or increase) in the value of the Fund's investment portfolio, the leverage will decrease (or increase) the net asset value per Common Share to a greater extent than if the Fund were not leveraged. During periods in which the Fund is using leverage, the fees paid to the Investment Manager will be higher than if the Fund did not use leverage because the fees paid will be calculated on the basis of the Fund's Managed Assets. Thus, the Investment Manager has a financial incentive for the Fund to use leverage, which may result in a conflict of interest between the Investment Manager and the Common Shareholders. Fees and expenses paid by the Fund are borne entirely by the Common Shareholders (and not by preferred shareholders or debtholders, if any). These include costs associated with any offering of series of preferred shares or debt securities by the Fund, which will be borne immediately by Common Shareholders, as will the costs associated with any borrowings or other forms of leverage used by the Fund.

Under the 1940 Act, the Fund generally is not permitted to engage in borrowings (including through the use of reverse repurchase agreements, swaps and other derivatives to the extent that these instruments constitute senior securities) unless immediately after a borrowing the value of the Fund's total assets less liabilities (other than the borrowing) is at least 300% of the principal amount of such borrowing (*i.e.*, such principal amount may not exceed 33 1/3% of the Fund's total assets). In addition, the Fund is not permitted to declare any cash dividend or other distribution on Common Shares unless, at the time of such declaration, the value of the Fund's total assets, less liabilities other than borrowing, is at least 300% of such principal amount. If the Fund borrows, it intends, to the extent possible, to prepay all or a portion of the principal amount of the borrowing to the extent necessary in order to maintain the required asset coverage. Failure to maintain certain asset coverage requirements could result in an event of default and entitle preferred shareholders, if any, to elect a majority of the Trustees of the Fund. Derivative instruments used by the Fund will not constitute senior securities (and will not be subject to the Fund's limitations on borrowings) to the extent that the Fund segregates liquid assets at least equal in amount to its obligations under the instruments, or enters into offsetting transactions or owns positions covering its obligations. For instance, the Fund may cover its position in a reverse repurchase agreement by segregating liquid assets at least equal in amount to its forward purchase



commitment.

Under the 1940 Act, the Fund is not permitted to issue preferred shares unless immediately after such issuance the value of the Fund's total net assets is at least 200% of the liquidation value of the outstanding preferred shares plus the aggregate amount of any senior securities of the Fund representing indebtedness (*i.e.*, such liquidation value plus the aggregate amount of senior securities representing indebtedness may not exceed 50% of the Fund's total net assets). In addition, the Fund is not permitted to declare any cash dividend or other distribution on its Common Shares unless, at the time of such declaration, the value of the Fund's total net assets satisfies the above-referenced 200% coverage requirement. When preferred shares are outstanding, the Fund intends, to the extent possible, to purchase or redeem preferred shares from time to time to the extent necessary in order to maintain net asset coverage of at least 200%. If the Fund has preferred shares outstanding, two of the Fund's Trustees will be elected by the holders of preferred shares, voting separately as a class. The remaining Trustees of the Fund will be elected by holders of Common Shares and preferred shares voting together as a single class. In the event the Fund were to fail to pay dividends on preferred shares for two years or other defaults, preferred shareholders would be entitled to elect a majority of the Trustees of the Fund.

The Fund's Board of Trustees has authorized the redemption of all the Fund's outstanding Preferred Shares, which is currently anticipated to take place in August 2018. The Fund will use other forms of leverage, including by purchasing mortgage dollar rolls and/or borrowing from a financial institution, following the redemption of the Preferred Shares.

Assuming that its senior securities represent approximately [ ]% of the Fund's Managed Assets and pay dividends at an annual average rate of [ ]%, the income generated by the Fund's portfolio (net of expenses) would have to exceed [ ]% in order to cover the cost of such leverage. Of course, these numbers are merely estimates, used for illustration purposes only. The Fund's actual cost of leverage will vary frequently and may be significantly higher or lower than the rate identified above.

The following table is furnished in response to requirements of the SEC. It is designed to illustrate the effect of leverage on the total return of the Common Shares, assuming investment portfolio total returns (consisting of income and changes in the value of investments held in the Fund's portfolio) of -10%, -5%, 0%, 5% and 10%. These assumed investment portfolio returns are hypothetical figures and are not necessarily indicative of the investment portfolio returns expected to be experienced by the Fund. The table further assumes the complete redemption of the Fund's currently outstanding Preferred Shares, the issuance of senior securities representing approximately [ ]% of the Fund's Managed Assets and the Fund's annual cost of leverage of [ ]%. See "Risks and Special Considerations."

<b>Assumed Portfolio Total Return</b>	-10.00%	-5.00%	0.00%	5.00%	10.00%
<b>Common Share Total Return</b>	-[ ]%	-[ ]%	[ ]%	[ ]%	[ ]%

Common Share total return is composed of two elements: the Common Share dividends paid by the Fund (the amount of which is largely determined by the net investment income of the Fund after paying the cost of leverage) and gains or losses on the value of the securities the Fund owns. As required by SEC rules, the table assumes that the Fund is more likely to suffer capital losses than to enjoy capital appreciation. For example, to assume a total return of 0%, the Fund must assume that the interest it receives on its investments is entirely offset by losses in the value of those investments.

## **RISKS AND SPECIAL CONSIDERATIONS**

An investment in the Fund involves certain risks and considerations, which are described below.

### **Net Asset Value Discount Risk**

As with any stock, the price of the Fund's Common Shares will fluctuate with market conditions and other factors. Shares of closed-end investment companies frequently trade at a discount from net asset value. This characteristic is a risk separate and distinct from the risk that net asset value will decrease. The Fund cannot predict whether its Common Shares in the future will trade at, below or above net asset value. This risk that shares of a closed-end fund might trade at a discount is more significant for investors who wish to sell their shares in a relatively short period of time. For those investors, realization of gain or loss on their investment is likely to be more dependent upon the existence of a premium or discount than upon portfolio performance. If Common Shares are sold, the price received may be more or less than the original investment. The Common Shares are designed for long-term investors and should not be treated as trading vehicles. Common Shares of closed-end management investment companies frequently trade at a discount from their net asset value.

### **Credit Risk**

An issuer of a debt security, including a governmental issuer, may be unable to make interest payments and repay principal. The Fund could lose money if the issuer of a debt obligation, or the counterparty to a derivatives contract, repurchase agreement, loan of portfolio securities or other obligation, is, or is perceived to be, unable or unwilling to make timely principal and/or interest payments, or to otherwise honor its obligations. The downgrade of a security may further decrease its value. For mortgage-backed securities, factors contributing to these risks include the effects of general and local economic conditions on home values, the financial conditions of homeowners, and other market factors. This risk is mitigated by a U.S. government agency's or instrumentality's guarantee of the underlying debt obligation.

### **Mortgage-Related Risk**

The Fund may invest in a variety of mortgage-related securities, including commercial mortgage securities and agency-issued securities and other mortgage-backed instruments. Rising interest rates tend to extend the duration of mortgage-related securities, which in turn could lengthen the average duration of the Fund's portfolio, making the portfolio more sensitive to changes in interest rates, and may reduce the market value of the portfolio's mortgage-related securities. This possibility is often referred to as extension risk. Extending the average life of a mortgage-related security increases the risk of depreciation due to future increases in market interest rates. In addition, mortgage-related securities are subject to prepayment risk—the risk that borrowers may pay off their mortgages sooner than expected, particularly when interest rates decline. This can reduce the Fund's returns because the Fund may have to reinvest that money at lower prevailing interest rates. The Fund's investments in other asset-backed securities are subject to risks similar to those associated with mortgage-backed securities, as well as additional risks associated with the nature of the assets and the servicing of those assets.

Certain government agencies or instrumentalities, such as the Government National Mortgage Association ("GNMA"), the Federal National Mortgage Association ("FNMA"), and the Federal Home Loan Mortgage Corporation ("FHLMC"), provide a guarantee as to timely payment of principal and interest for mortgage-backed instruments each entity issues, backs or otherwise guarantees. Guarantees may or may not be backed by the full faith and credit of the U.S. government. Since September 2008, the Federal Housing Finance Agency ("FHFA"), an agency of the U.S. government, has acted as the conservator to operate FNMA and FHLMC until they are stabilized. It is unclear how

long the conservatorship will last or what effect this conservatorship will have on the securities issued or guaranteed by FNMA or FHLMC for the long-term.

### **Loan Risk**

Bank loans, loan participations and assignments involve credit risk, interest rate risk, liquidity risk, and the risks of being a lender. Indebtedness of companies whose creditworthiness is poor involves substantially greater risks, and may be highly speculative. Some companies may never pay off their indebtedness, or may pay only a small fraction of the amount owed. Consequently, when investing in indebtedness of companies with poor credit, the Fund bears a substantial risk of losing the entire amount invested. If the Fund purchases a loan, it may only be able to enforce its rights through the lender, and may assume the credit risk of both the lender and the borrower.

Corporate loans in which the Fund may invest may be unrated and generally will not be registered with the SEC or listed on a securities exchange. In addition, the amount of public information available with respect to corporate loans generally will be less extensive than that available for more widely rated, registered and exchange-listed securities. As a result, corporate loans generally are more difficult to value than more widely rated, registered and exchange-listed securities.

### **High Yield Risk**

In general, lower rated debt securities carry a greater degree of risk that the issuer will be unable to make interest and principal payments when due, which could have a negative impact on the Fund's net asset value or dividends. The Fund may invest in debt securities and other income-producing instruments that are rated below investment grade by each Rating Agency rating the security (below Baa by Moody's or below BBB by S&P or Fitch) or that are unrated but judged by the portfolio managers to be of comparable quality, including debt securities or other income-producing instruments that are in default or the issuers of which are in bankruptcy. The prices of these lower grade bonds and income-producing instruments are more sensitive to negative developments, such as a decline in the issuer's revenues or a general economic downturn, than are the prices of higher grade securities. In addition, the secondary market on which high yield securities or similar instruments are traded may be less liquid than the market for investment grade securities, meaning these holdings are subject to greater liquidity risk than investment grade securities. Because the Fund may invest a significant portion of its assets in below investment grade debt securities and income-producing instruments, the Investment Manager's investment decisions and analytical capabilities in this area will be particularly important. [The Fund will not invest more than 10% of its total assets in securities that are, at the time of purchase, rated CCC/Caa or lower by each Rating Agency rating the security or that are unrated but judged by the portfolio managers to be of comparable quality.] The Fund may invest in debt securities or other obligations that are in default or the issuers of which are in bankruptcy. Under normal conditions, the Fund will not invest more than 5% of its total assets in debt securities or other obligations whose issuers are in default at the time of purchase.

### **Interest Rate Risk**

Changes in interest rates may present risks to the Fund. When interest rates rise, debt security prices generally fall. The opposite is also true: debt security prices generally rise when interest rates fall. Because market interest rates are currently near their lowest levels in many years, there is a great risk that the Fund's portfolio will decline in value. Generally, debt securities will decrease in value when interest rates rise and increase in value when interest rates decline. This means that the net asset value of the Common Shares may fluctuate with interest rate changes and the corresponding changes in the value of the Fund's holdings. Because market interest rates are currently near their lowest levels in many years, there is a greater risk that the Fund's portfolio will decline in value. The prices of short-term debt obligations generally fluctuate less than the prices of long-term debt obligations as interest rates change.

The prices of fixed-rate securities with longer durations tend to be more sensitive to changes in interest rates than securities with shorter durations, usually making them more volatile. Because the Fund will normally have an

estimated dollar-weighted average duration of between two and five years (including the effects of anticipated leverage), the Common Shares' net asset value and market price will tend to fluctuate more in response to changes in market interest rates than if the Fund invested mainly in short-term debt securities and less than if the Fund invested mainly in longer-term debt securities.

The cost of leverage employed by the Fund is based on certain interest rates. If the cost of leverage exceeds the rate of return on the debt obligations and other investments held by the Fund that were acquired during periods of generally lower interest rates, the returns to Common Shareholders may be reduced.

The Fund's use of leverage, as described above, will tend to increase Common Share interest rate risk. The Fund may use certain strategies, including investments in structured notes and interest rate swaps and caps, for the purposes of changing the duration of the overall portfolio, reducing the interest rate sensitivity of the portfolio or decreasing the Fund's exposure to interest rate risk, although there is no assurance that the Fund will do so or that such strategies will be successful. See "How the Fund Manages Risk—Hedging and Related Strategies."

### **Inflation Risk**

Inflation risk is the risk that the value of assets or income from the Fund's investments will be worth less in the future as inflation decreases the value of money. As inflation increases, the real value of the Common Shares and distributions thereon can decline. In addition, during any periods of rising inflation, the Fund's cost of leverage would likely increase, which would tend to further reduce returns to Common Shareholders. This risk is mitigated to some degree by the Fund's investments in bank loans made to corporate and other business entities.

### **Leverage Risk**

The Fund uses leverage, including the purchase of mortgage dollar rolls, on an ongoing basis for investment purposes, in order to leverage the Common Shares. The Fund may also leverage the portfolio through the borrowing of funds from banks or other financial institutions, the issuance of preferred shares, the lending of portfolio securities, the use of swaps, other derivatives, reverse repurchase agreements, and when-issued, delayed delivery or forward commitment transactions.

The precise amount of leverage used by the Fund may vary from time to time. The issuance of preferred shares and any debt securities (including borrowings) have seniority over the Common Shares.

If the cost of leverage exceeds the net rate of return on the Fund's portfolio, the leverage will result in a lower return on its portfolio investments than if the Fund were not leveraged, and the Fund's ability to pay dividends and meet its asset coverage requirements on indebtedness (including borrowings) or preferred shares would be reduced.

Any decline in the net asset value of the Fund's investments could result in the Fund being in danger of failing to meet its asset coverage requirements or of losing a rating on any preferred shares issued. In an extreme case, the Fund's current investment income might not be sufficient to meet the Fund's cost of leverage. In order to counteract such an event, the Fund might need to liquidate investments in order to reduce its leverage. Liquidation at times of adverse economic conditions may result in a capital loss to the Fund. There is no assurance that the Fund's leveraging strategy will be successful.

While the Fund may from time to time consider reducing leverage in response to actual or anticipated changes in interest rates in an effort to mitigate the increased volatility of current income and net asset value associated with leverage, there can be no assurance that the Fund will actually reduce leverage in the future or that any reduction, if undertaken, will be effective. Changes in the future direction of interest rates are very difficult to predict accurately. If the Fund were to reduce leverage based on a prediction about future changes to interest rates, and that prediction turned out to be incorrect, the reduction in leverage would likely operate to reduce the Fund's return on its investment portfolio relative to the circumstance where the Fund had not reduced leverage. The Fund may decide that this risk outweighs the likelihood of achieving the desired reduction to volatility in income and net asset value if the prediction were to turn out to be correct, and determine not to reduce leverage as described above.





Because the fees received by the Investment Manager are based on the Managed Assets of the Fund (including assets attributable to any preferred shares that are outstanding or the outstanding amount of any borrowing or short-term debt securities), the Investment Manager has a financial incentive for the Fund to issue senior securities, which may create a conflict of interest between the Investment Manager and the holders of the Common Shares.

### **Portfolio Security Issuer Risk**

The value of the Fund's investments may decline for a number of reasons that directly relate to the issuer, such as management performance, financial leverage and performance and factors affecting the issuer's industry (such as reduced demand for the issuer's goods and services).

### **Management Risk**

The Fund is subject to management risk because it is an actively managed investment portfolio. The Investment Manager will apply investment techniques and risk analyses in making investment decisions for the Fund, but there can be no guarantee that these will produce the desired results.

### **Foreign (Non-U.S.) Investment Risk**

Investing in securities or other income-producing instruments issued by companies and governments in foreign countries typically involves more risks than investing in U.S. securities. Certain of these risks also may apply to securities of U.S. companies with significant foreign operations. These risks can increase the potential for losses in the Fund and affect its share price. The political, economic and social structures of some foreign countries may be less stable and more volatile than those in the U.S. It is possible that a government may take over the assets or operations of a company or impose restrictions on the exchange or export of currency or other assets. Some countries also may have different legal systems that may make it difficult for the Fund to pursue legal remedies with respect to its foreign investments.

You should consider carefully the substantial risks involved in securities of companies of foreign nations, which are in addition to the usual risks inherent in domestic investments. The Fund may buy foreign securities that are traded in the U.S. or securities of U.S. issuers that are denominated in a foreign currency. The Fund may invest up to 15% of its total assets in securities or other income-producing instruments issued by companies and governments in any foreign country, including developed or developing countries. The Fund also may invest up to 5% of its total assets in securities or other income-producing instruments denominated in foreign currencies, including obligations of non-U.S. governments and their respective sub-divisions, agencies and government-sponsored enterprises.

There may be less publicly available information about foreign companies comparable to the reports and ratings published about companies in the U.S. Foreign companies are not generally subject to uniform accounting or financial reporting standards, and auditing practices and requirements may not be comparable to those applicable to U.S. companies. The Fund, therefore, may encounter difficulty in obtaining market quotations for purposes of valuing its portfolio and calculating its net asset value. Foreign markets have substantially less volume than the New York Stock Exchange (the "NYSE") and securities of some foreign companies are less liquid and more volatile than securities of comparable U.S. companies. Commission rates in foreign countries, which are generally fixed rather than subject to negotiation as in the U.S., are likely to be higher. In many foreign countries there is less government supervision and regulation of stock exchanges, brokers, and listed companies than in the U.S.

### **Developing Countries and Emerging Markets**

Investments in companies domiciled in developing countries or based in underdeveloped emerging markets may be subject to potentially higher risks than investments in developed countries or mature markets. These risks include: (i) greater risks of expropriation, confiscatory taxation, nationalization, and less social, political, and economic stability; (ii) the small current size of the markets for such securities and the currently low or nonexistent volume of trading, which result in a lack of liquidity and in greater price volatility; (iii) certain national policies which may restrict the Fund's investment opportunities, including restrictions on investment in issuers or industries deemed sensitive to national interests; (iv) foreign taxation; (v) the absence of developed legal structures governing private or foreign investment or allowing for judicial redress for injury to private property; and (vi) the absence or early stage of development of a capital market structure or market-oriented economy.

In addition, many countries in which the Fund may invest have experienced substantial, and in some periods extremely high, rates of inflation for many years. Inflation and rapid fluctuations in inflation rates have had and may continue to have negative effects on the economies and securities markets of certain countries. Moreover, the economies of some developing countries may differ favorably or unfavorably from the U.S. economy in such respects as growth of gross domestic product, rate of inflation, currency depreciation, capital reinvestment, resource self-sufficiency, and balance of payments position.

### **Foreign Currency**

The Fund's management endeavors to buy and sell foreign currencies on as favorable a basis as practicable. Some price spread on currency exchange (to cover service charges) may be incurred, particularly when the Fund changes investments from one country to another or when proceeds of the sale of shares in U.S. dollars are used for the purchase of securities in foreign countries. Also, some countries may adopt policies that would prevent the Fund from transferring cash out of the country or withhold portions of interest and dividends at the source. There is the possibility of cessation of trading on national exchanges, expropriation, nationalization, or confiscatory taxation, withholding, and other foreign taxes on income or other amounts, foreign exchange controls (which may include suspension of the ability to transfer currency from a given country), default in foreign government securities, political or social instability, or diplomatic developments that could affect investments in securities of issuers in foreign nations.

The Fund may be affected either favorably or unfavorably by fluctuations in the relative rates of exchange between the currencies of different nations, by exchange control regulations, and by indigenous economic and political developments. Some countries in which the Fund may invest may also have fixed or managed currencies that are not free-floating against the U.S. dollar. Further, certain currencies may not be internationally traded.

Certain of these currencies have experienced a steady devaluation relative to the U.S. dollar. Any devaluations in the currencies in which the Fund's portfolio securities are denominated may have a detrimental impact on the Fund. Through the Fund's flexible policy, management endeavors to avoid unfavorable consequences and to take advantage of favorable developments in particular nations where, from time to time, it places the Fund's investments.

The exercise of this flexible policy may include decisions to purchase securities with substantial risk characteristics and other decisions such as changing the emphasis on investments from one nation to another and from one type of security to another. Some of these decisions may later prove profitable and others may not. No assurance can be given that profits, if any, will exceed losses.

### **Forward Currency Exchange Contracts**

The Fund may enter into forward currency exchange contracts (currency forward contracts) to attempt to minimize the risk to the Fund from adverse changes in the relationship between currencies or to enhance income. The Fund will either cover its position in such a transaction or maintain, in a segregated account with its custodian bank, cash or high-grade marketable securities having an aggregate value equal to the amount of any such commitment until payment is made. For more information about currency forward contracts, see "Derivative Instruments-Currency Forward Contracts."

## **Sovereign Issuers**

The Fund also may invest in sovereign debt issued by foreign governments, their agencies or instrumentalities, or other government-related entities, including debt of developing or “emerging market” issuers. As a holder of sovereign debt, the Fund may be requested to participate in the rescheduling of such debt and to extend further loans to governmental entities. In addition, there are generally no bankruptcy proceedings similar to those in the United States by which defaulted sovereign debt may be collected. Sovereign debt is subject to other risks, including: the possibility that a sovereign country might prevent capital, in the form of U.S. dollars, from flowing across its borders; adverse political and economic developments; the extent and quality of government regulation of financial markets and institutions; the imposition of foreign withholding taxes; and the expropriation or nationalization of foreign issuers.

## **Derivatives Risk**

Derivatives are financial contracts whose value depends on, or is derived from, the value of an underlying asset, reference rate or index (or relationship between two indexes). The Fund may invest in a variety of derivative instruments, such as options, futures contracts, swap agreements and short sales. The Fund may use derivatives as a substitute for taking a position in an underlying debt instrument or other asset and/or as part of a strategy designed to reduce exposure to other risks, such as interest rate or currency risk. The Fund also may use derivatives to add leverage to the portfolio or to manage the duration of the portfolio. The Fund’s use of derivative instruments involves risks different from, and possibly greater than, the risks associated with investing directly in securities and other traditional investments. Derivatives are subject to a number of risks described elsewhere in this Prospectus, such as liquidity risk, interest rate risk, credit risk, leverage risk, volatility risk, the risk of ambiguous documentation, and management risk. They also involve the risk of mispricing or improper valuation and the risk that changes in the value of the derivative may not correlate perfectly with the underlying asset, rate or index. If the Fund invests in a derivative instrument, it could lose more than the principal amount invested. Also, suitable derivative transactions may not be available in all circumstances and there can be no assurance that the Fund will engage in these transactions to reduce exposure to other risks when that would be beneficial. The use of derivatives also may increase the amount of taxes payable by shareholders. In addition to the risks applicable to derivatives generally, swaps involve special risks because they are difficult to value, are highly susceptible to liquidity and credit risk, and generally provide a return to the party that has paid the premium only in the event of an actual default by the issuer of the underlying obligation (as opposed to a credit downgrade or other indication of financial difficulty).

Use of these instruments could also result in a loss if the counterparty to the transaction does not perform as promised, including because of such counterparty’s bankruptcy or insolvency. This risk is heightened with respect to over-the-counter (“OTC”) instruments, such as certain swap agreements, and may be greater during volatile market conditions. Other risks include the inability to close out a position because the trading market becomes illiquid (particularly in the OTC markets) or the availability of counterparties becomes limited for a period of time. In addition, the presence of speculators in a particular market could lead to price distortions. To the extent that the Fund is unable to close out a position because of market illiquidity, the Fund may not be able to prevent further losses of value in its derivatives holdings and the Fund’s liquidity may be impaired to the extent that it has a substantial portion of its otherwise liquid assets marked as segregated to cover its obligations under such derivative instruments. Some derivatives can be particularly sensitive to changes in interest rates or other market prices. Investors should bear in mind that, while the Fund intends to use derivative strategies on a regular basis, it is not obligated to actively engage in these transactions, generally or in any particular kind of derivative, if the investment manager elects not to do so due to availability, cost or other factors.

The use of derivative strategies may also have a tax impact on the Fund. The timing and character of income, gains or losses from these strategies could impair the ability of the investment manager to use derivatives when it wishes to do so.



**Swap Risk.** The use of swap transactions is a highly specialized activity, which involves investment techniques and risks different from those associated with ordinary portfolio securities transactions. Whether the Fund will be successful in using swap agreements to achieve its investment goal depends on the ability of the investment manager correctly to predict which types of investments are likely to produce greater returns. If the investment manager, in using swap agreements, is incorrect in its forecasts of market values, interest rates, inflation, currency exchange rates or other applicable factors, the investment performance of the Fund will be less than its performance would have been if it had not used the swap agreements.

The risk of loss to the Fund for swap transactions that are entered into on a net basis depends on which party is obligated to pay the net amount to the other party. If the counterparty is obligated to pay the net amount to the Fund, the risk of loss to the Fund is loss of the entire amount that the Fund is entitled to receive. If the Fund is obligated to pay the net amount, the Fund's risk of loss is limited to that net amount. If the swap agreement involves the exchange of the entire principal value of a security, the entire principal value of that security is subject to the risk that the other party to the swap will default on its contractual delivery obligations. In addition, the Fund's risk of loss also includes any margin at risk in the event of default by the counterparty (in an uncleared swap) or the central counterparty or FCM (in a cleared swap), plus any transaction costs.

Because swap agreements may have terms of greater than seven days, they may be illiquid and, therefore, subject to the Fund's limitation on investments in illiquid securities. If a swap transaction is particularly large or if the relevant market is illiquid, the Fund may not be able to establish or liquidate a position at an advantageous time or price, which may result in significant losses. Participants in the swap markets are not required to make continuous markets in the swap contracts they trade. Participants could refuse to quote prices for swap contracts or quote prices with an unusually wide spread between the price at which they are prepared to buy and the price at which they are prepared to sell. However, the swap markets have grown substantially in recent years, with a large number of financial institutions acting both as principals and agents, using standardized swap documentation. As a result, the swap markets have become increasingly liquid. Some swap agreements entail complex terms and may require a greater degree of subjectivity in their valuation.

Uncleared swap agreements are typically executed bilaterally with a swap dealer rather than traded on exchanges. As a result, swap participants are not as protected as participants on organized exchanges. Performance of a swap agreement is the responsibility only of the swap counterparty and not of any exchange or clearinghouse. As a result, the Fund is subject to the risk that a counterparty will be unable or will refuse to perform under such agreement, including because of the counterparty's bankruptcy or insolvency. The Fund risks the loss of the accrued but unpaid amounts under a swap agreement, which could be substantial, in the event of a default, insolvency or bankruptcy by a swap counterparty. In such an event, the Fund will have contractual remedies pursuant to the swap agreements, but bankruptcy and insolvency laws could affect the Fund's rights as a creditor. If the counterparty's creditworthiness declines, the value of a swap agreement would likely decline, potentially resulting in losses. The Fund's investment manager will only approve a swap agreement counterparty for the Fund if the investment manager deems the counterparty to be creditworthy under the Fund's Counterparty Credit Review Standards, adopted and reviewed annually by the Fund's board. However, in unusual or extreme market conditions, a counterparty's creditworthiness and ability to perform may deteriorate rapidly, and the availability of suitable replacement counterparties may become limited.

*Developing government regulation of derivatives.* The regulation of swaps, as well as other derivatives, is a rapidly changing area of law and is subject to modification by government and judicial action. In addition, the SEC, CFTC and the exchanges are authorized to take extraordinary actions in the event of a market emergency, including, for example, the implementation or reduction of speculative position limits, the implementation of higher margin requirements, the establishment of daily price limits and the suspension of trading. It is not possible to predict fully the effects of current or future regulation. However, it is possible that developments in government regulation of

various types of derivative instruments, such as speculative position limits on certain types of derivatives, or limits or restrictions on the counterparties with which the Fund engages in derivative transactions, may limit or prevent the Fund from using or limit the Fund's use of these instruments effectively as a part of its investment strategy, and could adversely affect the Fund's ability to achieve its investment objectives. The investment manager will continue to monitor developments in the area, particularly to the extent regulatory changes affect the Fund's ability to enter into desired swap agreements. New requirements, even if not directly applicable to the Fund, may increase the cost of the Fund's investments and cost of doing business.

Certain Internal Revenue Service positions may limit the Fund's ability to use swap agreements in a desired tax strategy. It is possible that developments in the swap markets and/or the laws relating to swap agreements, including potential government regulation, could adversely affect the Fund's ability to benefit from using swap agreements, or could have adverse tax consequences.

### **Counterparty Risk**

The Fund will be subject to credit risk with respect to the counterparties to the derivative contracts purchased by the Fund. If a counterparty becomes bankrupt or otherwise fails to perform its obligations under a derivative contract due to financial difficulties, the Fund may experience significant delays in obtaining any recovery under the derivative contract in a bankruptcy or other reorganization proceeding. The Fund may obtain only a limited recovery or may obtain no recovery in such circumstances.

### **Volatility Risk**

The market values for some or all of the Fund's holdings may be volatile. The Fund's investment grade or long-term debt securities, will generally be more sensitive to changing interest rates and less sensitive to changes in the economic environment. The Fund's high yield investments will typically be less sensitive to changing interest rates than investment grade debt securities, but they may be more sensitive to a deteriorating economic environment. The Fund's investments may be subject to liquidity constraints and as a result, higher price volatility. The Fund's use of leverage may increase the volatility of the Fund's investment portfolio and could result in larger losses than if the strategies were not used.

### **Reinvestment Risk**

The Fund may reinvest the proceeds from matured, traded or called debt obligations. If the Fund reinvests such proceeds at lower interest rates, the overall return of the Fund may decline. Reinvestment risk is the risk that income from the Fund's bond portfolio will decline if and when the Fund invests the proceeds from matured, traded or called bonds at market interest rates that are below the portfolio's current earnings rate. A decline in income could affect the Fund's net asset value or reduce asset coverage on any preferred shares or indebtedness outstanding.

### **Call Risk**

A debt security may be prepaid (called) before maturity. An issuer is more likely to call its securities when interest rates are falling, because the issuer can issue new securities with lower interest payments. If a debt security is called, the Fund may have to replace it with a lower-yielding security. High-yield bonds frequently have call features that allow the issuer to redeem the security at dates prior to its stated maturity at a specified price only if certain prescribed conditions are met ("call protection"). An issuer may redeem a high-yield bond if, for example, the issuer can refinance the debt at a lower cost due to declining interest rates or an improvement in the credit standing of the issuer. Corporate loans and mortgage-related securities typically have no such call protection. For premium bonds (bonds acquired at prices that exceed their par or principal value) purchased by the Fund, call risk may be enhanced. At any time, the Fund may have a large amount of its assets invested in securities subject to call risk. A call of some or all of these securities may lower the Fund's income and yield and its distributions to shareholders.



## **Liquidity Risk**

The Fund may invest up to 15% of its total assets in securities (excluding swaps) which are illiquid at the time of investment. The term “illiquid securities” for this purpose is determined using the SEC’s standard applicable to open-end investment companies, i.e., securities that cannot be disposed of within seven days in the ordinary course of business at approximately the value at which the Fund has valued the securities. Illiquid securities may be subject to wide fluctuations in market value. The Fund may be subject to significant delays in disposing of illiquid securities. Accordingly, the Fund may be forced to sell these securities at less than fair market value or may not be able to sell them when the Investment Manager believes it is desirable to do so. Illiquid securities also may entail registration expenses and other transaction costs that are higher than those for liquid securities. Restricted securities, i.e., securities subject to legal or contractual restrictions on resale, may also be illiquid. However, some restricted securities (such as securities issued pursuant to Rule 144A under the Securities Act of 1933, as amended (the “Securities Act”) and certain commercial paper) may be treated as liquid for these purposes. To the extent the Investment Manager determines there is a liquid institutional or other market for these securities, the Fund considers them to be liquid securities. The Board of Trustees will review any determination by the Investment Manager to treat a restricted security as a liquid security on an ongoing basis, including the Investment Manager’s assessment of current trading activity and the availability of reliable price information. In determining whether a restricted security is properly considered a liquid security, the Investment Manager and the Fund’s board of trustees will take into account the following factors: (i) the frequency of trades and quotes for the security; (ii) the number of dealers willing to buy or sell the security and the number of other potential buyers; (iii) dealer undertakings to make a market in the security; and (iv) the nature of the security and the nature of the marketplace trades (e.g., the time needed to dispose of the security, the method of soliciting offers, and the mechanics of transfer). To the extent the Fund invests in restricted securities that are deemed liquid, the general level of illiquidity in the Fund may increase if qualified institutional buyers become uninterested in buying these securities or the market for these securities contracts.

The Fund may invest in securities that are not deemed “illiquid” but that are currently traded on a limited basis. The value of such securities may fluctuate more sharply than securities that are traded more widely. Although the Fund may be able to dispose of such securities in a short period of time, the Fund may lose money on such sales.

## **Income Risk**

Because the Fund can distribute only what it earns, the Fund’s distributions to shareholders may decline. The income investors receive from the Fund is based primarily on the interest it earns from its investments, which can vary widely over the short- and long-term. If prevailing market interest rates drop, investors’ income from the Fund over time could drop as well. The Fund’s income could also be affected already when prevailing short-term interest rates increase and the Fund is using leverage, although this risk is mitigated by the Fund’s investment in bank loans made to corporate and other business entities.

## **Zero-Coupon Securities Risk**

Zero-coupon securities are especially sensitive to changes in interest rates, and their prices generally are more volatile than debt securities that pay interest periodically. Lower quality zero-coupon bonds are generally subject to the same risks as high yield debt securities. The Fund typically will not receive any interest payments on these securities until maturity. If the issuer defaults, the Fund may lose its entire investment, which will affect the Fund’s share price.

## **Smaller Company Risk**

Although under current market conditions the Fund does not presently intend to invest a significant portion of its assets in smaller companies, as market conditions change over time, the Fund may invest more of its assets in such

companies. The general risks associated with income-producing securities are particularly pronounced for securities issued by companies with smaller market capitalizations. These companies may have limited product lines, markets or financial resources or they may depend on a few key employees. As a result, they may be subject to greater levels of credit, market and issuer risk. Securities of smaller companies may trade less frequently and in lesser volume than more widely held securities and their values may fluctuate more sharply than other securities. Companies with medium-sized market capitalizations may have risks similar to those of smaller companies.

### **Real Estate Risk**

Since the Fund may invest in REITs and mortgage securities secured by real estate, the Fund may be subject to risks similar to those associated with the direct ownership of real estate (in addition to securities markets risks). These risks include declines in the value of real estate, risks related to general and local economic conditions, dependency on management skill, increases in interest rates, possible lack of availability of mortgage funds, overbuilding, extended vacancies of properties, increased competition, increases in property taxes and operating expenses, changes in zoning laws, losses due to costs resulting from the clean-up of environmental problems, casualty or condemnation losses, limitations on rents, and changes in neighborhood values and the appeal of properties to tenants.

Rising interest rates may cause investors in REITs to demand a higher annual yield from future distributions, which may in turn decrease market prices for equity securities issued by REITs. Rising interest rates also generally increase the costs of obtaining financing, which could cause the value of the Fund's investments to decline. During periods of declining interest rates, certain mortgage REITs may hold mortgages that the mortgagors elect to prepay, and such prepayment may diminish the yield on securities issued by such mortgage REITs. In addition, mortgage REITs may be affected by the borrowers' ability to repay when due the debt extended by the REIT, and equity REITs may be affected by the tenants' ability to pay rent.

### **Market Disruption and Geopolitical Risk**

The occurrence of events similar to those in recent years, such as the aftermath of the war in Iraq, instability in Afghanistan, Pakistan, Libya, Syria and other countries in the Middle East and North Africa, terrorist attacks in the U.S., Europe and elsewhere around the world, social and political discord and uncertainty, debt crises (such as the recent Greek crisis), sovereign debt downgrades, or the exit or potential exit of one or more countries from the EMU or the European Union (such as the United Kingdom), among others, may result in market volatility, may have long term effects on the U.S. and worldwide financial markets, and may cause further economic uncertainties in the U.S. and worldwide. Any such event(s) could have a significant adverse impact on the value and risk profile of the Fund's portfolio. The Fund does not know how long the securities markets may be affected by similar events and cannot predict the effects of similar events in the future on the U.S. economy and securities markets. There can be no assurance that similar events and other market disruptions will not have other material and adverse implications.

### **Special Risks for Holders of Rights**

There is a risk that performance of the Fund may result in the Common Shares purchasable upon exercise of the rights being less attractive to investors at the conclusion of the subscription period. This may reduce or eliminate the value of the rights. Investors who receive rights may find that there is no market to sell rights they do not wish to exercise. If investors exercise only a portion of the rights, Common Shares may trade at less favorable prices than larger offerings for similar securities.

### **Cyber Security Risk**

As the use of the Internet and other technologies has become more prevalent in the course of business, funds have become more susceptible to operational and financial risks associated with cyber security. Cyber security incidents can result from deliberate attacks such as gaining unauthorized access to digital systems (e.g., through "hacking" or malicious software coding) for purposes of misappropriating assets or sensitive information, corrupting data, or causing operational disruption, or from unintentional events, such as the inadvertent release of confidential information. Cyber security failures or breaches of the Fund or its service providers or the issuers of securities in which the Fund invests have the ability to cause disruptions and impact business operations, potentially resulting in financial losses, the inability of Fund shareholders to transact business, violations of applicable privacy and other

laws, regulatory fines, penalties, reputational damage, reimbursement or other compensation costs, and/or additional compliance costs. While measures have been developed which are designed to reduce the risks associated with cyber security, there is no guarantee that those measures will be effective, particularly since the Fund does not directly control the cyber security defenses or plans of its service providers with which it does business and companies in which it invests.

### **Conflicts of Interest Risk**

The Investment Manager's advisory fees are based on Managed Assets. Consequently, the Investment Manager will benefit from an increase in the Fund's Managed Assets resulting from an offering. In addition, a Trustee who is an "interested person" (as such term is defined under the 1940 Act) of the Fund or a portfolio manager of the Fund could benefit indirectly from an offering because of such affiliations.

### **Distribution Rate**

The Fund has a managed distribution policy under which monthly distributions to Common Shareholders, at an annual minimum fixed rate of 10% based on the average monthly net asset value of the Fund's Common Shares, are paid from current income and, to the extent necessary, paid-in capital. See "Dividends and Distributions." There can be no assurance that the distribution rate set at any time, or the policy itself, will be maintained. To the extent total distributions for a year exceed the Fund's net investment income, such excess will be deemed for U.S. federal income tax purposes to have been distributed from realized capital gains and/or will be treated as return of capital, as applicable. In general terms, a return of capital would involve a situation in which a Fund distribution (or a portion thereof) represents a return of a portion of a shareholder's investment in the Fund, rather than making a distribution that is funded from the Fund's earned income or other profits. Although return of capital distributions may not be currently taxable, such distributions would decrease the basis of a shareholder's shares, and therefore, may increase a shareholder's tax liability for capital gains upon a sale of shares, even if sold at a loss to the shareholder's original investments.

If the Fund's investments do not generate sufficient income, the Fund may be required to liquidate a portion of its portfolio to fund these distributions, and therefore a portion or all of such distributions may represent a reduction of the shareholders' principal investment. Such liquidation might be at a time when independent investment judgment would not dictate such action, increasing the Fund's overall portfolio turnover (and related transaction costs) and making it more difficult for the Fund to achieve its investment objective.

### **Share Repurchases**

Any acquisition by the Fund of its shares, pursuant to its share repurchase program, will decrease the amount of total assets of the Fund, and therefore, may increase the Fund's expense ratio. Furthermore, if the Fund borrows to finance share repurchases, interest on such borrowings would reduce the Fund's net investment income. If the Fund liquidates a portion of its investment portfolio in connection with a share repurchase, such liquidation might be at a time when independent investment judgment would not dictate such action, increasing the Fund's overall portfolio turnover (and related transaction costs) and making it more difficult for the Fund to achieve its investment objective.

## HOW THE FUND MANAGES RISK

### Investment Limitations

The Fund has adopted certain investment limitations designed to limit investment risk and maintain portfolio diversification. These limitations (two of which are listed below) are fundamental and may not be changed without the approval of the holders of a majority of the outstanding Common Shares and any preferred shares voting together as a single class, and, if the Fund has preferred shares outstanding, the approval of the holders of a majority of any preferred shares voting as a separate class. The Fund may not:

- Concentrate its investments in a particular “industry,” as that term is used in the 1940 Act and as interpreted, modified, or otherwise permitted by regulatory authority having jurisdiction, from time to time (this limitation does not apply to securities issued or guaranteed by the U.S. Government or any of its agencies or instrumentalities); and
- With respect to 75% of the Fund’s total assets, purchase the securities of any issuer, except securities issued or guaranteed by the U.S. Government or any of its agencies or instrumentalities or securities of other investment companies, if, as a result, (i) more than 5% of the Fund’s total assets would be invested in the securities of that issuer, or (ii) the Fund would hold more than 10% of the outstanding voting securities of that issuer. For the purpose of this restriction, each state and each separate political subdivision, agency, authority or instrumentality of such state, each multi-state agency or authority, and each obligor, if any, is treated as a separate issuer of municipal bonds.

The Fund would be deemed to “concentrate” its investments in a particular industry if it invested more than 25% of its total assets in that industry. The Fund’s industry concentration policy does not preclude it from focusing investments in issuers in a group of related industrial sectors (such as different types of utilities).

When the Fund has preferred shares or debt outstanding, the Fund may be subject to certain restrictions imposed by guidelines of one or more rating agencies that may issue ratings for such preferred shares or debt issued by the Fund, or by limitations under financing arrangements entered into by the Fund, which are more limiting than the investment restrictions set forth above and other restrictions set forth in the SAI, in order to obtain and maintain ratings on the preferred shares or debt by rating agencies, and the Fund may become subject to additional guidelines in the future. See “Leverage.” The ability of the Fund to use some of the strategies discussed in this Prospectus and in the SAI, such as derivatives, would be limited by such rating agency guidelines or such financing arrangements. See “Leverage” in this Prospectus and “Investment Objectives and Policies” and “Investment Restrictions and Additional Investment Information” in the SAI for information about these guidelines and a complete list of the fundamental investment policies of the Fund.

### Management of Investment Portfolio and Capital Structure to Limit Leverage Risk

The Fund may take certain actions if short-term interest rates increase or market conditions otherwise change (or the Fund anticipates such an increase or change) and the Fund’s leverage begins (or is expected) to adversely affect Common Shareholders. In order to attempt to offset such a negative impact of leverage on Common Shareholders, the Fund may shorten the average maturity or duration of its investment portfolio (by investing in short-term, high quality securities or implementing certain hedging strategies) or may seek to extend the maturity of any outstanding preferred shares or debt. The Fund also may attempt to reduce leverage by reducing any holdings in instruments that create leverage. As explained above under “Risks and Special Considerations—Leverage Risk,” the success of any such attempt to limit leverage risk depends on the Investment Manager’s ability to accurately predict interest rate or other market

changes. Because of the difficulty of making such predictions, the Fund may not be successful in managing its interest rate exposure in the manner described above.

If market conditions suggest that additional leverage would be beneficial, the Fund may borrow from a financial institutional, issue preferred shares, enter into additional mortgage dollar rolls, or use other forms of leverage, such as swaps and other derivative instruments. Any such actions could be restricted or prohibited under existing financing arrangements. The Fund's investment in swaps will not be included as illiquid investments for purposes of determining compliance with the 15% limit on illiquid investments. Accordingly, the Fund may invest more than 15% of its total assets in swaps. However, the Fund's use of derivative instruments (other than swaps) will be limited by the Fund's 15% limit on illiquid investments to the extent such derivatives are determined to be illiquid. See "Portfolio Contents and Other Information" and "Risks and Special Considerations—Liquidity Risk."

### **Hedging and Related Strategies**

The Fund may use various investment strategies designed to limit the risk of price fluctuations of its portfolio securities and to preserve capital. For instance, the Fund may purchase credit default swap contracts for the purpose of hedging the Fund's exposure to certain issuers and, thereby, decreasing its exposure to credit risk, and it may invest in structured notes or interest rate swap or cap transactions for the purpose of reducing the interest rate sensitivity of the Fund's portfolio and, thereby, decreasing the Fund's exposure to interest rate risk. See "Investment Objectives and Strategies—Swaps," and "Investment Objectives and Strategies—Structured Notes and Related Instruments" in this Prospectus. Other hedging strategies that the Fund may use include: financial futures contracts; short sales; other types of swap agreements or options thereon; options on financial futures; and options based on either an index or individual debt securities whose prices, the Investment Manager believes, correlate with the prices of the Fund's investments. Income earned by the Fund from many hedging activities will be distributed to shareholders in taxable distributions. If effectively used, hedging strategies will offset in varying percentages losses incurred on the Fund's investments due to adverse interest rate changes. There is no assurance that these hedging strategies will be available at any time or that the Investment Manager will determine to use them for the Fund or, if used, that the strategies will be successful. In addition, the Fund may be subject to certain restrictions on its use of hedging strategies imposed by guidelines of one or more rating agencies that may issue ratings for preferred shares or debt issued by the Fund or by limitations in financing arrangements entered into by the Fund.

In order to reduce the interest rate risk inherent in the Fund's underlying investments and capital structure, the Fund may enter into interest rate swap or cap transactions. For example, the Fund may enter into interest rate swaps that are intended to approximate the Fund's variable rate payment obligation on preferred shares or debt securities issued by the Fund or other outstanding borrowings. The Fund also may use an interest rate cap, which would require the Fund to pay a premium to the counterparty and would entitle the Fund, to the extent that a specified variable rate index exceeds a predetermined fixed rate, to receive from the counterparty payment of the difference based on the notional amount. The Fund may use interest rate swaps or caps with the intent to reduce or eliminate the risk that an increase in short-term interest rates could pose for the performance of the Common Shares as a result of leverage, and also may use these instruments for other hedging or investment purposes. The Fund may choose or be required to decrease its outstanding leverage. Such decrease would likely result in the Fund seeking to terminate early all or a portion of any swap or cap transaction. Such early termination of a swap could result in a termination payment by or to the Fund. Any termination of a cap could result in a termination payment to the Fund.

## **MANAGEMENT OF THE FUND**

### **Trustees and Officers**

The Board of Trustees is responsible for the management of the Fund, including supervision of the duties performed by the Investment Manager. There are currently nine Trustees of the Fund, two of whom are currently treated by the Fund as an "interested person" (as defined in the 1940 Act). The names and business addresses of the Trustees and



officers of the Fund and their principal occupations and other affiliations during the past five years are set forth under “Management of the Fund” in the SAI.

## **The Investment Manager**

Franklin Advisers, Inc. (the “Investment Manager”) serves as the investment adviser of the Fund. Subject to the supervision of the Board of Trustees, the Investment Manager is responsible for managing the investment activities of the Fund and the Fund’s business affairs and other administrative matters. The Investment Manager is located at One Franklin Parkway, San Mateo, California 94403-1906. Franklin Resources, Inc. (“Franklin”), is the parent company of the Investment Manager and the Fund’s administrator. Founded in 1947, Franklin is one of the oldest mutual fund organizations. In 1992, Franklin, a leader in managing fixed-income mutual funds and an innovator in creating domestic equity funds, joined forces with Templeton, a pioneer in international investing.

The Investment Manager and its affiliates (collectively known as “Franklin Templeton Investments”) provide investment management and advisory services to closed-end and open-end investment company clients, as well as private accounts. As of May 31, 2018, Franklin Templeton Investments had approximately \$732 billion in assets under management for more than three million U.S. based mutual fund shareholder and other accounts.

## **Portfolio Management Team**

Roger A. Bayston, CFA, Christopher J. Molumphy, CFA, Glenn I. Voyles, CFA, Madeline Lam, Justin Ma, CFA serve as the portfolio management team responsible for managing the Fund’s portfolio investments. Each of them has experience managing Franklin mutual funds and private accounts.

**Mr. Bayston** has been a portfolio manager of the Fund since inception. He joined Franklin Templeton Investments in 1991.

**Ms. Lam** has been a portfolio manager of the Fund since 2013. She joined Franklin Templeton Investments in 1998.

**Mr. Ma** has been a portfolio manager of the Fund since 2013. He joined Franklin Templeton Investments in 2006.

**Mr. Molumphy** has been a portfolio manager of the Fund since inception. He joined Franklin Templeton Investments in 1988.

**Mr. Voyles** has been a portfolio manager of the Fund since 2006. He joined Franklin Templeton Investments in 1993.

The Fund’s SAI provides additional information about the portfolio managers’ compensation, other accounts managed by the portfolio managers and the portfolio manager’s ownership of securities in the Fund.

## **Investment Management Agreement**

Pursuant to an investment management agreement between the Investment Manager and the Fund (the “Investment Management Agreement”), the Fund has agreed to pay the Investment Manager an annual fee, payable monthly, in an amount equal to 0.70% of the average daily value of the Fund’s Managed Assets for the investment management services it provides.

In addition to the fees of the Investment Manager, the Fund pays all other costs and expenses of its operations, including compensation of its Trustees (other than those affiliated with the Investment Manager), custodial expenses, shareholder servicing expenses, transfer agency and dividend disbursing expenses, legal fees, expenses of independent auditors, expenses of repurchasing shares, expenses of issuing any preferred shares or debt or entering into borrowing arrangements, expenses of preparing, printing and distributing prospectuses, shareholder reports, notices, proxy

statements and reports to governmental agencies, and taxes, if any. The ordinary “Other Expenses” of the Fund, which are estimated above, may, and are likely to, vary from the Fund’s actual expenses. See “Summary of Fund Expenses.”

Because the fees received by the Investment Manager are based on the Managed Assets of the Fund (including the aggregate liquidation preference of any outstanding preferred shares or the outstanding amount of any borrowing or short-term debt securities), the Investment Manager has a financial incentive for the Fund to employ leverage, which may create a conflict of interest between the Investment Manager and the holders of the Fund's Common Shares.

### **Administrator**

Under an agreement with the Investment Manager, Franklin Templeton Services, LLC ("FT Services") provides certain administrative services, such as portfolio recordkeeping, to the Fund. FT Services is an affiliate of the Investment Manager, both of which are subsidiaries of Franklin Resources, Inc. FT Services is located at One Franklin Parkway, San Mateo, CA 94403-1906.

The administrative services FT Services provides include but are not limited to preparing and maintaining books, records, and tax and financial reports, and monitoring compliance with regulatory requirements. The administrative fee is paid by the Investment Manager based on the Fund's average daily net assets, and is not an additional expense of the Fund.

### **Custodian**

The Bank of New York Mellon, Corporate Trust Dealing & Trading-Auctions, 101 Barclay Street, 7W, New York, NY 10286, acts as the custodian of the Fund's securities and other assets.

### **Shareholder Servicing Agent and Transfer Agent**

The transfer agent, registrar and dividend disbursement agent for the Common Shares is American Stock Transfer & Trust Company, LLC, 6201 15th Avenue, Brooklyn, NY 11219.

For its services, American Stock Transfer & Trust Company, LLC receives a fixed fee per account. The Fund also will reimburse American Stock Transfer & Trust Company, LLC for certain out-of-pocket expenses, which may include payments by American Stock Transfer & Trust Company, LLC to entities, including affiliated entities, that provide sub-shareholder services, recordkeeping and/or transfer agency services to beneficial owners of the Fund. The amount of reimbursements for these services per benefit plan participant Fund account per year will not exceed the per account fee payable by the Fund to American Stock Transfer & Trust Company, LLC in connection with maintaining shareholder accounts.

## **DIVIDENDS AND DISTRIBUTIONS**

The Fund began, in January 2017, making monthly distributions to common shareholders at an annual minimum fixed rate of 10% based on average NAV of the Fund's common shares. The primary purpose of the Plan is to provide the Fund's shareholders with a constant, but not guaranteed, fixed minimum rate of distribution each month. The plan is intended to narrow the discount between the market price and the NAV of the Fund's common shares, but there is no assurance that the plan will be successful in doing so.

Under the Plan, to the extent that sufficient investment income is not available on a monthly basis, the Fund will distribute long-term capital gains and/or return of capital in order to maintain its managed distribution level. The Board may amend the terms of the Plan or terminate the Plan at any time without prior notice to the Fund's shareholders. The amendment or termination of the Plan could have an adverse effect on the market price of the Fund's common shares. The Plan is subject to periodic review by the Board, including a yearly review of the annual

minimum fixed rate to determine if an adjustment should be made.

The Fund calculates the average NAV from the previous month based on the number of business days in that month on which the NAV is calculated. The distribution is calculated as 10% of the previous month's average NAV, divided by 12. Typically, distributions will be declared by press release 10 days before the last business day of each month, with the record date on the last business day of the month. The payment date for the distribution will typically be during the middle of the next month.

With each distribution that does not consist solely of net investment income, the Fund will issue a notice to shareholders and an accompanying press release that will provide detailed information regarding the amount and composition of the distribution and other related information. The amounts and sources of distributions reported in the notice to shareholders are only estimates and are not being provided for tax reporting purposes. The actual amounts and sources of the amounts for tax reporting purposes will depend upon the Fund's investment experience during its full fiscal year and may be subject to changes based on tax regulations.

The Fund may at times distribute more than its net investment income and net realized capital gains; therefore, a portion of the distribution may result in a return of capital. A return of capital occurs when some or all of the money that shareholders invested in the Fund is paid back to them. A return of capital does not necessarily reflect the Fund's investment performance and should not be confused with 'yield' or 'income'. Any such returns of capital will decrease the Fund's total assets and, therefore, could have the effect of increasing the Fund's expense ratio. In addition, in order to make the level of distributions called for under its plan, the Fund may have to sell portfolio securities at a less than opportune time.

Unless you elect to receive distributions in cash, all of your distributions will be automatically reinvested in additional Common Shares under the Fund's Dividend Reinvestment Plan. See "Dividend Reinvestment Plan."

Although it does not now intend to do so, the Board of Trustees may change the Fund's dividend policy and the amount or timing of the distributions, based on a number of factors, including the amount of the Fund's undistributed net investment income and historical and projected investment income and the amount of the expenses and dividend rates on any outstanding preferred shares or indebtedness.

## **DIVIDEND REINVESTMENT PLAN**

The Fund's Dividend Reinvestment Plan (the "Plan") offers you a prompt and simple way to reinvest dividends and capital gain distributions ("Distributions") in shares of the Fund. American Stock Transfer & Trust Company, LLC (the "Agent"), P.O. Box 922, Wall Street Station, New York, NY 10269-0560, acts as your Plan Agent in administering the Plan. The Agent will open an account for you under the Plan in the same name as your outstanding shares are registered.

You are automatically enrolled in the Plan unless you elect to receive Distributions in cash. If you own shares in your own name, you should notify the Agent, in writing, if you wish to receive Distributions in cash.

If the Fund declares a Distribution, you, as a participant in the Plan, will automatically receive an equivalent amount of shares of the Fund purchased on your behalf by the Agent. If on the payment date for a Distribution, the net asset value per share is equal to or less than the market price per share plus estimated brokerage commissions, the Agent shall receive newly issued shares, including fractions, from the Fund for your account. The number of additional shares to be credited shall be determined by dividing the dollar amount of the Distribution by the greater of the net asset value per share on the payment date, or 95% of the then current market price per share.

If the net asset value per share exceeds the market price plus estimated brokerage commissions on the payment date for a Distribution, the Agent (or a broker-dealer selected by the Agent) shall try, for a purchase period of 30 days, to apply the amount of such Distribution on your shares (less your pro rata share of brokerage commissions incurred) to purchase shares on the open market. The weighted average price (including brokerage commissions) of all shares it purchases shall be your allocated price per share. If, before the Agent has completed its purchases, the market price plus estimated brokerage commissions exceeds the net asset value of the shares as of the payment date, the purchase price the Agent paid may exceed the net asset value of the shares, resulting in the acquisition of fewer shares than if such Distribution had been paid in shares issued by the Fund. Participants should note that they will not be able to instruct the Agent to purchase shares at a specific time or at a specific price. The Agent may make open-market purchases on any securities exchange where shares are traded, in the over-the-counter market or in negotiated transactions, and may be on such terms as to price, delivery and otherwise as the Agent shall determine.

The market price of shares on a particular date shall be the last sales price on NYSE American, or, if there is no sale on the exchange on that date, then the mean between the closing bid and asked quotations on the exchange on such date. The net asset value per share on a particular date shall be the amount most recently calculated by or on behalf of the Fund as required by law.

The Agent shall at all times act in good faith and agree to use its best efforts within reasonable limits to ensure the accuracy of all services performed under this agreement and to comply with applicable law, but assumes no responsibility and shall not be liable for loss or damage due to errors unless such error is caused by the Agent's negligence, bad faith, or willful misconduct or that of its employees. Your uninvested funds held by the Agent will not bear interest. The Agent shall have no responsibility for the value of shares acquired. For the purpose of cash investments, the Agent may commingle your funds with those of other participants in the same Fund.

There is no direct charge to participants for reinvesting Distributions, since the Agent's fees are paid by the Fund. However, when shares are purchased in the open market, each participant will pay a pro rata portion of any brokerage commissions incurred. If you elect by notice to the Agent to have it sell part or all of your shares and remit the proceeds, the Agent will deduct brokerage commissions from the proceeds.

The automatic reinvestment of Distributions does not relieve you of any taxes that may be payable on Distributions. In connection with the reinvestment of Distributions, shareholders generally will be treated as having received a Distribution equal to the cash Distribution that would have been paid.

The Agent will forward to you any proxy solicitation material and will vote any shares so held for you first in accordance with the instructions set forth on proxies you return to the Fund, and then with respect to any proxies you do not return to the Fund in the same portion as the Agent votes proxies the participants return to the Fund.

As long as you participate in the Plan, the Agent will hold the shares it has acquired for you in safekeeping, in its name or in the name of its nominee. This convenience provides added protection against loss, theft or inadvertent destruction of certificates. However, you may request that a certificate representing your Plan shares be issued to you. Upon your written request, the Agent will deliver to you, without charge, a certificate or certificates for the full shares. The Agent will send you a confirmation of each acquisition made for your account as soon as practicable, but not later than 60 days after the acquisition date. Although from time to time you may have an undivided fractional interest in a share of the Fund, no certificates for a fractional share will be issued. Distributions on fractional shares will be credited to your account. If you terminate your account under the Plan, the Agent will adjust for any such undivided fractional interest in cash at the market value of shares at the time of termination.

You may withdraw from the Plan at any time, without penalty, by notifying the Agent in writing at the address above or by telephone at (800) 416-5585. Such termination will be effective with respect to a Distribution if the Agent receives your notice prior to the Distribution record date. The Agent or the Fund may terminate the Plan upon notice to you in writing mailed at least 30 days prior to any record date for the payment of any Distribution. Upon any termination, the Agent will issue, without charge, stock certificates for all full shares you own and will convert any fractional shares you hold at the time of termination to cash at current market price and send you a check for the proceeds.



The Fund or the Agent may amend the Plan. You will receive written notice at least 30 days before the effective date of any amendment.

## RIGHTS OFFERINGS

The Fund may in the future, and at its discretion, choose to make offerings of rights to its shareholders to purchase Common Shares. Rights may be issued independently or together with any other offered security and may or may not be transferable by the person purchasing or receiving the rights. In connection with a rights offering to shareholders, we would distribute certificates or other documentation (i.e., rights cards distributed in lieu of certificates) evidencing the rights and a prospectus supplement to our shareholders as of the record date that we set for determining the shareholders eligible to receive rights in such rights offering. Any such future rights offering will be made in accordance with the 1940 Act. Under the laws of Delaware, the Board is authorized to approve rights offerings without obtaining shareholder approval.

The staff of the SEC has interpreted the 1940 Act as not requiring shareholder approval of a transferable rights offering to purchase Common Shares at a price below the then current net asset value so long as certain conditions are met, including: (i) a good faith determination by a fund's board that such offering would result in a net benefit to existing shareholders; (ii) the offering fully protects shareholders' preemptive rights and does not discriminate among shareholders (except for the possible effect of not offering fractional rights); (iii) management uses its best efforts to ensure an adequate trading market in the rights for use by shareholders who do not exercise such rights; and (iv) the ratio of a transferable rights offering does not exceed one new share for each three rights held.

The applicable prospectus supplement would describe the following terms of the rights in respect of which this Prospectus is being delivered:

- the period of time the offering would remain open;
- the underwriter or distributor, if any, of the rights and any associated underwriting fees or discounts applicable to purchases of the rights;
- the title of such rights;
- the exercise price for such rights (or method of calculation thereof);
- the number of such rights issued in respect of each Share;
- the number of rights required to purchase a single Share;
- the extent to which such rights are transferable and the market on which they may be traded if they are transferable;
- if applicable, a discussion of the material U.S. federal income tax considerations applicable to the issuance or exercise of such rights;
- the date on which the right to exercise such rights will commence, and the date on which such right will expire (subject to any extension);

- the extent to which such rights include an over-subscription privilege with respect to unsubscribed securities and the terms of such over-subscription privilege;
- termination right we may have in connection with such rights offering; and
- any other terms of such rights, including exercise, settlement and other procedures and limitations relating to the transfer and exercise of such rights.

A certain number of rights would entitle the holder of the right(s) to purchase for cash such number of Common Shares at such exercise price as in each case is set forth in, or be determinable as set forth in, the prospectus supplement relating to the rights offered thereby. Rights would be exercisable at any time up to the close of business on the expiration date for such rights set forth in the prospectus supplement. After the close of business on the expiration date, all unexercised rights would become void. Upon expiration of the rights offering and the receipt of payment and the rights certificate or other appropriate documentation properly executed and completed and duly executed at the corporate trust office of the rights agent, or any other office indicated in the prospectus supplement, the Common Shares purchased as a result of such exercise will be issued as soon as practicable. To the extent permissible under applicable law, we may determine to offer any unsubscribed offered securities directly to persons other than shareholders, to or through agents, underwriters or dealers or through a combination of such methods, as set forth in the applicable prospectus supplement.

## TAXATION

The following is intended to be a general summary of certain tax consequences that may result to the Fund and its shareholders. It is not intended as a complete discussion of all such tax consequences, nor does it purport to deal with all categories of investors. Investors are therefore advised to consult with their tax advisers before making an investment in the Fund.

Dividends paid out of the Fund's investment company taxable income (which includes dividends, interest and net short-term capital gains) generally will be taxable to shareholders as ordinary income. Because the Fund invests primarily in debt securities, it is expected that either none or only a small portion of the Fund's income dividends may be eligible for the dividends-received deduction available to corporate shareholders or the reduced rate of taxation on qualified dividend income received by individuals. Properly reported distributions of long-term capital gains, if any, earned by the Fund are taxable to shareholders as long-term capital gains, regardless of how long shareholders have held their shares. Long-term capital gain is a maximum rate of taxed at 15% or 20% for individuals, depending on whether their incomes exceed certain thresholds, which are adjusted annually for inflation. Distributions in excess of the Fund's current and accumulated earnings and profits will first reduce a shareholder's basis in his shares and, after the shareholder's basis is reduced to zero, will constitute capital gains to the shareholder who holds his shares as capital assets.

Fund distributions are taxable to shareholders in the same manner whether received in cash or reinvested in additional Fund shares.

Fund distributions may also subject shareholders to alternative minimum tax liability. Because of the complexity of the alternative minimum tax rules, shareholders should consult their tax advisers as to their applicability to a Fund investment.

A distribution will be treated as paid to shareholders on December 31 of the current calendar year if it is declared by the Fund in October, November or December with a record date in such a month and paid by the Fund during January of the following calendar year. Such distributions will be taxable to shareholders in the calendar year in which the distributions are declared, rather than the calendar year in which distributions are received.

Each year, the Fund will notify shareholders of the tax status of dividends and other distributions.

A shareholder who invests through a tax-deferred account, such as a retirement plan, generally will not pay tax on Fund dividends or other taxable distributions until they are distributed from the account. These accounts are subject to complex rules. Shareholders should consult their tax advisers about investment through a tax-deferred account.

Income received by the Fund from sources within foreign countries may be subject to withholding and other taxes imposed by such countries. Tax conventions between certain countries and the U.S. may reduce or eliminate such taxes. Under certain circumstances, the Fund may elect to pass-through foreign taxes paid by the Fund to shareholders, although it reserves the right not to do so. If the Fund makes such an election and obtains a refund of foreign taxes paid by the Fund in a prior year, the Fund may be eligible to reduce the amount of foreign taxes reported by the Fund to its shareholders, generally by the amount of the foreign taxes refunded, for the year in which the refund is received.

Upon the sale or other disposition of Fund shares, a shareholder may realize a capital gain or loss which may be long-term or short-term, depending on how long the shareholder held the shares.



Taxable distributions and redemptions are subject to a 3.8% federal Medicare contribution tax on “net investment income,” including, among other things, dividends, interest and net gain from investments, for individuals with income exceeding \$200,000 (\$250,000 if married and filing jointly).

The Fund may be required to apply backup withholding at a 24% rate to all taxable distributions payable to a non-exempt shareholder if the shareholder fails to provide the Fund with such shareholder’s correct taxpayer identification number or to make required certifications, or if the shareholder has been notified by the IRS that such shareholder is subject to backup withholding. Backup withholding is not an additional tax. Any amounts withheld may be credited against a shareholder’s U.S. federal income tax liability.

Separately, a 30% withholding tax is currently imposed on U.S.-source dividends, interest and other income items paid, and will be imposed on proceeds from the sale, redemption or other disposition of property producing U.S.-source dividends and interest paid after December 31, 2018, to foreign financial institutions including non-U.S. investment funds and certain other foreign entities. To avoid withholding, foreign financial institutions will need to (i) enter into agreements with the IRS that state that they will provide the IRS information, including the names, addresses and taxpayer identification numbers of direct and indirect U.S. account holders, comply with due diligence procedures with respect to the identification of U.S. accounts, report to the IRS certain information with respect to U.S. accounts maintained, agree to withhold tax on certain payments made to non-compliant foreign financial institutions or to account holders who fail to provide the required information, and determine certain other information as to their account holders, or (ii) in the event that an applicable intergovernmental agreement and implementing legislation are adopted, provide local revenue authorities with similar account holder information. Other foreign entities will need to either provide the name, address, and taxpayer identification number of each substantial U.S. owner or certifications of no substantial U.S. ownership unless certain exceptions apply or agree to provide certain information to other revenue authorities for transmittal to the IRS.

Fund distributions also may be subject to state, local and foreign taxes. Shareholders should consult their own tax advisers regarding the particular tax consequences of an investment in the Fund.

## **TAXATION OF HOLDERS OF RIGHTS**

The value of a Right will not be includible in the income of a Common Shareholder at the time the Right is issued.

The basis of a Right issued to a Common Shareholder will be zero, and the basis of the share with respect to which the subscription right was issued (the old share) will remain unchanged, unless either (a) the fair market value of the Right on the date of distribution is at least 15% of the fair market value of the old share, or (b) such shareholder affirmatively elects (in the manner set out in Treasury regulations under the Code) to allocate to the subscription right a portion of the basis of the old share. If either (a) or (b) applies, such shareholder must allocate basis between the old share and the Right in proportion to their fair market values on the date of distribution.

The basis of a Right purchased in the market will generally be its purchase price.

The holding period of a Right issued to a Common Shareholder will include the holding period of the old share. No gain or loss will be recognized by a Common Shareholder upon the exercise of a Right.

No loss will be recognized by a Common Shareholder if a Right distributed to such Common Shareholder expires unexercised because the basis of the old share may be allocated to a Right only if the Right is exercised. If a Right that has been purchased in the market expires unexercised, there will be a recognized loss equal to the basis of the Right.

Any gain or loss on the sale of a Right will be a capital gain or loss if the Right is held as a capital asset (which in the case of Rights issued to Common Shareholders will depend on whether the old share of common stock is held as a capital asset), and will be a long-term capital gain or loss if the holding period is deemed to exceed one year.

## **ANTI-TAKEOVER AND OTHER PROVISIONS IN THE DECLARATION OF TRUST**

The Declaration includes provisions that could limit the ability of other entities or persons to acquire control of the Fund or to convert the Fund to open-end status. The Fund's Trustees are divided into three classes. At each annual meeting of shareholders, the term of one class will expire and each Trustee elected to that class will hold office for a term of three years. The classification of the Board of Trustees in this manner could delay for an additional year the replacement of a majority of the Board of Trustees. In addition, the Declaration provides that a Trustee may be removed only for cause and only by action of at least seventy-five percent (75%) of the outstanding shares of the classes or series of shares entitled to vote for the election of such Trustee.

The Declaration requires the approval of the Board of Trustees and the affirmative vote of the holders of 75% of the Fund's shares (including Common Shares and any preferred shares) entitled to vote to approve, adopt or authorize certain Fund transactions not in the ordinary course of business, including (i) a merger or consolidation or sale or transfer of the Fund and (ii) conversion of the Fund from a closed-end to an open-end investment company, unless such action was previously approved, adopted or authorized by the affirmative vote of 66<sup>2</sup>/3% of the Board of Trustees, in which case such action must be approved by the holders of a "majority of the outstanding" Common Shares and any preferred shares voting together as a single class, and, if the Fund has preferred shares outstanding, of the holders of a "majority of the outstanding" preferred shares voting as a separate class. A "majority of the outstanding" shares (whether voting together as a single class or voting as a separate class) means (i) 67% or more of such shares present at a meeting, if the holders of more than 50% of those shares are present or represented by proxy, or (ii) more than 50% of such shares, whichever is less. See "Anti-Takeover and Other Provisions in the Declaration of Trust" in the SAI for a more detailed summary of these provisions.

The Trustees may from time to time grant other voting rights to shareholders with respect to these and other matters in the Fund's Bylaws.

The overall effect of these provisions is to render more difficult the accomplishment of a merger or the assumption of control by a third party. They provide, however, the advantage of potentially requiring persons seeking control of the Fund to negotiate with its management regarding the price to be paid and facilitating the continuity of the Fund's investment objective and policies. The provisions of the Declaration described above could have the effect of depriving the Common Shareholders of opportunities to sell their Common Shares at a premium over the then current market price of the Common Shares by discouraging a third party from seeking to obtain control of the Fund in a tender offer or similar transaction. The Board of Trustees of the Fund has considered the foregoing anti-takeover provisions and concluded that they are in the best interests of the Fund and its Common Shareholders.

The foregoing is intended only as a summary and is qualified in its entirety by reference to the full text of the Declaration and the Fund's Bylaws, both of which are on file with the SEC.

The Declaration contains an express disclaimer of shareholder liability for debts or obligations of the Fund and requires that notice of such limited liability be given in each agreement, obligation or instrument entered into or executed by the Fund or the Trustees. The Declaration further provides for indemnification out of the assets and property of the Fund for all loss and expense of any shareholder held personally liable for the obligations of the Fund. Thus, the risk of a shareholder incurring financial loss on account of shareholder liability is limited to circumstances in which the Fund would be unable to meet its obligations. The Fund believes that the likelihood of such circumstances is remote.





## **REPURCHASE OF COMMON SHARES; CONVERSION TO OPEN-END FUND**

The Fund is a closed-end investment company and as such holders of its Common Shares do not have the right to cause the Fund to redeem their shares. Instead, the Common Shares trade in the open market at a price that is a function of several factors, including dividend levels (which are in turn affected by expenses), net asset value, call protection, dividend stability, portfolio credit quality, relative demand for and supply of such shares in the market, general market and economic conditions and other factors. Shares of a closed-end investment company may frequently trade at prices lower than net asset value. The Fund's Board of Trustees regularly monitors the relationship between the market price and net asset value of the Common Shares. If the Common Shares were to trade at a substantial discount to net asset value for an extended period of time, the Board may consider the repurchase of its Common Shares on the open market or in private transactions, the making of a tender offer for such shares, or the conversion of the Fund to an open-end investment company. The Fund cannot assure you that its Board of Trustees will decide to take or propose any of these actions, or that share repurchases or tender offers will actually reduce market discount.

The Declaration requires the affirmative vote or consent of a majority of the Board of Trustees and the affirmative vote or consent of the holders of at least seventy-five percent (75%) of the Fund's shares (including Common Shares and any preferred shares) entitled to vote to approve, unless the conversion has been authorized by a the affirmative vote or consent of two-thirds (66<sup>2</sup>/3%) of the Board of Trustees, in which case shareholders would have only the minimum voting rights required by the 1940 Act with respect to the conversion.

If the Fund were to convert to an open-end company, it would be required to redeem all preferred shares then outstanding (requiring in turn that it liquidate a portion of its investment portfolio), and the Common Shares would no longer be listed on the NYSE American. In contrast to a closed-end investment company, shareholders of an open-end investment company may require the company to redeem their shares at any time (except in certain circumstances as authorized by or under the 1940 Act) at their net asset value, less any redemption charge that is in effect at the time of redemption.

Before deciding whether to take any action to convert the Fund to an open-end investment company, the Board would consider all relevant factors, including the extent and duration of the discount, the liquidity of the Fund's portfolio, the impact of any action that might be taken on the Fund or its shareholders, and market considerations. Based on these considerations, even if the Fund's shares should trade at a discount, the Board of Trustees may determine that, in the interest of the Fund and its shareholders, no action should be taken.

## **PLAN OF DISTRIBUTION**

We may sell Common Shares, including to existing shareholders in a rights offering, through underwriters or dealers, directly to one or more purchasers (including existing shareholders in a rights offering), through agents, to or through underwriters or dealers, or through a combination of any such methods of sale. The applicable Prospectus Supplement will identify any underwriter or agent involved in the offer and sale of our Common Shares, any sales loads, discounts, commissions, fees or other compensation paid to any underwriter, dealer or agent, the offering price, net proceeds and use of proceeds and the terms of any sale. In the case of a rights offering, the applicable Prospectus Supplement will set forth the number of our Common Shares issuable upon the exercise of each right and the other terms of such rights offering.

The distribution of our Common Shares may be effected from time to time in one or more transactions at a fixed price or prices, which may be changed, at prevailing market prices at the time of sale, at prices related to such prevailing market prices, or at negotiated prices. Sales of our Common Shares may be made in transactions that are deemed to be “at the market” as defined in Rule 415 under the Securities Act, including sales made directly on the NYSE American or sales made to or through a market maker other than on an exchange.

We may sell our Common Shares directly to, and solicit offers from, institutional investors or others who may be deemed to be underwriters as defined in the Securities Act for any resales of the securities. In this case, no underwriters or agents would be involved. We may use electronic media, including the Internet, to sell offered securities directly.

In connection with the sale of our Common Shares, underwriters or agents may receive compensation from us in the form of discounts, concessions or commissions. Underwriters may sell our Common Shares to or through dealers, and such dealers may receive compensation in the form of discounts, concessions or commissions from the underwriters and/or commissions from the purchasers for whom they may act as agents. Underwriters, dealers and agents that participate in the distribution of our Common Shares may be deemed to be underwriters under the Securities Act, and any discounts and commissions they receive from us and any profit realized by them on the resale of our Common Shares may be deemed to be underwriting discounts and commissions under the Securities Act. Any such underwriter or agent will be identified and any such compensation received from us will be described in the applicable Prospectus Supplement. The maximum amount of compensation to be received by any Financial Industry Regulatory Authority (“FINRA”) member or independent broker-dealer will not exceed eight percent for the sale of any securities being offered pursuant to Rule 415 under the Securities Act. We will not pay any compensation to any underwriter or agent in the form of warrants, options, consulting or structuring fees or similar arrangements. In connection with any rights offering to existing shareholders, we may enter into a standby underwriting arrangement with one or more underwriters pursuant to which the underwriter(s) will purchase Common Shares remaining unsubscribed after the rights offering.

If a Prospectus Supplement so indicates, we may grant the underwriters an option to purchase additional Common Shares at the public offering price, less the underwriting discounts and commissions, within 45 days from the date of the Prospectus Supplement, to cover any over-allotments.

Under agreements into which we may enter, underwriters, dealers and agents who participate in the distribution of our Common Shares may be entitled to indemnification by us against certain liabilities, including liabilities under the Securities Act. Underwriters, dealers and agents may engage in transactions with us, or perform services for us, in the ordinary course of business.

If so indicated in the applicable Prospectus Supplement, we will ourselves, or will authorize underwriters or other persons acting as our agents to solicit offers by certain institutions to purchase our Common Shares from us pursuant to contracts providing for payment and delivery on a future date. Institutions with which such contacts may be made include commercial and savings banks, insurance companies, pension funds, investment companies, educational and charitable institutions and others, but in all cases such institutions must be approved by us. The obligation of any purchaser under any such contract will be subject to the condition that the purchase of the Common Shares shall not at the time of delivery be prohibited under the laws of the jurisdiction to which such purchaser is subject. The underwriters and such other agents will not have any responsibility in respect of the validity or performance of such contracts. Such contracts will be subject only to those conditions set forth in the Prospectus Supplement, and the Prospectus Supplement will set forth the commission payable for solicitation of such contracts.

To the extent permitted under the 1940 Act and the rules and regulations promulgated thereunder, the underwriters may from time to time act as brokers or dealers and receive fees in connection with the execution of our portfolio transactions after the underwriters have ceased to be underwriters and, subject to certain restrictions, each may act as a broker while it is an underwriter.

A Prospectus and accompanying Prospectus Supplement in electronic form may be made available on the websites maintained by underwriters. The underwriters may agree to allocate a number of securities for sale to their online brokerage account holders. Such allocations of securities for Internet distributions will be made on the same basis as other allocations. In addition, securities may be sold by the underwriters to securities dealers who resell securities to online brokerage account holders.

In order to comply with the securities laws of certain states, if applicable, our Common Shares offered hereby will be sold in such jurisdictions only through registered or licensed brokers or dealers.



## **LEGAL PROCEEDINGS**

There are no material pending legal proceedings to which the Fund or the Investment Manager is a party.

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**\$200,000,000**

**FRANKLIN LIMITED DURATION INCOME TRUST**

**Common Shares**

**Rights to Purchase Common Shares**

**PROSPECTUS**

**[ ], 2018**





**The information in this Prospectus Supplement is not complete and may be changed. The Franklin Limited Duration Income Trust may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This Prospectus Supplement is not an offer to sell these securities and is not soliciting offers to buy these securities in any state where the offer or sale is not permitted.**

**SUBJECT TO COMPLETION, DATED [ ], 2018**

PROSPECTUS SUPPLEMENT

(To Prospectus dated [ ], 2018)

Filed Pursuant to Rule 497(c)  
Registration Statement No. 333-[ ]

**FRANKLIN LIMITED DURATION INCOME TRUST**

**[ ] Common Shares**

The Franklin Limited Duration Income Trust (the “Fund”, “we”, “us” or “our”) is offering for sale [ ] of our common shares. Our common shares are listed on the New York Stock Exchange under the symbol “FTF”. As of the close of business on [ ], 2018, the last reported net asset value per share of our common shares was \$[ ] and the last reported sales price per share of our common shares on the NYSE American was \$[ ].

The Fund is a diversified, closed-end management investment company registered under the Investment Company Act of 1940, as amended. The Fund seeks high current income, with a secondary objective of capital appreciation to the extent possible and consistent with the Fund’s primary objective. The Fund’s investment adviser is Franklin Advisers, Inc. (the “Investment Manager”).

[Sales of our common shares, if any, under this Prospectus Supplement and the accompanying Prospectus may be made in negotiated transactions or transactions that are deemed to be “at the market” as defined in Rule 415 under the Securities Act of 1933, as amended (the “Securities Act”), including sales made directly on the NYSE American or sales made to or through a market maker other than on an exchange.]

An investment in the Fund is not appropriate for all investors. We cannot assure you that the Fund’s investment objectives will be achieved. You should read this Prospectus Supplement and the accompanying Prospectus before deciding whether to invest in the common shares and retain it for future reference. The Prospectus Supplement and the accompanying Prospectus contain important information about the Fund. Material that has been incorporated by reference and other information about us can be obtained from the Fund by calling (800) DIAL-BEN ((800) 342-5236), writing to the Fund at Franklin Templeton Investor Services, LLC, P.O. Box 997151, Sacramento, CA 95899-9983, accessing the Fund’s website at franklintempleton.com or from the Securities and Exchange Commission’s (“SEC”) website (<http://www.sec.gov>).

**Investing in common shares involves certain risks that are described in the “Risk Factors and Special Considerations” section beginning on page [ ] of the accompanying Prospectus.**

**NEITHER THE SEC NOR ANY STATE SECURITIES COMMISSION HAS APPROVED OR DISAPPROVED THESE SECURITIES OR DETERMINED IF THIS PROSPECTUS SUPPLEMENT IS TRUTHFUL OR COMPLETE. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.**

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	<b><u>Per Share</u></b>	<b><u>Total (1)</u></b>
Public offering price	\$[ ]	\$[ ]
Underwriting discounts and commissions	\$[ ]	\$[ ]
Proceeds, before expenses, to us	\$[ ]	\$[ ]

(1) The aggregate expenses of the offering (excluding underwriting discounts and commissions) are estimated to be \$[ ], which represents approximately \$[ ] per share.

[The underwriters may also purchase up to an additional [ ] common shares from us at the public offering price, less underwriting discounts and commissions, to cover over-allotments, if any, within 30 days after the date of this Prospectus Supplement. If the over-allotment option is exercised in full, the total proceeds, before expenses, to the Fund would be \$[ ] and the total underwriting discounts and commissions would be \$[ ].] The underwriters are expected to deliver the common shares in book-entry form with The Depository Trust Company on or about [ ],[ ].

[ ], 2018

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**You should rely only on the information contained or incorporated by reference in this Prospectus Supplement and the accompanying Prospectus. Neither the Fund nor the underwriters have authorized anyone to provide you with different information. The Fund is not making an offer to sell these securities in any jurisdiction where the offer or sale is not permitted. You should not assume that the information contained in this Prospectus Supplement and the accompanying Prospectus is accurate as of any date other than the date of this Prospectus Supplement and the accompanying Prospectus, respectively. Our business, financial condition, results of operations and prospects may have changed since those dates. In this Prospectus Supplement and in the accompanying Prospectus, unless otherwise indicated, “Fund,” “us,” “our” and “we” refer to The Franklin Limited Duration Income Trust. This Prospectus Supplement also includes trademarks owned by other persons.**

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## CAUTIONARY NOTICE REGARDING FORWARD-LOOKING STATEMENTS

This Prospectus Supplement, the accompanying Prospectus and the Statement of Additional Information (the “SAI”) contain “forward-looking statements.” Forward-looking statements can be identified by the words “may,” “will,” “intend,” “expect,” “estimate,” “continue,” “plan,” “anticipate,” and similar terms and the negative of such terms. Such forward-looking statements may be contained in this Prospectus Supplement as well as in the accompanying Prospectus. By their nature, all forward-looking statements involve risks and uncertainties, and actual results could differ materially from those contemplated by the forward-looking statements. Several factors that could materially affect our actual results are the performance of the portfolio of securities we hold, the price at which our shares will trade in the public markets and other factors discussed in our periodic filings with the SEC.

Although we believe that the expectations expressed in our forward-looking statements are reasonable, actual results could differ materially from those projected or assumed in our forward-looking statements. Our future financial condition and results of operations, as well as any forward-looking statements, are subject to change and are subject to inherent risks and uncertainties, such as those disclosed in the “Risk Factors and Special Considerations” section of the accompanying prospectus. All forward-looking statements contained or incorporated by reference in this Prospectus Supplement or the accompanying Prospectus are made as of the date of this Prospectus Supplement or the accompanying Prospectus, as the case may be. Except for our ongoing obligations under the federal securities laws, we do not intend, and we undertake no obligation, to update any forward-looking statement. The forward-looking statements contained in this Prospectus Supplement, the accompanying Prospectus and the SAI are excluded from the safe harbor protection provided by Section 27A of the Securities Act of 1933, as amended (the “Securities Act”).

Currently known risk factors that could cause actual results to differ materially from our expectations include, but are not limited to, the factors described in the “Risk Factors and Special Considerations” section of the accompanying Prospectus. We urge you to review carefully those sections for a more detailed discussion of the risks of an investment in our common shares.



**TABLE OF FEES AND EXPENSES**

The following tables are intended to assist you in understanding the various costs and expenses directly or indirectly associated with investing in our common shares as a percentage of managed assets attributable to common shares. Amounts are for the current fiscal year after giving effect to anticipated net proceeds of the offering, assuming that we incur the estimated offering expenses.

**Shareholder Transaction Expenses**

Record Date Sales Load (as a percentage of offering price)	[ ]%
Offering Expenses (as a percentage of offering price) <sup>(1)</sup>	[ ]%
Dividend Reinvestment Plan Fees <sup>(2)</sup>	None

**Annual Operating Expenses**

	<b>Percentage of Managed Assets Attributable to Common Shares</b>
Management Fees <sup>(3)</sup>	[ ]%
Other Expenses <sup>(4)</sup>	[ ]%
Total Annual Fund Operating Expenses	[ ]%

(1) Fund shareholders will pay all offering expenses involved with this offering.

(2) You will pay brokerage charges if you direct the plan agent to sell your Common Shares held in a dividend reinvestment account.

(3) The Investment Manager is entitled to receive an investment management fee of 0.70% per year of the Fund's average daily managed assets. Managed assets are defined as the Fund's gross asset value minus the sum of accrued liabilities, other than the liquidation value of the preferred shares and other financial leverage. If a Fund uses leverage, the amount of fees paid to the Investment Manager for investment management services will be higher than if the Fund does not use leverage because the fees paid are calculated on the Fund's managed assets, which include assets purchased with leverage. The management fee for the Fund reflects the leverage used by the Fund as of its December 31, 2017 fiscal year end.

(4) "Other Expenses" have been estimated assuming the completion of the proposed issuance.

The purpose of the table above and the example below is to help you understand all fees and expenses that you, as a holder of common shares, would bear directly or indirectly.

**Example**

The following example illustrates the expenses you would pay on a \$1,000 investment in common shares, assuming a 5% annual portfolio total return.\*

	<b>1 Year</b>	<b>3 Years</b>	<b>5 Years</b>	<b>10 Years</b>
Total Expenses Incurred	\$[ ]	\$[ ]	\$[ ]	\$[ ]

\* The example should not be considered a representation of future expenses. The example assumes that the amounts set forth in the Table of Fees and Expenses table are accurate and that all distributions are reinvested at net asset value. Actual expenses may be greater or less than those assumed. Moreover, the Fund's actual rate of return may be greater or less than the hypothetical 5% return shown in the example.

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### USE OF PROCEEDS

We estimate the total net proceeds of the offering to be \$[ ] (\$[ ] if the over-allotment option is exercised in full), based on the public offering price of \$[ ] per share and after deducting underwriting discounts and commissions and estimated offering expenses payable by us.

The Investment Manager anticipates that the investment of the proceeds will be made in accordance with the Fund's investment objectives and policies as appropriate investment opportunities are identified, which is expected to be substantially completed within three months; however, the identification of appropriate investment opportunities pursuant to the Fund's investment style or changes in market conditions could result in the Fund's anticipated investment period extending to as long as six months. Pending such investment, the Investment Manager expects that it will initially invest the proceeds of the offering in cash and/or high quality short term debt securities and instruments. Depending on market conditions and operations, a portion of the cash held by the Fund, including any proceeds raised from the offering, may be used to pay distributions in accordance with the Fund's distribution policy and may be a return of capital. A return of capital is a return to investors of a portion of their original investment in the Fund. In general terms, a return of capital would involve a situation in which a Fund distribution (or a portion thereof) represents a return of a portion of a shareholder's investment in the Fund, rather than making a distribution that is funded from the Fund's earned income or other profits. Although return of capital distributions may not be currently taxable, such distributions would decrease the basis of a shareholder's shares, and therefore, may increase a shareholder's tax liability for capital gains upon a sale of shares, even if sold at a loss to the shareholder's original investments.

### CAPITALIZATION

The following table sets forth the unaudited capitalization of the Fund as of [ ], 2018 and its adjusted capitalization assuming the common shares available in the offering discussed in this Prospectus Supplement had been issued.

[To be provided.]

**PRICE RANGE OF COMMON SHARES**

The following table sets forth for the quarters indicated, the high and low sale prices on the New York Stock Exchange per common share and the net asset value and the premium or discount from net asset value per share at which the common shares were trading, expressed as a percentage of net asset value, at each of the high and low sale prices provided.

During Quarter Ended	NAV per Common Share on Date of Market Price <sup>(1)</sup>		NYSE American Market Price per Common Share <sup>(2)</sup>		Premium/(Discount) on Date of Market Price <sup>(3)</sup>		Trading Volume
	High	Low	High	Low	High	Low	
March 31, 2016	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
June 30, 2016	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
September 30, 2016	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
December 31, 2016	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
March 31, 2017	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
June 30, 2017	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
September 30, 2017	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
December 31, 2017	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
March 31, 2018	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
April 1, 2018 through [ ], 2018	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]

(1) Based on the Fund's computations.

(2) Source: NYSE American.

(3) Based on the Fund's computations.

(4) Source: Bloomberg.

The last reported price for our common shares on [ ], 2018 was \$[ ] per share. As of [ ], 2018, the net asset value per share of the Fund's common shares was \$[ ]. Accordingly, our common shares traded at a [premium to] [discount from] net asset value of [ ]% on [ ], 2018.

**UNDERWRITING**

[To be provided.]

**LEGAL MATTERS**

Certain legal matters will be passed on by Willkie Farr & Gallagher LLP, special counsel to the Fund in connection with the offering, and Stradley Ronon Stevens & Young, LLP, counsel to the Fund. [Certain legal matters will be passed on by [ ] as special counsel to the Underwriters in connection with the offering.]



**FRANKLIN LIMITED DURATION INCOME TRUST**

**Common Shares**

**PROSPECTUS SUPPLEMENT**

[ ], 2018

**The information in this Prospectus Supplement is not complete and may be changed. The Franklin Limited Duration Income Trust may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This Prospectus Supplement is not an offer to sell these securities and is not soliciting offers to buy these securities in any state where the offer or sale is not permitted.**

**SUBJECT TO COMPLETION, DATED [ ], 2018**

## **PROSPECTUS SUPPLEMENT**

(To Prospectus dated [ ], 2018)

Filed Pursuant to Rule 497(c)

Registration Statement No. 333-[ ]

### **FRANKLIN LIMITED DURATION INCOME TRUST**

**[ ] Rights for [ ] Common Shares**

#### **Subscription Rights to Acquire Common Shares**

The Franklin Limited Duration Income Trust (the “Fund”, “we”, “us” or “our”) is issuing subscription rights (the “Rights”) to common shareholders (the “Common Shareholders”) to purchase additional common shares (each, a “Common Share” and collectively, the “Common Shares”).

The Fund is a diversified, closed-end management investment company registered under the Investment Company Act of 1940, as amended (the “1940 Act”). The Fund seeks to provide high current income, with a secondary objective of capital appreciation to the extent possible and consistent with the Fund’s primary objective. The Fund’s investment adviser is Franklin Advisers, Inc. (the “Investment Manager”).

The Common Shares are listed on the NYSE American under the symbol “FTF”. Common shareholders of record on [ ], 2018 (the “Record Date”) will receive [ ] Right for each Common Share held. These Rights are transferable and will allow the holders thereof to purchase additional Common Shares. The Rights will be listed for trading on the [ ] under the symbol “[ ]” during the course of the Rights offering.

On [ ], 2018 (the last trading date prior to the Common Shares trading ex-Rights), the last reported net asset value per share of the Common Shares was \$[ ] and the last reported sales price per share of Common Shares on the NYSE American was \$[ ].

An investment in the Fund is not appropriate for all investors. We cannot assure you that the Fund’s investment objectives will be achieved. You should read this Prospectus Supplement and the accompanying Prospectus before deciding whether to invest in the Common Shares and retain it for future reference. The Prospectus Supplement and the accompanying Prospectus contain important information about the Fund. Material that has been incorporated by reference, including the Fund’s audited annual financial statements, and other information about the Fund can be obtained from the Fund by calling (800) DIAL-BEN ((800) 342-5236), writing to the Fund at Franklin Templeton Investor Services, LLC, P.O. Box 997151, Sacramento, CA 95899-9983, accessing the Fund’s website at [franklintempleton.com](http://franklintempleton.com) or from the Securities and Exchange Commission’s (“SEC”) website (<http://www.sec.gov>). For



additional information all holders of Rights should contact the Information Agent, [ ], at [ ]. Common Shareholders please call toll-free at [ ] (banks and brokers please call [ ]) or please send written requests to [ ].

**Investing in Common Shares through Rights involves certain risks that are described in the “Special Characteristics and Risks of the Rights Offering” section of this Prospectus Supplement.**

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**SHAREHOLDERS WHO DO NOT FULLY EXERCISE THEIR RIGHTS MAY, AT THE COMPLETION OF THE OFFERING, OWN A SMALLER PROPORTIONAL INTEREST IN THE FUND THAN IF THEY EXERCISED THEIR RIGHTS. AS A RESULT OF THE OFFERING YOU MAY EXPERIENCE SUBSTANTIAL DILUTION OF THE AGGREGATE NET ASSET VALUE OF YOUR COMMON SHARES DEPENDING UPON WHETHER THE FUND'S NET ASSET VALUE PER COMMON SHARE IS ABOVE OR BELOW THE SUBSCRIPTION PRICE ON THE EXPIRATION DATE. ALL COSTS OF THE OFFERING WILL BE BORNE BY THE FUND, AND INDIRECTLY BY CURRENT SHAREHOLDERS WHETHER THEY EXERCISE THEIR RIGHTS OR NOT. RIGHTS EXERCISED BY A SHAREHOLDER ARE IRREVOCABLE.**

**ANY COMMON SHARES ISSUED AS A RESULT OF THE RIGHTS OFFERING WILL NOT BE RECORD DATE SHARES FOR THE FUND'S MONTHLY DISTRIBUTION TO BE PAID ON [ ], 2018 AND WILL NOT BE ENTITLED TO RECEIVE SUCH DISTRIBUTION.**

**NEITHER THE SEC NOR ANY STATE SECURITIES COMMISSION HAS APPROVED OR DISAPPROVED THESE SECURITIES OR DETERMINED IF THIS PROSPECTUS SUPPLEMENT IS TRUTHFUL OR COMPLETE. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.**

	<b>Per Share</b>	<b>Total</b>
Estimated subscription price of Common Shares to shareholders exercising Rights <sub>(1)</sub>	\$ [ ]	\$ [ ]
Underwriting discounts and commissions	\$ [ ]	\$ [ ]
Estimated proceeds, before expenses, to the Fund <sub>(2)</sub>	\$ [ ]	\$ [ ]

(1)The estimated Subscription Price to the public is based upon [ ]% of the last reported sales price of the Fund's Common Shares of beneficial interest on the NYSE American on [ ], 2018.

(2)Before deduction of expenses related to the Rights offering, which are estimated approximately at \$[ ]. Any offering expenses are paid indirectly by shareholders. Such fees and expenses will immediately reduce the net asset value per share of each Common Share purchased by an investor in the Rights offering. The indirect expenses of the offering that shareholders will pay are estimated to be \$[ ] in the aggregate and \$[ ] per share. The amount of proceeds to the Fund net of any fees and expenses of the offering are estimated to be \$[ ] in the aggregate and \$[ ] per share. Shareholders will not directly bear any offering expenses.

The Common Shares are expected to be ready for delivery in book-entry form through the Depository Trust Company on or about [ ], 2018[, unless extended. If the offering is extended, the Common Shares are expected to be ready for delivery in book-entry form through the Depository Trust Company on or about [ ], 2018.]

**The date of this Prospectus Supplement is [ ], 2018.**

**You should rely only on the information contained or incorporated by reference in this Prospectus Supplement and the accompanying Prospectus. The Fund has not authorized anyone to provide you with different information. The Fund is not making an offer to sell these securities in any jurisdiction where the offer or sale is not permitted. You should not assume that the information contained in this Prospectus Supplement and the accompanying Prospectus is accurate as of any date other than the date of this Prospectus Supplement and the accompanying Prospectus, respectively. This Prospectus Supplement will be amended to reflect material changes to the information contained herein and will be delivered to shareholders. Our business, financial condition, results of operations and prospects may have changed since those dates. In this Prospectus Supplement and in the accompanying Prospectus, unless otherwise indicated, “Fund,” “us,” “our” and “we” refer to Franklin Limited Duration Income Trust, a Delaware statutory trust. This Prospectus Supplement also includes trademarks owned by other persons.**

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## **CAUTIONARY NOTICE REGARDING FORWARD-LOOKING STATEMENTS**

This Prospectus Supplement, the accompanying Prospectus and the Statement of Additional Information (“SAI”) contain “forward-looking statements.” Forward-looking statements can be identified by the words “may,” “will,” “intend,” “expect,” “estimate,” “continue,” “plan,” “anticipate,” and similar terms and the negative of such terms. Such forward-looking statements may be contained in this Prospectus Supplement as well as in the accompanying Prospectus and in the SAI. By their nature, all forward-looking statements involve risks and uncertainties, and actual results could differ materially from those contemplated by the forward-looking statements. Several factors that could materially affect our actual results are the performance of the portfolio of securities we hold, the price at which our shares will trade in the public markets and other factors discussed in our periodic filings with the SEC.

Although we believe that the expectations expressed in our forward-looking statements are reasonable, actual results could differ materially from those projected or assumed in our forward-looking statements. Our future financial condition and results of operations, as well as any forward-looking statements, are subject to change and are subject to inherent risks and uncertainties, such as those disclosed in the “Risks and Special Considerations” section of the accompanying Prospectus and “Special Characteristics and Risks of the Rights Offering” in this Prospectus Supplement. All forward-looking statements contained or incorporated by reference in this Prospectus Supplement or the accompanying Prospectus, or in the SAI, are made as of the date of this Prospectus Supplement or the accompanying Prospectus or SAI, as the case may be. Except for our ongoing obligations under the federal securities laws, we do not intend, and we undertake no obligation, to update any forward-looking statement. The forward-looking statements contained in this Prospectus Supplement, the accompanying Prospectus and the SAI are excluded from the safe harbor protection provided by Section 27A of the Securities Act of 1933, as amended (the “Securities Act”).

Currently known risk factors that could cause actual results to differ materially from our expectations include, but are not limited to, the factors described in the “Risks and Special Considerations” section of the accompanying Prospectus as well as in the “Special Characteristics and Risks of the Rights Offering” section of this Prospectus Supplement. We urge you to review carefully those sections for a more detailed discussion of the risks of an investment in the Common Shares.

**SUMMARY OF THE TERMS OF THE RIGHTS OFFERING**

<b>Terms of the Rights Offering</b>	One transferable subscription right (a “Right”) will be issued for each common share of the Fund (each, a “Common Share,” and collectively, the “Common Shares”) held on the record date. Rights are expected to trade on the [ ] under the symbol “[ ]”. The Rights will allow common shareholders to subscribe for new Common Shares of the Fund. [ ] Common Shares of the Fund are outstanding as of [ ], 2018. [ ] Rights will be required to purchase one Common Share. Shares of the Fund, as a closed-end fund, can trade at a discount to net asset value. Upon exercise of the Rights offering, Fund shares will be issued at a price below net asset value per Common Share. [An over-subscription privilege will be offered, [subject to the right of the Board of Trustees of the Fund (the “Board”) to eliminate the over-subscription privilege.] [ ] Common Shares of the Fund will be issued if all Rights are exercised. See “Terms of the Rights Offering.” Any Common Shares issued as a result of the Rights offering will not be record date shares for the Fund’s monthly distribution to be paid on [ ], 2018 and will not be entitled to receive such distribution. The exercise of rights by a shareholder is irrevocable.
<b>Amount Available for Primary Subscription</b>	Approximately \$[ ], before expenses.
<b>Title</b>	Subscription Rights to Acquire Common Shares
<b>Subscription Price</b>	The subscription price per Common Share will be determined based upon a formula equal to [ ]% of the average of the last reported sales price of the Fund’s Common Shares on the NYSE American on the Expiration Date (as defined below) and each of the [four] preceding trading days (the “Subscription Price”). See “Terms of the Rights Offering.”
<b>Record Date</b>	Rights will be issued to holders of record of the Fund’s Common Shares as of the close of business on [ ], 2018 (the “Record Date”). See “Terms of the Rights Offering.”
<b>Number of Rights Issued</b>	One Right will be issued in respect of each Common Share of the Fund outstanding as of the close of business on the Record Date. See “Terms of the Rights Offering.”
<b>Number of Rights Required to Purchase One Common Share</b>	A holder of Rights may purchase [ ] Common Shares of the Fund for every [ ] Rights exercised. The number of Rights to be issued to a shareholder as of the close of business on the Record Date will be rounded up to the nearest number of Rights evenly divisible by [ ]. See “Terms of the Rights Offering.”
<b>Over-Subscription Privilege</b>	<p>Holders of Common Shares as of the close of business on the Record Date (“Record Date Shareholders”) who fully exercise all Rights initially issued to them are entitled to buy those Common Shares, referred to as “primary over-subscription shares,” that were not purchased by other Rights holders at the same Subscription Price. If enough primary over-subscription shares are available, all such requests will be honored in full. If the requests for primary over-subscription shares exceed the primary over-subscription shares available, the available primary over-subscription shares will be allocated pro rata among those fully exercising Record Date Shareholders who over-subscribe based on the number of Rights originally issued to them by the Fund. Common Shares acquired pursuant to the primary over-subscription privilege are subject to allotment. <i>Rights acquired in the secondary market may not participate in the primary over-subscription privilege.</i></p> <p>[In addition, the Fund, in its sole discretion, may determine to issue additional Common Shares in an amount of up to [ ]% of the shares issued pursuant to the primary subscription at the Subscription Price, referred to as “secondary over-subscription shares.” Should the Fund determine to issue some or all of the secondary over-subscription shares, they will be allocated only among Record Date Shareholders who submitted over-subscription requests. Secondary over-subscription shares will be allocated pro rata among those fully exercising Record Date Shareholders who over-subscribe based on the number of Rights originally issued to them by the Fund. <i>Rights acquired in the secondary market may not participate in the secondary</i></p>

*over-subscription privilege.]*

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Notwithstanding the above, the Board has the right in its absolute discretion to eliminate the primary over-subscription privilege and/or secondary over-subscription privilege (together, the “over-subscription privilege”) if it considers it to be in the best interest of the Fund to do so. The Board may make that determination at any time, without prior notice to Rights holders or others, up to and including the fifth day following the Expiration Date (as defined below). See “Over-Subscription Privilege.”

Any Common Shares issued pursuant to the over-subscription privilege will be shares registered under the Prospectus.

**Transfer of Rights** The Rights will be transferable. See “Terms of the Rights Offering,” “Sales by Rights Agent” and “Method of Transferring Rights.”

**Subscription Period** The Rights may be exercised at any time after issuance and prior to expiration of the Rights (the “Subscription Period”), which will be [5:00 PM Eastern Time] on [ ], 2018 (the “Expiration Date”), unless otherwise extended. See “Terms of the Rights Offering” and “Method of Exercise of Rights.” The Rights offering may be terminated [or extended] by the Fund at any time for any reason before the Expiration Date. If the Fund terminates the rights offering, the Fund will issue a press release announcing such termination and will direct the Rights Agent (defined below) to return, without interest, all subscription proceeds received to such shareholders who had elected to purchase Shares.

**Offering Expenses** The expenses of the Rights offering are expected to be approximately \$[ ] and will be borne by holders of the Fund’s Common Shares. See “Use of Proceeds.”

**Sale of Rights** The Rights are transferable until the completion of the Subscription Period and will be admitted for trading on the [ ] under the symbol “[ ]”. Although no assurance can be given that a market for the Rights will develop, trading in the Rights on the [ ] is expected to begin two Business Days prior to the Record Date and may be conducted until the close of trading on the last [ ] trading day prior to the Expiration Date. For purposes of this Prospectus Supplement, a “Business Day” shall mean any day on which trading is conducted on the [ ].

The value of the Rights, if any, will be reflected by their market price on the [ ]. Rights may be sold by individual holders through their broker or financial advisor or may be submitted to the Rights Agent (defined below) for sale. Any Rights submitted to the Rights Agent for sale must be received by the Rights Agent prior to [5:00 PM, Eastern Time], on or before [ ], 2018, [ ] Business Days prior to the Expiration Date (or, if the subscription period is extended, prior to [5:00 PM, Eastern Time], on the [ ] Business Day prior to the extended Expiration Date). Rights that are sold will not confer any right to acquire any Common Shares in any over-subscription, and any Record Date Shareholder who sells any Rights will not be eligible to participate in the over-subscription privilege, if any.

Trading of the Rights on the [ ] will be conducted on a when-issued basis until and including the date on which the Subscription Certificates (as defined below) are mailed to Record Date Shareholders of record and thereafter will be conducted on a regular-way basis until and including the last [ ] trading day prior to the completion of the Subscription Period. The shares are expected to begin trading ex-Rights one Business Day prior to the Record Date.

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If the Rights Agent receives Rights for sale in a timely manner, it will use its best efforts to sell the Rights on the [ ]. The Rights Agent will also attempt to sell any Rights attributable to shareholders of record whose addresses are outside the United States, or who have an APO or FPO address. See “Foreign Restrictions.”

Any commissions will be paid by the selling Rights holders. Neither the Fund nor the Rights Agent will be responsible if Rights cannot be sold and neither has guaranteed any minimum sales price for the Rights. If the Rights can be sold, sales of these Rights will be deemed to have been effected at the weighted average price received by the Rights Agent on the day such



Rights are sold, less any applicable brokerage commissions, taxes and other expenses (i.e., costs incidental to the sale of Rights).

Shareholders are urged to obtain a recent trading price for the Rights on the [ ] from their broker, bank, financial advisor or the financial press.

Banks, broker-dealers and trust companies that hold shares for the accounts of others are advised to notify those persons that purchase Rights in the secondary market that such Rights will not participate in any over-subscription privilege. See “Terms of the Rights Offering” and “Sales by Rights Agent.”

**Use of Proceeds**

The Fund estimates the net proceeds of the Rights offering to be approximately \$[ ]. This figure is based on the Subscription Price per Common Share of \$[ ] ([ ]% of the last reported sales price of the Fund’s Common Shares on the NYSE American on [ ], 2018) and assumes all new Common Shares offered are sold and that the expenses related to the Rights offering estimated at approximately \$[ ] are paid.

The Investment Manager anticipates that investment of the proceeds will be made in accordance with the Fund’s investment objective and policies as appropriate investment opportunities are identified, which is expected to be substantially completed in approximately three months; however, the identification of appropriate investment opportunities pursuant to the Fund’s investment style or changes in market conditions may cause the investment period to extend as long as six months. Pending such investment, the proceeds will be held in cash and/or high quality short term debt securities and instruments. Depending on market conditions and operations, a portion of the cash held by the Fund, including any proceeds raised from the offering, may be used to pay distributions in accordance with the Fund’s distribution policy and may be a return of capital. A return of capital is a return to investors of a portion of their original investment in the Fund. In general terms, a return of capital would involve a situation in which a Fund distribution (or a portion thereof) represents a return of a portion of a shareholder’s investment in the Fund, rather than making a distribution that is funded from the Fund’s earned income or other profits. Although return of capital distributions may not be currently taxable, such distributions would decrease the basis of a shareholder’s shares, and therefore, may increase a shareholder’s tax liability for capital gains upon a sale of shares, even if sold at a loss to the shareholder’s original investments. See “Use of Proceeds.”

**Taxation/ERISA**

**Rights Agent**

**Information Agent**

See “Taxation” and “Employee Benefit Plan and IRA Considerations.”

[ ]. See “Rights Agent.”

[ ]. See “Information Agent.”

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## DESCRIPTION OF THE RIGHTS OFFERING

### Terms of the Rights Offering

The Fund is issuing to Record Date Shareholders Rights to subscribe for Common Shares of the Fund. Each Record Date Shareholder is being issued one transferable Right for each Common Share owned on the Record Date. The Rights entitle the holder to acquire, at a subscription price per Common Share determined based upon a formula equal to [ ]% of the average of the last reported sales price of the Fund's Common Shares on the NYSE American on the Expiration Date (as defined below) and each of the four preceding trading days (the "Subscription Price"), [ ] new Common Share for each [ ] Rights held. The estimated Subscription Price to the public of \$[ ] is based upon [ ]% of the last reported sales price of the Fund's Common Shares on the NYSE American on [ ], 2018. Fractional shares will not be issued upon the exercise of the Rights. Accordingly, Common Shares may be purchased only pursuant to the exercise of Rights in integral multiples of [ ]. The number of Rights to be issued to a Record Date Shareholder will be rounded up to the nearest number of Rights evenly divisible by [ ]. In the case of Common Shares held of record by Cede & Co. ("Cede"), as nominee for the Depository Trust Company ("DTC"), or any other depository or nominee, the number of Rights issued to Cede or such other depository or nominee will be adjusted to permit rounding up (to the nearest number of Rights evenly divisible by [ ]) of the Rights to be received by beneficial owners for whom it is the holder of record only if Cede or such other depository or nominee provides to the Fund on or before the close of business on [ ], 2018 written representation of the number of Rights required for such rounding. Rights may be exercised at any time during the period (the "Subscription Period") which commences on [ ], 2018, and ends at [5:00 PM Eastern Time] on [ ], 2018 (the "Expiration Date"), unless otherwise extended. Shares of the Fund, as a closed-end fund, can trade at a discount to net asset value. Upon exercise of the Rights offering, Fund shares will be issued at a price below net asset value per Common Share. The right to acquire one Common Share for each [ ] Rights held during the Subscription Period (or any extension of the Subscription Period) at the Subscription Price will be referred to in the remainder of this Prospectus Supplement as the "Rights offering." *Rights will expire on the Expiration Date and thereafter may not be exercised. Any Common Shares issued as a result of the Rights offering will not be Record Date shares for the Fund's monthly distribution to be paid on [ ], 2018 and will not be entitled to receive such distribution.*

Rights may be evidenced by subscription certificates or may be uncertificated and evidenced by other appropriate documentation (*i.e.*, a rights card distributed to registered shareholders in lieu of a subscription certificate) ("Subscription Certificates"). The number of Rights issued to each holder will be stated on the Subscription Certificate delivered to the holder. The method by which Rights may be exercised and Common Shares paid for is set forth below in "Method of Exercise of Rights" and "Payment for Shares." A holder of Rights will have no right to rescind a purchase after [ ] (the "Rights Agent") has received payment. See "Payment for Shares" below. It is anticipated that the Common Shares issued pursuant to an exercise of Rights will be listed on the [ ].

[Holders of Rights [who are Record Date Shareholders] are entitled to subscribe for additional Common Shares at the same Subscription Price pursuant to the over-subscription privilege, subject to certain limitations, allotment and the right of the Board to eliminate the primary over-subscription privilege [or secondary] over-subscription privilege. See "Over-Subscription Privilege" below.]

For purposes of determining the maximum number of Common Shares that may be acquired pursuant to the Rights offering, broker-dealers, trust companies, banks or others whose shares are held of record by Cede or by any other depository or nominee will be deemed to be the holders of the Rights that are held by Cede or such other depository or nominee on their behalf.

The Rights are transferable until the completion of the Subscription Period and will be admitted for trading on the [ ] under the symbol "[ ]". Assuming a market exists for the Rights, the Rights may be purchased and sold through usual

brokerage channels and also sold through the Rights Agent. Although no assurance can be given that a market for the Rights will develop, trading in the Rights on the [ ] is expected to begin two Business Days prior to the Record Date and may be conducted until the close of trading on the last [ ] trading day prior to the Expiration Date. Trading of the Rights on the [ ] is expected to be conducted on a when-issued basis until and including the date on which the Subscription Certificates are mailed to Record Date Shareholders of record and thereafter is expected to be conducted on a regular way basis until and including the last [ ] trading day prior to the Expiration Date. The method by which Rights may be transferred is set forth below under “Method of Transferring Rights.” The Common Shares are expected to begin trading ex-Rights one Business Day prior to the Record Date as determined and announced by the [ ]. The Rights offering may be terminated or extended by the Fund at any time for any reason before the Expiration Date. If the Fund terminates the Rights offering, the Fund will issue a press release announcing such termination and will direct the Rights Agent to return, without interest, all subscription proceeds received to such shareholders who had elected to purchase Common Shares.

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Nominees who hold the Fund’s Common Shares for the account of others, such as banks, broker-dealers, trustees or depositories for securities, should notify the respective beneficial owners of such shares as soon as possible to ascertain such beneficial owners’ intentions and to obtain instructions with respect to the Rights. If the beneficial owner so instructs, the nominee should complete the Subscription Certificate and submit it to the Rights Agent with proper payment. In addition, beneficial owners of the Common Shares or Rights held through such a nominee should contact the nominee and request the nominee to effect transactions in accordance with such beneficial owner’s instructions.

[Participants in the Fund’s Dividend Reinvestment Plan (the “Plan”) will be issued Rights in respect of the Common Shares held in their accounts in the Plan. Participants wishing to exercise these Rights must exercise the Rights in accordance with the procedures set forth in “Method of Exercise of Rights” and “Payment for Shares.”]

### Conditions of the Rights Offering

The rights offering is being made in accordance with the 1940 Act without shareholder approval. The staff of the SEC has interpreted the 1940 Act as not requiring shareholder approval of a transferable rights offering to purchase common shares at a price below the then current net asset value so long as certain conditions are met, including: (i) a good faith determination by a fund’s board that such offering would result in a net benefit to existing shareholders; (ii) the offering fully protects shareholders’ preemptive rights and does not discriminate among shareholders (except for the possible effect of not offering fractional rights); (iii) management uses its best efforts to ensure an adequate trading market in the rights for use by shareholders who do not exercise such rights; and (iv) the ratio of a transferable rights offering does not exceed one new share for each three rights held.

### Important Dates to Remember

[Please note that the dates in the table below may change if the rights offering is extended.]

<b>Event</b>	<b>Date</b>
Record Date	[ ], 2018
Subscription Period	[ ], 2018 through [ ], 2018†
Expiration Date*	[ ], 2018†
Payment for Guarantees of Delivery Due*	[ ], 2018†
Issuance Date	[ ], 2018†
Confirmation Date	[ ], 2018†

\* A shareholder exercising Rights must deliver to the Rights Agent by [5:00 PM Eastern Time] on [ ], 2018 (unless the offer is extended) either (a) a Subscription Certificate and payment for Common Shares or (b) a notice of guaranteed delivery and payment for Common Shares.

† Unless the offer is extended.

### **[Over-Subscription Privilege**

The Board has the right in its absolute discretion to eliminate the over-subscription privilege with respect to primary over-subscription shares and secondary over-subscription shares if it considers it to be in the best interest of the Fund to do so. The Board may make that determination at any time, without prior notice to Rights holders or others, up to and including the fifth day following the Expiration Date. If the primary over-subscription privilege is not eliminated, it will operate as set forth below.

Rights holders [who are Record Date Shareholders and who fully exercise their Rights] are entitled to subscribe for additional Common Shares at the same Subscription Price pursuant to the over-subscription privilege, subject to certain limitations and subject to allotment.

[Record Date Shareholders who fully exercise all Rights initially issued to them] are entitled to buy those Common Shares, referred to as “primary over-subscription shares,” that were not purchased by other holders of Rights at the same Subscription Price. If enough primary over-subscription shares are available, all such requests will be honored in full. If the requests for primary over-subscription shares exceed the primary over-subscription shares available, the available primary over-subscription shares will be allocated pro rata among those fully exercising [Record Date Shareholders] who over-subscribe based on the number of Rights originally issued to them by the Fund. ***Common Shares acquired pursuant to the over-subscription privilege are subject to allotment.***

[In addition, the Fund, in its sole discretion, may determine to issue additional Common Shares in an amount of up to [ ]% of the shares issued pursuant to the primary subscription, referred to as “secondary over-subscription shares.” Should the Fund determine to issue some or all of the secondary over-subscription shares, they will be allocated only among Record Date Shareholders who submitted over-subscription requests. Secondary over-subscription shares will be allocated pro rata among those fully exercising Record Date Shareholders who over-subscribe based on the number of Rights originally issued to them by the Fund. *Rights acquired in the secondary market may not participate in the over-subscription privilege.*]

Record Date Shareholders who are fully exercising their Rights during the Subscription Period should indicate, on the Subscription Certificate that they submit with respect to the exercise of the Rights issued to them, how many Common Shares they are willing to acquire pursuant to the over-subscription privilege. Rights acquired in the secondary market may not participate in the over-subscription privilege.

To the extent sufficient Common Shares are not available to fulfill all over-subscription requests, unsubscribed Common Shares (the “Excess Shares”) will be allocated pro rata among those Record Date Shareholders who over-subscribe based on the number of Rights issued to them by the Fund. The allocation process may involve a series of allocations in order to assure that the total number of Common Shares available for over-subscriptions is distributed on a pro rata basis.

The formula to be used in allocating the Excess Shares is as follows:

Banks, broker-dealers, trustees and other nominee holders of Rights will be required to certify to the Rights Agent, before any over-subscription privilege may be exercised with respect to any particular beneficial owner, as to the aggregate number of Rights exercised during the Subscription Period and the number of Common Shares subscribed for pursuant to the over-subscription privilege by such beneficial owner and that such beneficial owner’s subscription was exercised in full. Nominee holder over-subscription forms and beneficial owner certification forms will be

distributed to banks, broker-dealers, trustees and other nominee holders of Rights with the Subscription Certificates. [Nominees should also notify holders purchasing Rights in the secondary market that such Rights may not participate in the over-subscription privilege.]

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The Fund will not otherwise offer or sell any Common Shares that are not subscribed for pursuant to the primary subscription, the primary over-subscription privilege or the secondary over-subscription privilege pursuant to the Rights offering.]

### **Sales by Rights Agent**

Holders of Rights who are unable or do not wish to exercise any or all of their Rights may instruct the Rights Agent to sell any unexercised Rights. The Subscription Certificates representing the Rights to be sold by the Rights Agent must be received prior to [5:00 PM, Eastern Time], on [ ], 2018, five Business Days prior to the Expiration Date (or, if the subscription period is extended, prior to [5:00 PM, Eastern Time], on the fifth Business Day prior to the extended Expiration Date). Upon the timely receipt of the appropriate instructions to sell Rights, the Rights Agent will use its best efforts to complete the sale and will remit the proceeds of sale, net of any commissions, to the holders. The Rights Agent will also attempt to sell any Rights attributable to shareholders of record whose addresses are outside the United States, or who have an APO or FPO address. The selling Rights holder will pay all brokerage commissions incurred by the Rights Agent. These sales may be effected by the Rights Agent. The Rights Agent will automatically attempt to sell any unexercised Rights that remain unclaimed as a result of Subscription Certificates being returned by the postal authorities as undeliverable as of the [ ] Business Day prior to the Expiration Date. These sales will be made net of commissions, taxes and any other expenses paid on behalf of the nonclaiming holders of Rights. Proceeds from those sales will be held by American Stock Transfer & Trust Company, LLC in its capacity as the Fund's transfer agent, for the account of the nonclaiming holder of Rights until the proceeds are either claimed or escheated. There can be no assurance that the Rights Agent will be able to complete the sale of any of these Rights and neither the Fund nor the Rights Agent has guaranteed any minimum sales price for the Rights. All of these Rights will be sold at the market price, if any, through an exchange or market trading the Rights. If the Rights can be sold, sales of the Rights will be deemed to have been effected at the weighted average price received by the Rights Agent on the day such Rights are sold, less any applicable brokerage commissions, taxes and other expenses.

### **[Dealer Manager**

[ ] (the "Dealer Manager"), a registered broker-dealer, may also act on behalf of its clients to purchase or sell Rights in the open market and be compensated for its services at a commission of up to \$[ ] per Right, provided that, if the Rights trade at a value of \$0.01 or less at the time of such sale, then no commission will be charged. Holders of Rights attempting to sell any unexercised Rights in the open market through a broker-dealer other than the Dealer Manager should consider the commissions and fees charged by the broker-dealer prior to selling their Rights on the open market.]

### **Sale of Rights**

The Rights are transferable and will be admitted for trading on the [ ] under the symbol "[ ]." Although no assurance can be given that a market for the Rights will develop, trading in the Rights on the [ ] is expected to being two Business Days prior to the Record Date and may be conducted until the close of trading on the last [ ] trading day prior to the Expiration Date.

The value of the Rights, if any, will be reflected by the market price. Rights may be sold by individual holders or may be submitted to the Rights Agent for sale. Any Rights submitted to the Rights Agent for sale must be received by the Rights Agent prior to [5:00 PM, Eastern Time], on [ ], 2018, five Business Days prior to the Expiration Date (or, if the subscription period is extended, prior to [5:00 PM, Eastern Time], on the [ ] Business Day prior to the extended Expiration Date).

[Rights that are sold will not confer any right to acquire any Common Shares in any primary over-subscription privilege or secondary over-subscription privilege, if any, and any Record Date Shareholder who sells any Rights will not be eligible to participate in the primary over-subscription privilege or secondary over-subscription privilege, if any.]

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Trading of the Rights on the [ ] will be conducted on a when-issued basis until and including the date on which the Subscription Certificates (as defined below) are mailed to Record Date Shareholders of record and thereafter will be conducted on a regular-way basis until and including the last [ ] trading day prior to the Expiration Date. The Common Shares are expected to begin trading ex-Rights one Business Day prior to the Record Date.

Shareholders are urged to obtain a recent trading price for the Rights on the [ ] from their broker, bank, financial advisor or the financial press.

### **Method of Transferring Rights**

The Rights evidenced by a single Subscription Certificate may be transferred in whole by endorsing the Subscription Certificate for transfer in accordance with the accompanying instructions. A portion of the Rights evidenced by a single Subscription Certificate (but not fractional Rights) may be transferred by delivering to the Rights Agent a Subscription Certificate properly endorsed for transfer, with instructions to register the portion of the Rights evidenced thereby in the name of the transferee (and to issue a new Subscription Certificate to the transferee evidencing the transferred Rights). In this event, a new Subscription Certificate evidencing the balance of the Rights will be issued to the Rights holder or, if the Rights holder so instructs, to an additional transferee.

Holders wishing to transfer all or a portion of their Rights (but not fractional Rights) should promptly transfer such Rights to ensure that: (i) the transfer instructions will be received and processed by the Rights Agent, (ii) a new Subscription Certificate will be issued and transmitted to the transferee or transferees with respect to transferred Rights, and to the holder with respect to retained Rights, if any, and (iii) the Rights evidenced by the new Subscription Certificates may be exercised or sold by the recipients thereof prior to the Expiration Date. Neither the Fund nor the Rights Agent shall have any liability to a transferee or holder of Rights if Subscription Certificates are not received in time for exercise or sale prior to the Expiration Date.

Except for the fees charged by the Rights Agent (which will be paid by the Fund as described below), all commissions, fees and other expenses (including brokerage commissions and transfer taxes) incurred in connection with the purchase, sale, transfer or exercise of Rights will be for the account of the holder of the Rights, and none of these commissions, fees or expenses will be borne by the Fund or the Rights Agent.

The Fund anticipates that the Rights will be eligible for transfer through, and that the exercise of the Rights may be effected through, the facilities of DTC (Rights exercised through DTC are referred to as "DTC Exercised Rights").

### **Rights Agent**

The Rights Agent is [ ]. The Rights Agent will receive from the Fund an amount estimated to be \$[ ], comprised of the fee for its services and the reimbursement for certain expenses related to the Rights offering. The shareholders of the Fund will indirectly pay such amount.

### **Information Agent**

INQUIRIES BY ALL HOLDERS OF RIGHTS SHOULD BE DIRECTED TO: THE INFORMATION AGENT, [ ]; HOLDERS PLEASE CALL TOLL-FREE AT [ ]; BANKS AND BROKERS PLEASE CALL [ ].

### **Method of Exercise of Rights**

Rights may be exercised by completing and signing the Subscription Certificate and mailing it in the envelope provided, or otherwise delivering the completed and signed Subscription Certificate to the Rights Agent, together with

payment for the Common Shares as described below under “Payment for Shares.” Rights may also be exercised through the broker of a holder of Rights, who may charge the holder of Rights a servicing fee in connection with such exercise.

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Completed Subscription Certificates and payment must be received by the Rights Agent prior to [5:00 PM Eastern Time], on the Expiration Date (unless payment is effected by means of a notice of guaranteed delivery as described below under “Payment for Shares”). Your broker, bank, trust company or other intermediary may impose a deadline for exercising Rights earlier than [5:00 PM, Eastern Time], on the Expiration Date. The Subscription Certificate and payment should be delivered to the Rights Agent at the following address:

If By Mail:

Franklin Limited Duration Income Trust

[ ]

If By Overnight Courier:

Franklin Limited Duration Income Trust

[ ]

### **Payment for Shares**

Holders of Rights who acquire Common Shares in the Rights offering may choose between the following methods of payment:

(1) A holder of Rights can send the Subscription Certificate, together with payment in the form of a check (which must include the name of the shareholder on the check) for the Common Shares subscribed for in the Rights offering and, if eligible, for any additional Common Shares subscribed for pursuant to the over-subscription privilege, to the Rights Agent based on the Subscription Price. To be accepted, the payment, together with the executed Subscription Certificate, must be received by the Rights Agent at one of the addresses noted above prior to [5:00 PM Eastern Time] on the Expiration Date. The Rights Agent will deposit all share purchase checks received by it prior to the final due date into a segregated account pending proration and distribution of Common Shares. The Rights Agent will not accept cash as a means of payment for Common Shares.

(2) Alternatively, a subscription will be accepted by the Rights Agent if, prior to [5:00 PM Eastern Time] on the Expiration Date, the Rights Agent has received a written notice of guaranteed delivery by mail or email from a bank, trust company, or a NYSE American member, guaranteeing delivery of a properly completed and executed Subscription Certificate. In order for the notice of guarantee to be valid, full payment for the Common Shares at the Subscription Price must be received with the notice. The Rights Agent will not honor a notice of guaranteed delivery unless a properly completed and executed Subscription Certificate is received by the Rights Agent by the close of business on the [second] Business Day after the Expiration Date. The notice of guaranteed delivery must be emailed to the Rights Agent at [ ] or delivered to the Rights Agent at one of the addresses noted above.

**A PAYMENT PURSUANT TO THIS METHOD MUST BE IN UNITED STATES DOLLARS BY CHECK (WHICH MUST INCLUDE THE NAME OF THE SHAREHOLDER ON THE CHECK) DRAWN ON A BANK LOCATED IN THE CONTINENTAL UNITED STATES, MUST BE PAYABLE TO THE FRANKLIN LIMITED DURATION INCOME TRUST AND MUST ACCOMPANY AN EXECUTED SUBSCRIPTION CERTIFICATE TO BE ACCEPTED.**

If a holder of Rights who acquires Common Shares pursuant to the Rights offering does not make payment of all amounts due, the Fund reserves the right to take any or all of the following actions: (i) find other purchasers for such

subscribed-for and unpaid-for Common Shares; (ii) apply any payment actually received by it toward the purchase of the greatest whole number of Common Shares which could be acquired by such holder upon exercise of the Rights or any over-subscription privilege; (iii) sell all or a portion of the Common Shares purchased by the holder, in the open market, and apply the proceeds to the amounts owed; and (iv) exercise any and all other rights or remedies to which it may be entitled, including, without limitation, the right to set off against payments actually received by it with respect to such subscribed Common Shares and to enforce the relevant guarantee of payment.

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Any payment required from a holder of Rights must be received by the Rights Agent prior to [5:00 PM Eastern Time] on the Expiration Date. Issuance and delivery of the Common Shares purchased are subject to collection of checks.

Within [ ] Business Days following the Expiration Date (the “Confirmation Date”), a confirmation will be sent by the Rights Agent to each holder of Rights (or, if the Common Shares are held by Cede or any other depository or nominee, to Cede or such other depository or nominee), showing (i) the number of Common Shares acquired pursuant to the Subscription, (ii) the number of Common Shares, if any, acquired pursuant to the over-subscription privilege, and (iii) the per share and total purchase price for the Common Shares. Any payment required from a holder of Rights must be received by the Rights Agent on or prior to the Expiration Date. Any excess payment to be refunded by the Fund to a holder of Rights, or to be paid to a holder of Rights as a result of sales of Rights on its behalf by the Rights Agent, will be mailed by the Rights Agent to the holder within [ ] Business Days after the Expiration Date.

A holder of Rights will have no right to rescind a purchase after the Rights Agent has received payment either by means of a notice of guaranteed delivery or a check, which must include the name of the shareholder on the check.

Upon acceptance of a subscription, all funds received by the Rights Agent shall be held by the Rights Agent as agent for the Fund and deposited in one or more bank accounts. Such funds may be invested by the Rights Agent in: bank accounts, short term certificates of deposit, bank repurchase agreements, and disbursement accounts with commercial banks meeting certain standards. The Rights Agent may receive interest, dividends or other earnings in connection with such deposits or investments.

Holders, such as broker-dealers, trustees or depositories for securities, who hold Common Shares for the account of others, should notify the respective beneficial owners of the Common Shares as soon as possible to ascertain such beneficial owners’ intentions and to obtain instructions with respect to the Rights. If the beneficial owner so instructs, the record holder of the Rights should complete Subscription Certificates and submit them to the Rights Agent with the proper payment. In addition, beneficial owners of Common Shares or Rights held through such a holder should contact the holder and request that the holder effect transactions in accordance with the beneficial owner’s instructions. **[Banks, broker-dealers, trustees and other nominee holders that hold Common Shares of the Fund for the accounts of others are advised to notify those persons that purchase Rights in the secondary market that such Rights may not participate in any over-subscription privilege offered.]**

THE INSTRUCTIONS ACCOMPANYING THE SUBSCRIPTION CERTIFICATES SHOULD BE READ CAREFULLY AND FOLLOWED IN DETAIL. DO NOT SEND SUBSCRIPTION CERTIFICATES TO THE FUND.

THE METHOD OF DELIVERY OF SUBSCRIPTION CERTIFICATES AND PAYMENT OF THE SUBSCRIPTION PRICE TO THE RIGHTS AGENT WILL BE AT THE ELECTION AND RISK OF THE RIGHTS HOLDERS, BUT IF SENT BY MAIL IT IS RECOMMENDED THAT THE CERTIFICATES AND PAYMENTS BE SENT BY REGISTERED MAIL, PROPERLY INSURED, WITH RETURN RECEIPT REQUESTED, AND THAT A SUFFICIENT NUMBER OF DAYS BE ALLOWED TO ENSURE DELIVERY TO THE RIGHTS AGENT AND CLEARANCE OF PAYMENT PRIOR TO [5:00 PM EASTERN TIME], ON THE EXPIRATION DATE. BECAUSE UNCERTIFIED PERSONAL CHECKS MAY TAKE AT LEAST FIVE BUSINESS DAYS TO CLEAR, YOU ARE STRONGLY URGED TO PAY, OR ARRANGE FOR PAYMENT, BY MEANS OF A CERTIFIED OR CASHIER’S CHECK, WHICH MUST INCLUDE THE NAME OF THE SHAREHOLDER ON THE CHECK.

All questions concerning the timeliness, validity, form and eligibility of any exercise of Rights will be determined by the Fund, whose determinations will be final and binding. The Fund in its sole discretion may waive any defect or irregularity, or permit a defect or irregularity to be corrected within such time as it may determine, or reject the

purported exercise of any Right. Subscriptions will not be deemed to have been received or accepted until all irregularities have been waived or cured within such time as the Fund determines in its sole discretion. Neither the Fund nor the Rights Agent will be under any duty to give notification of any defect or irregularity in connection with the submission of Subscription Certificates or incur any liability for failure to give such notification.

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## **Foreign Restrictions**

Subscription Certificates will only be mailed to Record Date Shareholders of record whose addresses are within the United States (other than an APO or FPO address). Because the Rights offering will not be registered in any jurisdiction other than the United States, the Rights Agent will attempt to sell all of the Rights issued to shareholders of record outside of these jurisdictions and remit the net proceeds, if any, to such shareholders of record. If the Rights can be sold, sales of these Rights will be deemed to have been effected at the weighted average price received by the Rights Agent on the day the Rights are sold, less any applicable brokerage commissions, taxes and other expenses.

## **Notice of Net Asset Value Decline**

The Fund has, pursuant to the SEC's regulatory requirements, undertaken to suspend the Rights offering until the Fund amends this Prospectus Supplement if, after [ ], 2018 (the date of this Prospectus Supplement), the Fund's net asset value declines more than 10% from the Fund's net asset value as of that date. In that event, the Expiration Date will be extended and the Fund will notify Record Date Shareholders of record of any such decline and permit Rights holders to cancel their exercise of Rights.

## **Employee Benefit Plan and IRA Considerations**

Holders of Rights that are employee benefit plans subject to limitations imposed by the Internal Revenue Code of 1986, as amended (the "Code"), such as employee plans subject to the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), Keogh Plans and Individual Retirement Accounts ("IRA") (each a "Benefit Plan" and collectively, "Benefit Plans"), should be aware that the use of additional contributions of cash outside of the Benefit Plan to exercise Rights may be treated as additional contributions to the Benefit Plan. When taken together with contributions previously made, such deemed additional contributions may be in excess of tax limitations and subject the Rights holder to excise taxes for excess or nondeductible contributions. In the case of Benefit Plans qualified under Section 401(a) of the Code, additional contributions could cause the maximum contribution limitations of Section 415 of the Code or other qualification rules to be violated. Benefit Plans contemplating making additional contributions to exercise Rights should consult with their legal and tax counsel prior to making such contributions.

Benefit Plans and other tax exempt entities, including governmental plans, should also be aware that if they borrow to finance their exercise of Rights, they may become subject to the tax on unrelated business taxable income ("UBTI") under Section 511 of the Code. If any portion of an IRA is used as security for a loan, the portion so used may also be treated as distributed to the IRA depositor.

A Benefit Plan may also be subject to laws, such as ERISA, that impose certain requirements on the Benefit Plan and on those persons who are fiduciaries with respect to the Benefit Plans. Such requirements may include prudence and diversification requirements and require that investments be made in accordance with the documents governing the Benefit Plan. The exercise of Rights by a fiduciary for a Benefit Plan should be considered in light of such fiduciary requirements.

In addition, ERISA and the Code prohibit certain transactions involving the assets of a Benefit Plan and certain persons (referred to as "parties in interest" for purposes of ERISA and "disqualified persons" for purposes of the Code) having certain relationships to such Benefit Plans, unless a statutory or administrative exemption is applicable to the transaction. A party in interest or disqualified person who engages in a nonexempt prohibited transaction may be subject to excise taxes and other penalties and liabilities under ERISA and the Code (or with respect to certain Benefit Plans, such as IRAs, a prohibited transaction may cause the Benefit Plan to lose its tax- exempt status). In this regard, the U.S. Department of Labor has issued prohibited transaction class exemptions ("PTCEs") that may apply to the exercise of the Rights and holding of the Common Shares. These class exemptions include, without limitation, PTCE

84-14 respecting transactions determined by independent qualified professional asset managers, PTCE 90-1 respecting insurance company pooled separate accounts, PTCE 91-38 respecting bank collective investment funds, PTCE 95-60 respecting life insurance company general accounts and PTCE 96-23 respecting transactions determined by in-house asset managers, PTCE 84-24 governing purchases of shares in investment companies) and PTCE 75-1 respecting sales of securities. In addition, Section 408(b)(17) of ERISA and Section 4975(d)(20) of the Code each provides a limited exemption, commonly referred to as the “service provider exemption,” from the prohibited transaction provisions of ERISA and Section 4975 of the Code for certain transactions between a Benefit Plan and a person that is a party in interest and/or a disqualified person (other than a fiduciary or an affiliate that, directly or indirectly, has or exercises any discretionary authority or control or renders any investment advice with respect to the assets of any Benefit Plan involved in the transaction) solely by reason of providing services to the Benefit Plan or by relationship to a service provider, provided that the Benefit Plan receives no less, nor pays no more, than adequate consideration. There can be no assurance that all of the conditions of any such exemptions or any other exemption will be satisfied at the time that the Rights are exercised, or thereafter while the Common Shares are held, if the facts relied upon for using a prohibited transaction exemption change.



In addition, the person making the decision to exercise the Rights on behalf of a Benefit Plan (the “Benefit Plan Fiduciary”) will be deemed to have represented and warranted that (1) neither the Investment Manager nor the Dealer Manager has provided or will provide advice with respect to the exercise of the Rights by the Benefit Plan, other than to the Benefit Plan Fiduciary which is independent of the Investment Manager and the Dealer Manager, and the Benefit Plan Fiduciary either: (a) is a bank as defined in Section 202 of the Investment Advisers Act of 1940 (the “Advisers Act”), or similar institution that is regulated and supervised and subject to periodic examination by a state or federal agency; (b) is an insurance carrier which is qualified under the laws of more than one state to perform the services of managing, acquiring or disposing of assets of a Plan; (c) is an investment adviser registered under the Advisers Act, or, if not registered as an investment adviser under the Advisers Act by reason of Section 203A(a)(1) of the Advisers Act, is registered as an investment adviser under the laws of the state in which it maintains its principal office and place of business; (d) is a broker-dealer registered under the Securities Exchange Act of 1934; or (e) has total assets of at least U.S. \$50,000,000 under its management or control (provided that this clause (e) shall not be satisfied if the Benefit Plan Fiduciary is either (i) the owner or a relative of the owner of the individual retirement account that is exercising the Right, or (ii) a participant or beneficiary of the Benefit Plan exercising the Right in such capacity); (2) the Benefit Plan Fiduciary is capable of evaluating investment risks independently, both in general and with respect to particular transactions and investment strategies, including the exercise of the Right by the Benefit Plan; (3) the Benefit Plan Fiduciary is a “fiduciary” with respect to the Benefit Plan within the meaning of Section 3(21) of ERISA, Section 4975 of the Code, or both, and is responsible for exercising independent judgment in evaluating the Benefit Plan’s exercise of the Right; (4) neither the Investment Manager nor the Dealer Manager have exercised any authority to cause the Benefit Plan to exercise the Right or to negotiate the terms of such acquisition; (5) neither the Investment Manager nor the Dealer Manager receives a fee or other compensation from the Benefit Plan or the Plan Fiduciary in connection with the exercise of the Right; and (6) the Benefit Plan Fiduciary has been informed by the Investment Manager and the Dealer Manager: (a) (i) that neither the Investment Manager nor the Dealer Manager is undertaking to provide impartial investment advice or to give advice in a fiduciary capacity, and (ii) that neither entity has given investment advice or otherwise made a recommendation, in connection with the Benefit Plan’s exercising of the Right; and (b) of the existence and nature of the Investment Manager and Dealer Manager’s financial interests in the Benefit Plan’s exercise of the Right. The above representations are intended to comply with the Department of Labor’s Reg. Sections 29 C.F.R. 2510.3-21(a) and (c)(1) as promulgated on April 8, 2016 (81 Fed. Reg. 20,997). If these regulations are vacated, revoked, repealed or no longer effective, these representations (other than clauses 4 and 6(a)) shall be deemed to be no longer in effect.

Due to the complexity of these rules and the penalties for noncompliance, fiduciaries of Benefit Plans, including the Benefit Plan Fiduciary, should consult with their legal and tax counsel regarding the consequences of their exercise of Rights under ERISA, the Code and other similar laws.

**TABLE OF FEES AND EXPENSES**

The following tables are intended to assist you in understanding the various costs and expenses directly or indirectly associated with investing in our Common Shares as a percentage of net assets attributable to Common Shares. Amounts are for the current fiscal year after giving effect to anticipated net proceeds of the Rights offering, assuming that we incur the estimated offering expenses.

**Shareholder Transaction Expenses**

Record Date Sales Load (as a percentage of offering price)	[ ]%
Offering Expenses (as a percentage of offering price) <sup>(1)</sup>	[ ]%
Dividend Reinvestment Plan Fees <sup>(2)</sup>	None

**Annual Operating Expenses**

	<b>Percentage of Managed Assets Attributable to Common Shares</b>
Management Fees <sup>(3)</sup>	[ ]%
Other Expenses <sup>(4)</sup>	[ ]%
Total Annual Fund Operating Expenses	[ ]%

(1) Fund shareholders will pay all offering expenses involved with this offering.

(2) You will pay brokerage charges if you direct the plan agent to sell your Common Shares held in a dividend reinvestment account.

(3) The Investment Manager is entitled to receive an investment management fee of 0.70% per year of the Fund's average daily managed assets. Managed assets are defined as the Fund's gross asset value minus the sum of accrued liabilities, other than the liquidation value of the preferred shares and other financial leverage. If a Fund uses leverage, the amount of fees paid to the Investment Manager for investment management services will be higher than if the Fund does not use leverage because the fees paid are calculated on the Fund's managed assets, which include assets purchased with leverage. The management fee for the Fund reflects the leverage used by the Fund as of its December 31, 2017 fiscal year end.

(4) "Other Expenses" have been estimated assuming the completion of the proposed issuance.

The purpose of the table above and the examples below is to help you understand all fees and expenses that you, as a holder of Common Shares, would bear directly or indirectly.

**Example**

The following example illustrates the expenses you would pay on a \$1,000 investment in Common Shares, assuming a 5% annual portfolio total return.\*

	<b>1 Year</b>	<b>3 Years</b>	<b>5 Years</b>	<b>10 Years</b>
Total Expenses Incurred	\$[ ]	\$[ ]	\$[ ]	\$[ ]

\* The example should not be considered a representation of future expenses. The example assumes that the amounts set forth in the Table of Fees and Expenses table are accurate and that all distributions are reinvested at net asset value. Actual expenses may be greater or less than those assumed. Moreover, the Fund's actual rate of return may be greater or less than the hypothetical 5% return shown in the example.

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## USE OF PROCEEDS

The Fund estimates the net proceeds of the Rights offering to be approximately \$[ ], based on the estimated Subscription Price per Common Share of \$[ ] ([ ]% of the last reported sales price of the Fund's Common Shares on the NYSE American on [ ], 2018), assuming all new Common Shares offered are sold and that the expenses related to the Rights offering estimated at approximately \$[ ] are paid.

The Investment Manager expects that it will initially invest the proceeds of the offering in high quality short term debt securities and instruments. The Investment Manager anticipates that the investment of the proceeds will be made in accordance with the Fund's investment objectives and policies as appropriate investment opportunities are identified, which is expected to be substantially completed within three months; however, the identification of appropriate investment opportunities pursuant to the Fund's investment style or changes in market conditions may cause the investment period to extend as long as six months. Depending on market conditions and operations, a portion of the cash held by the Fund, including any proceeds raised from the Rights offering, may be used to pay distributions in accordance with the Fund's distribution policy and may be a return of capital. A return of capital is a return to investors of a portion of their original investment in the Fund. In general terms, a return of capital would involve a situation in which a Fund distribution (or a portion thereof) represents a return of a portion of a shareholder's investment in the Fund, rather than making a distribution that is funded from the Fund's earned income or other profits. Although return of capital distributions may not be currently taxable, such distributions would decrease the basis of a shareholder's shares, and therefore, may increase a shareholder's tax liability for capital gains upon a sale of shares, even if sold at a loss to the shareholder's original investments.

## CAPITALIZATION

The following table sets forth the unaudited capitalization of the Fund as of [ ], 2018 and its adjusted capitalization assuming the Common Shares available in the Rights offering discussed in this Prospectus Supplement had been issued.

[To be provided.]

## PRICE RANGE OF COMMON SHARES

The following table sets forth for the quarters indicated, the high and low sale prices on the NYSE American per share of our Common Shares and the net asset value and the premium or discount from net asset value per share at which the Common Shares were trading, expressed as a percentage of net asset value, at each of the high and low sale prices provided.

During Quarter Ended	NAV per Common Share on Date of Market Price <sup>(1)</sup>		NYSE American Market Price per Common Share <sup>(2)</sup>		Premium/(Discount) on Date of Market Price <sup>(3)</sup>		Trading Volume
	High	Low	High	Low	High	Low	
March 31, 2016	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
June 30, 2016	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
September 30, 2016	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
December 31, 2016	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
March 31, 2017	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
June 30, 2017	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
September 30, 2017	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
December 31, 2017	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
March 31, 2018	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
April 1, 2018 through [ ], 2018	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]

(1) Based on the Fund's computations.

(2) Source: NYSE American.

(3) Based on the Fund's computations.

(4) Source: Bloomberg.

On [ ], 2018, the last reported net asset value per Common Share was \$[ ] and the last reported sales price per Common Share on the NYSE American was \$[ ].

## SPECIAL CHARACTERISTICS AND RISKS OF THE RIGHTS OFFERING

Risk is inherent in all investing. Therefore, before investing in the Common Shares you should consider the risks associated with such an investment carefully. See "Risks and Special Considerations" in the Prospectus. The following summarizes some of the matters that you should consider before investing in the Fund through the Rights offering:

*Dilution.* Record Date Shareholders who do not exercise their Rights may, at the completion of the Subscription Period, own a smaller proportional interest in the Fund than if they exercised their Rights. As a result of the Rights offering, you may experience dilution in net asset value per share if the subscription price is below the net asset value per share as of the Expiration Date. If the Subscription Price per share is below the net asset value per Common Share of the Fund as of the Expiration Date, you will experience an immediate dilution of the aggregate net asset value of your shares if you do not participate in the Rights offering and you will experience a reduction in the net asset value per share of your shares whether or not you participate in the Rights offering. Such dilution is not currently determinable because it is not known how many Common Shares will be subscribed for or what the net asset value or market price of the Common Shares will be on the Expiration Date.

If you do not exercise all of your Rights, you may own a smaller proportional interest in the Fund when the Rights offering is over. In addition, you will experience an immediate dilution of the aggregate net asset value per Common Share if you do not participate in the Rights offering and will experience a reduction in the net asset value per Common Share whether or not you exercise your Rights, if the Subscription Price is below the Fund's net asset value per Common Share on the Expiration Date, because:

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- the offered Common Shares are being sold at less than their current net asset value;
- you will indirectly bear the expenses of the Rights offering; and
- the number of Common Shares outstanding after the Rights offering will have increased proportionately more than the increase in the amount of the Fund's net assets.

On the other hand, if the Subscription Price is above the Fund's net asset value per Common Share on the Expiration Date, you may experience an immediate accretion of the aggregate net asset value per share of your Common Shares even if you do not exercise your Rights and an immediate increase in the net asset value per Common Share whether or not you participate in the Rights offering, because:

- the offered Common Shares are being sold at more than their current net asset value after deducting the expenses of the Rights offering; and
- the number of Common Shares outstanding after the Rights offering will have increased proportionately less than the increase in the amount of the Fund's net assets.

[Furthermore, if you do not participate in the secondary over-subscription, if it is available, your percentage ownership will also be diluted.] The Fund cannot state precisely the amount of any dilution because it is not known at this time what the net asset value per Common Share will be on the Expiration Date or what proportion of the Rights will be exercised. The impact of the Rights offering on net asset value per Common Share is shown by the following examples, assuming the Rights offering is fully subscribed and a \$[ ] Subscription Price:

**Scenario 1: (assumes net asset value per share is above subscription price)<sup>(1)</sup>**

NAV	[ ]
Subscription Price	[ ]
Reduction in NAV (\$) <sup>(2)</sup>	[ ]
Reduction in NAV (%)	[ ]

**[Scenario 2: (assumes net asset value per share is below subscription price)<sup>(1)</sup>**

NAV	[ ]
Subscription Price	[ ]
Increase in NAV (\$) <sup>(2)</sup>	[ ]
Increase in NAV (%)	[ ]

(1) Both examples assume the full Primary Subscription [and Secondary Over-Subscription Privilege] are exercised. Actual amounts may vary due to rounding.

(2) Assumes \$[ ] in estimated offering expenses.

If you do not wish to exercise your Rights, you should consider selling them as set forth in this Prospectus Supplement. Any cash you receive from selling your Rights may serve as partial compensation for any possible

dilution of your interest in the Fund. The Fund cannot give assurance, however, that a market for the Rights will develop or that the Rights will have any marketable value.

[The Fund's largest shareholders could increase their percentage ownership in the Fund through the exercise of the primary subscription and over-subscription privilege.]

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*Leverage.* Leverage creates a greater risk of loss, as well as a potential for more gain, for the Common Shares than if leverage were not used. Following the completion of the Rights offering, the Fund's amount of leverage outstanding will decrease. The leverage of the Fund as of [ ], 2018 was approximately [ ]% of the Fund's managed assets. After the completion of the Rights offering, the amount of leverage outstanding is expected to decrease to approximately [ ]% of the Fund's managed assets. The use of leverage for investment purposes creates opportunities for greater total returns but at the same time increases risk. When leverage is employed, the net asset value and market price of the Common Shares and the yield to holders of Common Shares may be more volatile. Any investment income or gains earned with respect to the amounts borrowed in excess of the interest due on the borrowing will augment the Fund's income. Conversely, if the investment performance with respect to the amounts borrowed fails to cover the interest on such borrowings, the value of the Fund's Common Shares may decrease more quickly than would otherwise be the case, and distributions on the Common Shares could be reduced or eliminated. Interest payments and fees incurred in connection with such borrowings will reduce the amount of net income available for distribution to holders of the Common Shares.

Because the fee paid to the Investment Manager is calculated on the basis of the Fund's Managed Assets, which include the proceeds of leverage, the dollar amount of the management fee paid by the Fund to the Investment Manager will be higher (and the Investment Manager will be benefited to that extent) when leverage is used. The Investment Manager will use leverage only if it believes such action would result in a net benefit to the Fund's shareholders after taking into account the higher fees and expenses associated with leverage (including higher management fees).

The Fund's leveraging strategy may not be successful.

*Increase in Share Price Volatility; Decrease in Share Price.* The Rights offering may result in an increase in trading of the Common Shares, which may increase volatility in the market price of the Common Shares. The Rights offering may result in an increase in the number of shareholders wishing to sell their Common Shares, which would exert downward price pressure on the price of Common Shares.

*Under-Subscription.* It is possible that the Rights offering will not be fully subscribed. Under-subscription of the Rights offering would have an impact on the net proceeds of the Rights offering and whether the Fund achieves any benefits.

## **TAXATION**

The following is a general summary of the U.S. federal income tax consequences of the Rights offering to Record Date Shareholders who are U.S. persons for U.S. federal income tax purposes. The following summary supplements the discussion set forth in the accompanying Prospectus and SAI and is subject to the qualifications and assumptions set forth therein. The discussion set forth herein does not constitute tax advice and potential investors are urged to consult their own tax advisers to determine the tax consequences of investing in the Fund.

Please refer to the "Taxation" section in the Fund's Prospectus and SAI for a description of the consequences of investing in the Common Shares of the Fund. Special tax considerations relating to this Rights offering are summarized below:

- The value of a Right will not be includible in the income of a Common Shareholder at the time the Right is issued.
- The basis of a Right issued to a Common Shareholder will be zero, and the basis of the Common Share with respect to which the Right was issued (the "Old Common Share") will not change, unless either the fair market value of the Right on the date of distribution is at least 15% of the fair market value of the Old Common Share, or such

Common Shareholder affirmatively elects (in the manner set out in Treasury Regulations under the Code) to allocate to the Right a portion of the basis of the Old Common Share. If the basis of a Right or Old Common Share changes, such Common Shareholder must allocate basis between the Old Common Share and the Right in proportion to their fair market values on the date of distribution.

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- The basis of a Right purchased will generally be its purchase price.
- A Common Shareholder's holding period in a Right issued includes the holding period of the Old Common Share.
- A Common Shareholder will not recognize a loss if a Right distributed to such Common Shareholder expires unexercised because the basis of the Old Common Share may be allocated to a Right only if the Right is exercised. If a Right that has been purchased in the market expires unexercised, there will be a recognized loss equal to the basis of the Right.
- Any gain or loss on the sale of a Right will be a capital gain or loss if the Right is held as a capital asset (which in the case of a Right issued to Record Date Shareholders will depend on whether the Old Common Share is held as a capital asset), and will be a long term capital gain or loss if the holding period is deemed to exceed one year.
- No gain or loss will be recognized by a Common Shareholder upon the exercise of a Right, and the basis of any Common Share acquired upon exercise (the "New Common Share") will equal the sum of the basis, if any, of the Right and the subscription price for the New Common Share. The holding period for the New Common Share will begin on the date when the Right is exercised.

The foregoing is a general and brief summary of the provisions of the Code and the Treasury Regulations in effect as they directly govern the taxation of the Fund and its Common Shareholders, with respect to U.S. federal income taxation only. Other tax issues such as state and local taxation may apply. Investors are urged to consult their own tax advisors to determine the tax consequences of investing in the Fund. These provisions are subject to change by legislative or administrative action, and any such change may be retroactive.

## **PLAN OF DISTRIBUTION**

### **[Distribution Arrangements**

[ ] will act as Dealer Manager for this Rights offering. Under the terms and subject to the conditions contained in the Dealer Manager Agreement among the Dealer Manager, the Fund and the Investment Manager, the Dealer Manager will provide financial structuring and solicitation services in connection with the Rights offering and will solicit the exercise of Rights and participation in the over-subscription privilege. The Rights offering is not contingent upon any number of Rights being exercised. The Dealer Manager will also be responsible for forming and managing a group of selling broker-dealers (each a "Selling Group Member" and collectively the "Selling Group Members"), whereby each Selling Group Member will enter into a Selling Group Agreement with the Dealer Manager to solicit the exercise of Rights and to sell Common Shares purchased by the Selling Group Member from the Dealer Manager. In addition, the Dealer Manager will enter into a Soliciting Dealer Agreement with other soliciting broker-dealers (each a "Soliciting Dealer" and collectively the "Soliciting Dealers") to solicit the exercise of Rights. See "—Compensation to Dealer Manager" for a discussion of fees and other compensation to be paid to the Dealer Manager, Selling Group Members and Soliciting Dealers in connection with the Rights offering.

The Fund and the Investment Manager have each agreed to indemnify the Dealer Manager for losses arising out of certain liabilities, including liabilities under the Securities Act. The Dealer Manager Agreement also provides that the Dealer Manager will not be subject to any liability to the Fund in rendering the services contemplated by the Dealer Manager Agreement except for any act of willful misfeasance, bad faith or gross negligence of the Dealer Manager or reckless disregard by the Dealer Manager of its obligations and duties under the Dealer Manager Agreement.

[Prior to the Expiration Date, the Dealer Manager may purchase Rights in the open-market and may purchase Rights offered to it by the Subscription Agent from electing Record Date Shareholders, that remain unclaimed as a result of subscription certificates being returned by the postal authorities and/or unexercised Rights of Record Date Shareholders whose record addresses are outside the United States that are held by the Subscription Agent and for which no instructions are received. The Dealer Manager may purchase such Rights as principal or act as agent on behalf of its clients for the purchase (and resale) of such Rights. The Dealer Manager is authorized to exercise Rights it acquires prior to the expiration of the Rights offering for delivery of Common Shares prior to the expiration of the Rights offering at a subscription price equal to the greater of [ ]% of the last reported sale price of a Common Share on the NYSE American on the date of exercise or [ ]% of the last reported NAV). Prior to the Expiration Date, the Dealer Manager may independently offer for sale Common Shares it has acquired through purchasing and exercising the Rights to the public or to Selling Group Members at the offering price set by the Dealer Manager from time to time.

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Although the Dealer Manager may realize gains and losses in connection with purchases and sales of Common Shares, such offering of Common Shares is intended by the Dealer Manager to facilitate the Rights offering, and any such gains or losses are not expected to be material to the Dealer Manager. The Dealer Manager's fee for its financial structuring and soliciting services is independent of any gains or losses that may be realized by the Dealer Manager through the purchase and exercise of the Rights and the sale of Common Shares.]

In the ordinary course of their businesses, the Dealer Manager and/or its affiliates may engage in investment banking or financial transactions with the Fund, the Investment Manager and their affiliates. In addition, in the ordinary course of their businesses, the Dealer Manager and/or its affiliates may, from time to time, own securities of the Fund or its affiliates.

The principal business address of the Dealer Manager is [ ].

### **Compensation to Dealer Manager**

Pursuant to the Dealer Manager Agreement, the Fund has agreed to pay the Dealer Manager a fee for its financial structuring and solicitation services equal to [ ]% of the Subscription Price per Common Share for each Common Share issued pursuant to the exercise of Rights, including the over-subscription privilege.

The Dealer Manager will reallow to Selling Group Members in the Selling Group to be formed and managed by the Dealer Manager selling fees equal to [ ]% of the Subscription Price for each Common Share issued pursuant to the Rights offering or the over-subscription privilege as a result of their selling efforts. In addition, the Dealer Manager will reallow to Soliciting Dealers that have executed and delivered a Soliciting Dealer Agreement and have solicited the exercise of Rights, solicitation fees equal to [ ]% of the Subscription Price for each Common Share issued pursuant to the exercise of Rights as a result of their soliciting efforts, subject to a maximum fee based on the number of Common Shares held by such Soliciting Dealer through DTC on the Record Date. Fees will be paid to the broker-dealer designated on the applicable portion of the subscription certificates or, in the absence of such designation, to the Dealer Manager.

In addition, the Fund, has agreed to pay the Dealer Manager an amount up to \$[ ] as a partial reimbursement of its expenses incurred in connection with the Rights offering, including reasonable out-of-pocket fees and expenses, if any and not to exceed \$[ ], incurred by the Dealer Manager, Selling Group Members, Soliciting Dealers and other brokers, dealers and financial institutions in connection with their customary mailing and handling of materials related to the Rights offering to their customers. No other fees will be payable by the Fund or the Investment Manager to the Dealer Manager in connection with the Rights offering.

### **LEGAL MATTERS**

Certain legal matters will be passed on by Willkie Farr & Gallagher LLP, special counsel to the Fund in connection with the Rights offering, and Stradley Ronon Stevens & Young, LLP, counsel to the Fund. [Certain legal matters will be passed on by [ ] as special counsel to the Dealer Manager in connection with the Rights offering.]

### **FINANCIAL STATEMENTS**

The audited annual financial statements of the Fund are incorporated by reference into this Prospectus Supplement, the accompanying Prospectus and the Statement of Additional Information ("SAI"). Portions of the Fund's annual report other than the financial statements and related footnotes thereto are not incorporated into, and do not form a part of, this Prospectus Supplement, the accompanying Prospectus or the SAI.



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**FRANKLIN LIMITED DURATION INCOME TRUST**

**[ ] Rights for [ ] Common Shares**

**Subscription Rights to Acquire Common Shares**

**Issuable Upon Exercise of Rights to Subscribe for**

**Such Common Shares**

**PROSPECTUS SUPPLEMENT**



[ ], 2018

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**The information in this Statement of Additional Information is not complete and may be changed. The Franklin Limited Duration Income Trust may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This statement of additional information is not an offer to sell these securities and it is not soliciting an offer to buy these securities in any jurisdiction where the offer or sale is not permitted.**

**SUBJECT TO COMPLETION, DATED JUNE 14, 2018**

**Franklin Limited Duration Income Trust**

Statement of Additional Information

[ ], 2018

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The Franklin Limited Duration Income Trust, a Delaware statutory trust (the “Fund”), is a diversified, closed-end management investment company, registered with the U.S. Securities and Exchange Commission (“SEC”) under the Investment Company Act of 1940, as amended (“1940 Act”).

This Statement of Additional Information is not a prospectus, but should be read in conjunction with the Fund’s prospectus, dated [ ], 2018 (the “Prospectus”) and any related prospectus supplement. The Statement of Additional Information does not include all information that a prospective investor should consider before purchasing the Fund’s shares, and investors should obtain and read the Prospectus and any related prospectus supplement prior to purchasing such shares. Capitalized terms used but not defined in this Statement of Additional Information have the meanings ascribed to them in the Prospectus and any related prospectus supplement.

You may call (800) DIAL BEN/342-5236 to obtain, free of charge, copies of the Prospectus and any related prospectus supplement. The Fund’s Prospectus is also available on the Fund’s website at [www.franklintempleton.com](http://www.franklintempleton.com). You may also obtain a copy of the Prospectus on the SEC’s website (<http://www.sec.gov>).

No person has been authorized to give any information or to make any representations not contained in the Prospectus or any related prospectus supplement or in this Statement of Additional Information in connection with the offering made by the Prospectus and any related prospectus supplement, and, if given or made, such information or representations must not be relied upon as having been authorized by the Fund. The Prospectus and any related prospectus supplement and the Statement of Additional Information do not constitute an offering by the Fund in any jurisdiction in which such offering may not lawfully be made.

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## **THE FUND**

The Fund is a diversified, closed-end management investment company registered under the 1940 Act. The Fund was organized as a Delaware statutory trust on May 8, 2003, pursuant to the Fund's Amended and Restated Agreement and Declaration of Trust (the "Declaration"), which is governed by the laws of the State of Delaware. On June 30, 2014, the Fund changed its name from "Franklin Templeton Limited Duration Income Trust" to "Franklin Limited Duration Income Trust." The Fund's investment manager is Franklin Advisers, Inc. (the "Investment Manager").

The common shares of the Fund (the "Common Shares") are listed on the NYSE American under the symbol "FTF". As of May 31, 2018, the Fund has outstanding 22,604,126 Common Shares. As of May 31, 2018, the Fund has outstanding 1,200 Series M Auction Preferred Shares, 1,200 Series W Auction Preferred Shares and 1,200 Series F Auction Preferred Shares, each with a \$25,000 liquidation preference totaling \$90,000,000 (collectively, the "Preferred Shares"). The Preferred Shares are not listed on an exchange.

The Fund's Board of Trustees has authorized the redemption of all the Fund's outstanding Preferred Shares, which is currently anticipated to take place in August 2018. The Fund will use other forms of leverage, including by purchasing mortgage dollar rolls and/or borrowing from a financial institution, following the redemption of the Preferred Shares.

## **INVESTMENT OBJECTIVES AND POLICIES**

The investment objectives and general investment policies of the Fund are described in the Prospectus. The risks of investing in the Fund are described in the Prospectus and in this SAI; in considering such risks, you should read both of these documents carefully.

The Fund's primary investment objective is to seek high current income. Its secondary objective is to seek capital appreciation to the extent it is possible and is consistent with the Fund's primary objective. See "Investment Objectives and Strategies" in the Prospectus.

## **INVESTMENT RESTRICTIONS AND ADDITIONAL INVESTMENT INFORMATION**

### **Fundamental Investment Restrictions**

Generally, the policies and restrictions discussed in this SAI and in the Prospectus apply when the Fund makes an investment. In most cases, the Fund is not required to sell a security because circumstances change and the security no longer meets one or more of the Fund's policies or restrictions. If a percentage restriction or limitation is met at the time of investment, a later increase or decrease in the percentage due to a change in the value or liquidity of portfolio securities will not be considered a violation of the restriction or limitation.

If a bankruptcy or other extraordinary event occurs concerning a particular security the Fund owns, the Fund may receive stock, real estate, or other investments that the Fund would not, or could not, buy. If this happens, the Fund intends to sell such investments as soon as practicable while trying to maximize the return to shareholders.

The Fund has adopted certain investment restrictions as fundamental and non-fundamental policies. A fundamental policy may only be changed if the change is approved by (i) more than 50% of the Fund's outstanding shares or (ii) 67% or more of the Fund's shares present at a shareholder meeting if more than 50% of the Fund's outstanding shares are represented at the meeting in person or by proxy, whichever is less. A non-fundamental policy may be changed by the Board of Trustees without the approval of shareholders.

Except as described below, the Fund, as a fundamental policy, currently may not, without the approval of the holders of a majority of the outstanding Common Shares and, if issued, any outstanding preferred shares voting together as a single class, and, if applicable, of the holders of a majority of any outstanding preferred shares voting as a separate class:

- (1) Concentrate its investments in a particular “industry,” as that term is used in the 1940 Act and as interpreted, modified, or otherwise permitted by regulatory authority having jurisdiction, from time to time (this limitation does not apply to securities issued or guaranteed by the U.S. Government or any of its agencies or instrumentalities).
- (2) With respect to 75% of the Fund’s total assets, purchase the securities of any issuer, except securities issued or guaranteed by the U.S. Government or any of its agencies or instrumentalities or securities issued by other investment companies, if, as a result, (i) more than 5% of the Fund’s total assets would be invested in the securities of that issuer, or (ii) the Fund would hold more than 10% of the outstanding voting securities of that issuer. For the purpose of this restriction, each state and each separate political subdivision, agency, authority or instrumentality of such state, each multi-state agency or authority, and each obligor, if any, is treated as a separate issuer of municipal bonds.
- (3) Purchase or sell real estate unless acquired as a result of ownership of securities or other instruments and provided that this restriction does not prevent the Fund from investing in issuers which invest, deal, or otherwise engage in transactions in real estate or interests therein, or investing in securities that are secured by real estate or interests therein.
- (4) Purchase or sell commodities as defined in the Commodity Exchange Act, as amended, and the rules and regulations thereunder, unless acquired as a result of ownership of securities or other instruments and provided that this restriction does not prevent the Fund from engaging in transactions involving futures contracts and options thereon or investing in securities that are secured by physical commodities.
- (5) Borrow money or issue senior securities, except to the extent permitted by the 1940 Act, or any rules, exemptions or interpretations thereunder that may be adopted, granted or issued by the SEC. See “Risks and Special Considerations—Leverage Risk” in the Prospectus.
- (6) Make loans to other persons except (a) through the lending of its portfolio securities, (b) through the purchase of debt obligations, loan participations and/or engaging in direct corporate loans in accordance with its investment objectives and policies, and (c) to the extent the entry into a repurchase agreement is deemed to be a loan. The Fund may also make loans to other investment companies to the extent permitted by the 1940 Act or any exemptions therefrom which may be granted by the SEC.
- (7) Act as an underwriter except to the extent that, in connection with the disposition of portfolio securities, it may be deemed to be an underwriter under applicable securities laws.

For purposes of the foregoing, “majority of the outstanding,” when used with respect to particular shares of the Fund (whether voting together as a single class or voting as separate classes), means (i) 67% or more of such shares present at a meeting, if the holders of more than 50% of such shares are present or represented by proxy, or (ii) more than 50% of such shares, whichever is less.

The Board has approved, and has recommended that shareholders approve at the Fund’s annual shareholders’ meeting to be held on September 4, 2018, amendments to the Fund’s fundamental investment restrictions regarding: (a) borrowing, (b) underwriting, (c) lending, (d) investments in real estate, (e) investments in commodities, (f) issuing senior securities, (g) industry concentration and (h) diversification requirements. Recognizing the Fund’s emphasis on investing in debt instruments, the change to the fundamental investment restriction regarding lending would permit investments in additional forms of debt instruments, including non-corporate loans and other asset classes that may be broader or less liquid. If shareholders approve these amendments, the Fund, as a fundamental policy, would not, without the approval of the holders of a majority of the outstanding Common Shares and, if issued, any outstanding preferred shares voting together as a single class, and, if applicable, of the holders of a majority of any outstanding

preferred shares voting as a separate class:

- (1) Invest more than 25% of the Fund's net assets in securities of issuers in any one industry (other than securities issued or guaranteed by the U.S. government or any of its agencies or instrumentalities).



- (2) Purchase the securities of any one issuer (other than the U.S. government or any of its agencies or instrumentalities or securities of other investment companies, whether registered or excluded from registration under Section 3(c) of the 1940 Act) if immediately after such investment (a) more than 5% of the value of the Fund's total assets would be invested in such issuer or (b) more than 10% of the outstanding voting securities of such issuer would be owned by the Fund, except that up to 25% of the value of the Fund's total assets may be invested without regard to such 5% and 10% limitations.
- (3) Purchase or sell real estate unless acquired as a result of ownership of securities or other instruments and provided that this restriction does not prevent the Fund from (i) purchasing or selling securities or instruments secured by real estate or interests therein, securities or instruments representing interests in real estate or securities or instruments of issuers that invest, deal or otherwise engage in transactions in real estate or interests therein, and (ii) making, purchasing or selling real estate mortgage loans.
- (4) Purchase or sell commodities, except to the extent permitted by the 1940 Act or any rules, exemptions or interpretations thereunder that may be adopted, granted or issued by the SEC.
- (5) Borrow money, except to the extent permitted by the 1940 Act, or any rules, exemptions or interpretations thereunder that may be adopted, granted or issued by the SEC.
- (6) Make loans, except to the extent permitted by the 1940 Act or any rules, exemptions or interpretations thereunder that may be adopted, granted or issued by the SEC.
- (7) Act as an underwriter except to the extent the Fund may be deemed to be an underwriter when disposing of securities it owns or when selling its own shares.
- (8) Issue senior securities, except to the extent permitted by the 1940 Act or any rules, exemptions or interpretations thereunder that may be adopted, granted or issued by the SEC.

For purposes of the foregoing, "majority of the outstanding," when used with respect to particular shares of the Fund (whether voting together as a single class or voting as separate classes), means (i) 67% or more of such shares present at a meeting, if the holders of more than 50% of such shares are present or represented by proxy, or (ii) more than 50% of such shares, whichever is less.

#### **Non-Fundamental Investment Policies**

The Fund has adopted certain non-fundamental investment policies, including but not limited to the following:

- (1) The Fund may invest up to 15% of its total assets in securities (excluding swaps) which are illiquid at the time of investment (as determined by the Investment Manager) See "Illiquid Securities."

Unless otherwise indicated, all limitations applicable to the Fund's investments (as stated above and elsewhere in this SAI) apply only at the time a transaction is entered into. Any subsequent change in a rating assigned by any rating service to a security (or, if unrated, deemed by the Investment Manager to be of comparable quality), or change in the percentage of the Fund's total assets invested in certain securities or other instruments, or change in the average maturity or estimated average duration of the Fund's investment portfolio, resulting from market fluctuations or other changes in the Fund's total assets, will not require the Fund to dispose of an investment until the Investment Manager determines that it is practicable to sell or close out the investment without undue market or tax consequences to the Fund. In the event that rating agencies assign different ratings to the same security, the Investment Manager will determine which rating it believes best reflects the security's quality and risk at that time, which may be the higher of

the several assigned ratings.

Under the 1940 Act, a “senior security” does not include any promissory note or evidence of indebtedness where such loan is for temporary purposes only and in an amount not exceeding 5% of the value of the total assets of the issuer at the time the loan is made. A loan is presumed to be for temporary purposes if it is repaid within sixty days and is not extended or renewed.

The Fund would be deemed to “concentrate” in a particular industry if it invested more than 25% of its net assets in that industry. The Fund’s industry concentration policy does not preclude it from focusing investments in issuers in a group of related industrial sectors (such as different types of utilities).

The Fund may not change its duration policy, which is, under normal market conditions, to maintain an estimated average portfolio duration of between two and five years (including the effect of anticipated leverage), unless it provides 60 days’ prior notice to Common Shareholders.

To the extent the Fund covers its commitment under a reverse repurchase agreement, swap or other derivative instrument by the segregation of assets determined by the Investment Manager to be liquid and equal in value to the amount of the Fund’s commitment, such instrument will not be considered a “senior security” for purposes of the asset coverage requirements otherwise applicable to borrowings by the Fund or the Fund’s issuance of preferred shares.

The Fund interprets its policies with respect to borrowing and lending to permit such activities as may be lawful for the Fund, to the full extent permitted by the 1940 Act or by exemption from the provisions therefrom pursuant to exemptive order of the SEC.

To obtain and maintain the required ratings on any outstanding preferred shares or debt issued by the Fund, the Fund would be required to comply with investment quality, diversification and other guidelines established by a rating agency. Such guidelines are more restrictive than the restrictions set forth above. The ability of the Fund to use some of the strategies discussed in the Prospectus and in this SAI, such as derivatives, is limited by the rating agency guidelines. Rating agencies receive fees in connection with their ratings issuances.

Additional information concerning the characteristics of certain of the Fund’s investments is set forth below.

### **Debt Securities and Other Income-Producing Instruments**

A debt security typically has a fixed payment schedule that obligates the issuer to pay interest to the lender and to return the lender’s money over a certain time period. A company typically meets its payment obligations associated with its outstanding debt securities before it declares and pays any dividend to holders of its equity securities. Bonds, notes, debentures and commercial paper differ in the length of the issuer’s payment schedule, with bonds carrying the longest repayment schedule and commercial paper the shortest.

The Fund may invest in senior and subordinated debt securities. Subordinated debt is more risky because its holder will be paid only after the holders of senior debt securities are paid. The Fund may invest in “zero-coupon securities,” which are debt securities that typically pay interest only at maturity rather than periodically during the life of the security and are issued at a significant discount from their principal amount.

The Fund may buy both rated and unrated debt securities and other income-producing instruments. The Fund may invest a significant portion of its assets in investment grade debt securities. Investment grade debt securities are rated in one of the top four ratings categories by one of the nationally-recognized statistical rating organizations (“Rating Agencies”) such as Standard & Poor’s Ratings Services (“S&P”), Moody’s or Fitch.

Under normal market conditions, the Fund will invest at least [25]% of its total assets in debt securities and other income-producing instruments that are rated below investment grade. Debt securities that are rated below investment grade are sometimes called “high yield securities” or “junk bonds.” A debt security rated below the top four ratings categories by each of the Rating Agencies that cover the security, or, if unrated, are determined to be of comparable quality by the Investment Manager, will be considered below investment grade. See “High Yield Investments.”



The market value of debt securities and other income-producing instruments generally varies in response to changes in interest rates and the financial condition of each issuer. During periods of declining interest rates, the value of these investments generally increases. Conversely, during periods of rising interest rates, the value of such investments generally declines. These changes in market value will be reflected in the Fund's net asset value per share. Because market interest rates are currently near their lowest levels in many years, there is a great risk that the Fund's portfolio will decline in value.

The Fund may invest in debt securities or other income-producing instruments on which the issuer is not currently making interest payments (defaulted debt securities) or where the issuer is in bankruptcy. The Fund may buy defaulted debt securities or other instruments if, in the opinion of the Investment Manager, it appears likely that the issuer may resume interest payments or other advantageous developments appear likely in the near future. These securities may be illiquid. Under normal conditions, the Fund will not invest more than 5% of its total assets in debt securities or other obligations whose issuers are in default at the time of purchase.

An issuer of a debt security may be unable to make interest payments and repay principal. Changes in an issuer's financial strength or in a security's credit rating may affect a security's value and, thus, impact Fund performance.

### **Inflation-indexed securities**

Inflation-indexed securities are debt securities, the value of which is periodically adjusted to reflect a measure of inflation. Two structures are common for inflation-indexed securities. The U.S. Treasury and some other issuers use a structure that reflects inflation as it accrues by increasing the U.S. dollar amount of the principal originally invested. Other issuers pay out the inflation as it accrues as part of a semiannual coupon. Any amount accrued on an inflation-indexed security, regardless whether paid out as a coupon or added to the principal, is generally considered taxable income. Where the accrued amount is added to the principal and no cash income is received until maturity, the Fund may be required to sell portfolio securities that it would otherwise continue to hold in order to obtain sufficient cash to make distributions to shareholders required for U.S. tax purposes.

An investor could experience a loss of principal and income on investments in inflation-indexed securities. In a deflationary environment, the value of the principal invested in an inflation-indexed security will be adjusted downward, just as it would be adjusted upward in an inflationary environment. Because the interest on an inflation-indexed security is calculated with respect to the amount of principal which is smaller following a deflationary period, interest payments will also be reduced, just as they would be increased following an inflationary period.

In the case of U.S. Treasury inflation-indexed securities, the return of at least the original U.S. dollar amount of principal invested is guaranteed, so an investor receives the greater of its original principal or the inflation-adjusted principal. If the return of principal is not guaranteed, the investor may receive less than the amount it originally invested in an inflation-indexed security following a period of deflation. Any guarantee of principal provided by a party other than the U.S. government will increase the Fund's exposure to the credit risk of that party.

The value of inflation-indexed securities is generally expected to change in response to changes in "real" interest rates. The real interest rate is the rate of interest that would be paid in the absence of inflation. The actual rate of interest, referred to as the nominal interest rate, is equal to the real interest rate plus the rate of inflation. If inflation rises at a faster rate than nominal interest rates, real interest rates might decline, leading to an increase in value of inflation-indexed securities. In contrast, if nominal interest rates increase at a faster rate than inflation, real interest rates might rise, leading to a decrease in value of inflation-indexed securities.

While inflation-indexed securities are designed to provide some protection from long-term inflationary trends, short-term increases in inflation may lead to a decline in their value. For example, if interest rates rise due to reasons other than inflation, investors in these securities may not be protected to the extent that the increase is not reflected in the security's inflation measure. The reasons that interest rates may rise without a corresponding increase in inflation include changes in currency exchange rates and temporary shortages of credit or liquidity. When interest rates rise without a corresponding increase in inflation, the Fund's investment in inflation-indexed securities will forego the additional return that could have been earned on a floating rate debt security.

The periodic adjustment of U.S. inflation-protected debt securities is tied to the Consumer Price Index for Urban Consumers (“CPI-U”), which is calculated monthly by the U.S. Bureau of Labor Statistics. The CPI-U is an index of changes in the cost of living, made up of components such as housing, food, transportation and energy.

Inflation-protected debt securities issued by a foreign government are generally adjusted to reflect a comparable consumer inflation index, calculated by that government. There can be no assurance that the CPI-U or any foreign inflation index will accurately measure the actual rate of inflation in the prices of goods and services. Moreover, there can be no assurance that the rate of inflation in a foreign country will be correlated to the rate of inflation in the United States. To the extent that the Fund invests in inflation-indexed securities as a hedge against inflation, an imperfect hedge will result if the cost of living (as represented in the CPI-U) has a different inflation rate than the Fund’s interests in industries and sectors minimally affected by changes in the cost of living.

### **Mortgage-Related and Other Asset-Backed Securities**

Under normal market conditions, the Fund will invest at least [25]% of its assets in mortgage-backed and other asset-backed securities (unrelated to mortgage loans) that are offered to investors currently or in the future. Mortgage-related securities are interests in pools of residential or commercial mortgage loans, including mortgage loans made by savings and loan institutions, mortgage bankers, commercial banks and others. Pools of mortgage loans are assembled as securities for sale to investors by various governmental, government-related and private organizations. The value of some mortgage-related or asset-backed securities in which the Fund may invest may be particularly sensitive to changes in prevailing interest rates, and, like other debt obligations, the ability of the Fund to successfully use these instruments may depend in part upon the ability of the Investment Manager to forecast interest rates and other economic factors correctly. See “—Mortgage Pass-Through Securities” below. The Fund will not invest in interest-only or principal-only mortgage securities.

*Mortgage Pass-Through Securities.* Mortgage pass-through securities are securities representing interests in “pools” of mortgage loans secured by residential or commercial real property. Interests in pools of mortgage-related securities differ from other forms of debt obligations, which normally provide for periodic payment of interest in fixed amounts with principal payments at maturity or specified call dates. Instead, these securities provide a monthly payment which consists of both interest and principal payments. In effect, these payments are a “pass-through” of the monthly payments made by the individual borrowers on their residential or commercial mortgage loans, net of any fees paid to the issuer or guarantor of such securities. Additional payments are caused by repayments of principal resulting from the sale of the underlying property, refinancing or foreclosure, net of fees or costs which may be incurred. Some mortgage-related securities (such as securities issued by the Government National Mortgage Association (the “GNMA”)) are described as “modified pass-through.” These securities entitle the holder to receive all interest and principal payments owed on the mortgage pool, net of certain fees, at the scheduled payment dates regardless of whether or not the mortgagor actually makes the payment.

The rate of prepayments on underlying mortgages will affect the price and volatility of a mortgage-related security, and may have the effect of shortening or extending the effective maturity of the security beyond what was anticipated at the time of purchase. Early repayment of principal on some mortgage-related securities (arising from prepayments of principal due to the sale of the underlying property, refinancing, or foreclosure, net of fees and costs which may be incurred) may expose the Fund to a lower rate of return upon reinvestment of principal. Also, if a security subject to prepayment has been purchased at a premium, the value of the premium would be lost in the event of prepayment. Like other debt obligations, when interest rates rise, the value of a mortgage-related security generally will decline; however, when interest rates are declining, the value of mortgage-related securities with prepayment features may not increase as much as other debt obligations. To the extent that unanticipated rates of prepayment on underlying mortgages increase the effective maturity of a mortgage-related security, the volatility of such security can be expected to increase.

The primary issuers or guarantors of mortgage-backed securities have historically been the Government National Mortgage Association (“GNMA” or “Ginnie Mae”), the Federal National Mortgage Association (“FNMA” or “Fannie Mae”) and the Federal Home Loan Mortgage Corporation (“FHLMC” or “Freddie Mac”). Other issuers of mortgage-backed securities include commercial banks and other private lenders. Trading in mortgage-backed securities guaranteed by a governmental agency, instrumentality or sponsored enterprise may frequently take place in the to-be-announced (“TBA”) forward market. See “When-issued, delayed delivery and to-be-announced transactions” below.



Ginnie Mae is a wholly-owned United States government corporation within the Department of Housing and Urban Development. Ginnie Mae guarantees the principal and interest on securities issued by institutions approved by Ginnie Mae (such as savings and loan institutions, commercial banks and mortgage bankers). Ginnie Mae also guarantees the principal and interest on securities backed by pools of mortgages insured by the Federal Housing Administration (the “FHA”), or guaranteed by the Department of Veterans Affairs (the “VA”). Ginnie Mae’s guarantees are backed by the full faith and credit of the U.S. government. Guarantees as to the timely payment of principal and interest do not extend to the value or yield of mortgage-backed securities nor do they extend to the value of the Fund’s shares which will fluctuate daily with market conditions.

Fannie Mae is a government-sponsored corporation, but its common stock is owned by private stockholders. Fannie Mae purchases conventional (i.e., not insured or guaranteed by any government agency) residential mortgages from a list of approved seller/servicers which include state and federally chartered savings and loan associations, mutual savings banks, commercial banks and credit unions and mortgage bankers. Pass-through securities issued by Fannie Mae are guaranteed as to timely payment of principal and interest by Fannie Mae, but are not backed by the full faith and credit of the U.S. government.

Freddie Mac was created by Congress in 1970 for the purpose of increasing the availability of mortgage credit for residential housing. It is a government-sponsored corporation formerly owned by the twelve Federal Home Loan Banks but now its common stock is owned entirely by private stockholders. Freddie Mac issues Participation Certificates (“PCs”), which are pass-through securities, each representing an undivided interest in a pool of residential mortgages. Freddie Mac guarantees the timely payment of interest and ultimate collection of principal, but PCs are not backed by the full faith and credit of the U.S. government.

Although the mortgage-backed securities of Fannie Mae and Freddie Mac are not backed by the full faith and credit of the U.S. government, the Secretary of the Treasury has the authority to support Fannie Mae and Freddie Mac by purchasing limited amounts of their respective obligations. The yields on these mortgage-backed securities have historically exceeded the yields on other types of U.S. government securities with comparable maturities due largely to their prepayment risk. The U.S. government, in the past, provided financial support to Fannie Mae and Freddie Mac, but the U.S. government has no legal obligation to do so, and no assurance can be given that the U.S. government will continue to do so.

On September 6, 2008, the Federal Housing Finance Agency (“FHFA”) placed Fannie Mae and Freddie Mac into conservatorship. As the conservator, FHFA succeeded to all rights, titles, powers and privileges of Fannie Mae and Freddie Mac and of any stockholder, officer or director of Fannie Mae and Freddie Mac. FHFA selected a new chief executive officer and chairman of the board of directors for each of Fannie Mae and Freddie Mac. Also, the U.S. Treasury entered into a Senior Preferred Stock Purchase Agreement imposing various covenants that severely limit each enterprise’s operations.

Fannie Mae and Freddie Mac continue to operate as going concerns while in conservatorship and each remains liable for all of its obligations, including its guaranty obligations associated with its mortgage-backed securities. The FHFA has the power to repudiate any contract entered into by Fannie Mae and Freddie Mac prior to FHFA’s appointment as conservator or receiver, including the guaranty obligations of Fannie Mae and Freddie Mac. Accordingly, securities issued by Fannie Mae and Freddie Mac will involve a risk of non-payment of principal and interest.

Commercial banks, savings and loan institutions, private mortgage insurance companies, mortgage bankers and other secondary market issuers also create pass-through pools of conventional residential mortgage loans. Such issuers may, in addition, be the originators and/or servicers of the underlying mortgage loans as well as the guarantors of the mortgage-related securities. Pools created by such non-governmental issuers generally offer a higher rate of interest than government and government-related pools because there are no direct or indirect government or agency

guarantees of payments in such pools. However, timely payment of interest and principal of these pools may be supported by various forms of insurance or guarantees, including individual loan, title, pool and hazard insurance and letters of credit. The insurance and guarantees are issued by governmental entities, private insurers and the mortgage poolers. There can be no assurance that the private insurers or guarantors can meet their obligations under the insurance policies or guarantee arrangements. Although the market for such securities is becoming increasingly liquid, securities issued by certain private organizations may not be readily marketable. The Fund will not purchase mortgage-related securities or any other assets which in the Investment Manager's opinion are illiquid (excluding swaps) if, as a result, more than 15% of the value of the Fund's total assets (taken at market value at the time of investment) will be invested in illiquid securities.

Mortgage-related securities that are issued or guaranteed by the U.S. Government, its agencies or instrumentalities, are not subject to the Fund's industry concentration restrictions (see "Investment Restrictions and Additional Investment Information") by virtue of the exclusion from that test available to all U.S. Government securities. In the case of privately issued mortgage-related securities, the Fund takes the position that mortgage-related securities do not represent interests in any particular "industry" or group of industries. The assets underlying such securities may be represented by a portfolio of first lien residential mortgages (including both whole mortgage loans and mortgage participation interests) or portfolios of mortgage pass-through securities issued or guaranteed by GNMA, FNMA or FHLMC. Mortgage loans underlying a mortgage-related security may in turn be insured or guaranteed by the FHA or the VA. In the case of private issue mortgage-related securities whose underlying assets are neither U.S. Government securities nor U.S. Government-insured mortgages, to the extent that real properties securing such assets may be located in the same geographical region, the security may be subject to a greater risk of default than other comparable securities in the event of adverse economic, political or business developments that may affect such region and, ultimately, the ability of residential homeowners to make payments of principal and interest on the underlying mortgages.

*Commercial Mortgage-Related Securities.* The Fund may invest a significant portion of its assets in commercial mortgage-related securities issued by corporations. These are securities that represent an interest in, or are secured by, mortgage loans secured by commercial property, such as industrial and warehouse properties, office buildings, retail space and shopping malls, multifamily properties and cooperative apartments, hotels and motels, nursing homes, hospitals, and senior living centers. They may pay fixed or adjustable rates of interest. Many of the risks of investing in commercial mortgage-backed securities reflect the risks of investing in the real estate securing the underlying mortgage loans. These risks reflect the effects of local and other economic conditions on real estate markets, the ability of tenants to make loan payments, and the ability of a property to attract and retain tenants. Commercial mortgage-backed securities may be less liquid and exhibit greater price volatility than other types of mortgage- or asset-backed securities.

Commercial mortgage loans generally lack standardized terms, which may complicate their structure. Commercial properties themselves tend to be unique and difficult to value. Commercial mortgage loans tend to have shorter maturities than residential mortgage loans, and may not be fully amortizing, meaning that they may have a significant principal balance, or "balloon" payment, due on maturity. In addition, commercial properties, particularly industrial and warehouse properties, are subject to environmental risks and the burdens and costs of compliance with environmental laws and regulations.

*Other Mortgage-Related or Asset-Backed Securities.* Other mortgage-related securities in which the Fund may invest include mortgage pass-through securities, mortgage dollar rolls, and other securities that directly or indirectly represent a participation in, or are secured by and payable from, mortgage loans on real property.

The Fund may invest in securities issued by trusts and special purpose corporations with principal and interest payouts backed by, or supported by, any of various types of assets. These assets typically include receivables related to the purchase of manufactured housing, automobiles, credit card loans, and home equity loans. These securities generally take the form of a structured type of security, including pass-through, pay-through and senior subordinated payout structures.

The Fund may invest in other types of asset-backed securities that are offered in the marketplace, including Enhanced Equipment Trust Certificates ("EETCs"). Although any entity may issue EETCs, to date, U.S. airlines are the primary issuers. An airline EETC is an obligation secured directly by aircraft or aircraft engines as collateral. EETCs tend to be less liquid than bonds. Other asset-backed securities may be collateralized by the fees earned by service providers. The value of asset-backed securities may be substantially dependent on the servicing of the underlying asset pools and are therefore subject to risks associated with the negligence of, or defalcation by, their servicers. In certain

circumstances, the mishandling of related documentation may also affect the rights of the security holders in and to the underlying collateral. The insolvency of entities that generate receivables or that use the assets may result in added costs and delays in addition to losses associated with a decline in the value of the underlying assets.

Consistent with the Fund's investment objectives and policies, the Investment Manager also may invest in other types of asset-backed securities. Other asset-backed securities may be collateralized by the fees earned by service providers. The value of asset-backed securities may be substantially dependent on the servicing of the underlying asset pools and are therefore subject to risks associated with the negligence by, or defalcation of, their servicers. In certain circumstances, the mishandling of related documentation may also affect the rights of the security holders in and to the underlying collateral. The insolvency of entities that generate receivables or that use the assets may result in added costs and delays in addition to losses associated with a decline in the value of the underlying assets.

*Dollar Roll Transactions.* In a mortgage dollar roll transaction, the Fund sells mortgage-backed securities for delivery in the current month and simultaneously contracts to repurchase substantially similar (name, type, coupon, and maturity) securities on a specified future date. During the period between the sale and repurchase (the "roll period"), the Fund forgoes principal and interest paid on the mortgage-backed securities. The Fund is compensated by the difference between the current sales price and the lower forward price for the future purchase (often referred to as the "drop"), as well as by the interest earned on the cash proceeds of the initial sale. The cash received by the Fund for the sale in a dollar roll is used to purchase additional investments. The Fund then continues to engage in forward dollar roll transactions, continually "rolling" them forward as existing transactions move toward their settlement dates. The cost of borrowing associated with the mortgage dollar roll strategy is an implied rate, calculated from the difference between the lower forward settlement price at which the Fund is purchasing agency mortgage-backed securities and the higher current price at which the Fund is selling the securities.

The Fund could suffer a loss if the contracting party fails to perform the future transaction and the Fund is therefore unable to buy back the mortgage-backed securities it initially sold. The Fund intends to enter into mortgage dollar rolls only with high quality government securities dealers and member banks of the Federal Reserve System as approved by the Fund's Board of Trustees. In addition to counterparty risk, the use of dollar rolls is subject to the continued availability of these transactions at favorable rates. If mortgage dollar rolls cease to be available, have limited availability or are unavailable at favorable rates, the Fund may be unable to maintain this form of leverage and could be forced to make actual settlement on mortgage-backed securities purchased on the forward basis and possibly to seek alternative forms of borrowing. In addition, by entering into mortgage dollar rolls as a means of financing, the Fund is committed to acquiring the types of mortgage-backed securities upon which counterparties are willing to enter into mortgage dollar rolls. This could result in the Fund entering into mortgage dollar rolls for securities which the Investment Manager would not otherwise purchase for the Fund, or be required to reduce leverage through dollar rolls or find alternative forms of leverage, which may not be available at all or available on equally favorable terms.

As a matter of non-fundamental policy, the Fund considers the purchase and/or sale of a mortgage dollar roll to be a borrowing, for purposes of the Fund's investment restrictions.

### **Bank Loans and Loan Participations**

Under normal market conditions, the Fund will invest at least [25]% of its total assets bank loans made to corporate and other business entities (corporate loans). To implement that strategy, the Fund may acquire loan participations and other related direct or indirect bank debt obligations (bank loans or loan participations), in which the Fund will buy from a lender a portion of a larger loan that the lender has made to a borrower.

The rate of interest payable on corporate loans or other income-producing instruments with floating interest rates is generally established as the sum of a base lending rate plus a specified margin. These base lending rates generally are LIBOR, the Prime Rate of a designated U.S. bank, the CD Rate, or another base lending rate used by lenders loaning money to companies, so-called commercial lenders. The interest rate on Prime Rate-based corporate loans floats daily as the Prime Rate changes, while the interest rate on LIBOR-based and CD-based corporate loans is reset periodically, typically at regular intervals ranging between 30 days and one year.



A significant portion of the corporate loans held by the Fund may be issued in highly leveraged transactions. This means that the borrower is assuming large amounts of debt in order to have large amounts of financial resources to attempt to achieve its business objectives. Such business objectives may include: management's taking over control of a company (leveraged buyout); reorganizing the assets and liabilities of a company (leveraged recapitalization); or acquiring another company. Such corporate loans and similar income-producing instruments present special risks.

Corporate loans may be structured to include both term loans, which are generally fully funded at the time of the Fund's investment, and revolving credit facilities, which would require the Fund to make additional investments in the corporate loans as required under the terms of the credit facility at the borrower's demand. Such corporate loans also may include receivables purchase facilities, which are similar to revolving credit facilities secured by a borrower's receivables.

The Fund will generally invest in a corporate loan only if the Investment Manager judges that the borrower can meet the scheduled payments on the obligation. The Fund may, however, acquire loans in default. In addition, the Investment Manager will consider other factors it believes are appropriate to the analysis of the borrower and the corporate loan. Such factors may include, but are not limited to, financial ratios of the borrower, such as the interest coverage ratio and leverage ratio. The Investment Manager also will consider the nature of the industry in which the borrower is engaged, the nature of the borrower's assets and the general quality of the borrower.

When the Investment Manager selects corporate loans for investment by the Fund, it primarily considers the creditworthiness of the borrower. The Investment Manager will not base its selection upon the quality ratings of other debt obligations of a borrower. These other debt obligations are often subordinated to the corporate loans. Instead, the Investment Manager will perform its own independent credit analysis of the borrower, and of the collateral structure for the corporate loan. After the Fund invests in a corporate loan, the Investment Manager will continue to evaluate the corporate loan on an ongoing basis.

Indebtedness of companies whose creditworthiness is poor involves substantially greater risks, and may be highly speculative. Some companies may never pay off their indebtedness, or may pay only a small fraction of the amount owed. Consequently, when investing in indebtedness of companies with poor credit, the Fund bears a substantial risk of losing the entire amount invested. If the Fund purchases a loan, it may only be able to enforce its rights through the lender, and may assume the credit risk of both the lender and the borrower.

The Fund will be subject to the risk that collateral securing a loan will decline in value or have no value. Such a decline, whether as a result of bankruptcy proceedings or otherwise, could cause the loan to be undercollateralized or unsecured. In most credit agreements there is no formal requirement to pledge additional collateral. In addition, the Fund may invest in loans guaranteed by, or secured by assets of, shareholders or owners, even if the loans are not otherwise collateralized by assets of the borrower; provided, however, that such guarantees are fully secured. There may be temporary periods when the principal asset held by a borrower is the stock of a related company, which may not legally be pledged to secure a loan. On occasions when such stock cannot be pledged, the loan will be temporarily unsecured until the stock can be pledged or is exchanged for or replaced by other assets, which will be pledged as security for the loan. However, the borrower's ability to dispose of such securities, other than in connection with such pledge or replacement, will be strictly limited for the protection of the holders of loans and, indirectly, loans themselves.

If a borrower becomes involved in bankruptcy proceedings, a court may invalidate the Fund's security interest in the loan collateral or subordinate the Fund's rights under the loan to the interests of the borrower's unsecured creditors or cause interest previously paid to be refunded to the borrower. If a court required interest to be refunded, it could negatively affect the Fund's performance. Such action by a court could be based, for example, on a "fraudulent conveyance" claim to the effect that the borrower did not receive fair consideration for granting the security interest in

the loan collateral to the Fund. For loans made in connection with a highly leveraged transaction, consideration for granting a security interest may be deemed inadequate if the proceeds of the loan were not received or retained by the borrower, but were instead paid to other persons (such as shareholders of the borrower) in an amount which left the borrower insolvent or without sufficient working capital. There are also other events, such as the failure to perfect a security interest due to faulty documentation or faulty official filings, which could lead to the invalidation of the Fund's security interest in loan collateral. If the Fund's security interest in loan



collateral is invalidated or the loan is subordinated to other debt of a borrower in bankruptcy or other proceedings, the Fund would have substantially lower recovery, and perhaps no recovery on the full amount of the principal and interest due on the loan.

The Investment Manager generally considers loan participations to be liquid. To the extent loan participations are deemed to be liquid by the Investment Manager, they will not be subject to the Fund's restrictions on investments in illiquid securities. Generally, loan participations are sold without guarantee or recourse to the lending institution and are subject to the credit risks of both the borrower and the lending institution. Loan participations, however, may enable the Fund to acquire an interest in a loan from a financially strong borrower which it could not do directly. While loan participations generally trade at par value, the Fund may be permitted to buy loan participations that sell at a discount because of the borrower's credit problems or other issues associated with the credit risk of the loan. To the extent the credit problems are resolved, loan participations may appreciate in value.

### **High Yield Investments**

Under normal market conditions, the Fund will invest at least [25]% of its assets in debt securities and other income-producing instruments that are rated below investment grade by Moody's, S&P or Fitch (below Baa by Moody's, below BBB by S&P or Fitch) or that are unrated but judged by the portfolio managers to be of comparable quality. These debt securities are sometimes referred to as "high yield" securities or "junk bonds." Because the Fund will hold investments that are below investment grade, an investment in the Fund is subject to a higher degree of risk than an investment in a fund that invests primarily or solely in high-rated securities. You should consider the increased risk of loss to principal that is present with an investment in higher risk securities and other income-producing instruments, such as those in which the Fund invests. Accordingly, an investment in the Fund should not be considered a complete investment program and should be carefully evaluated for its appropriateness in light of your overall investment needs and goals.

The market value of high yield, lower-quality fixed-income securities and other income-producing instruments tends to reflect individual developments affecting the issuer to a greater degree than the market value of higher-quality securities, which react primarily to fluctuations in the general level of interest rates. Lower-rated or unrated investments also tend to be more sensitive to economic conditions than higher-quality securities.

Issuers of high yield, fixed-income securities and other income-producing instruments are often highly leveraged and may not have more traditional methods of financing available to them. Therefore, the risk associated with buying the securities or other instruments of these issuers is generally greater than the risk associated with higher-quality securities. For example, during an economic downturn or a sustained period of rising interest rates, issuers of lower-quality investments may experience financial stress and may not have sufficient cash flow to make interest payments. The issuer's ability to make timely interest and principal payments may also be adversely affected by specific developments affecting the issuer, including the issuer's inability to meet specific projected business forecasts or the unavailability of additional financing.

The risk of loss due to default may also be considerably greater with lower-quality investments because they are generally unsecured and are often subordinated to other creditors of the issuer. If the issuer of an instrument in the Fund's portfolio defaults, the Fund may have unrealized losses on the security, which may lower the Fund's net asset value per share. Defaulted instruments tend to lose much of their value before they default. Thus, the Fund's net asset value per share may be adversely affected before an issuer defaults. In addition, the Fund may incur additional expenses if it must try to recover principal or interest payments on a defaulted security. Notwithstanding the foregoing, the Fund may invest in securities and other instruments where the issuer is in default or bankruptcy.

High yield securities or other income-producing instruments frequently have call or buy-back features that allow an issuer to redeem the obligation from the Fund. Although these securities or other income-producing instruments are typically not callable for a period of time, usually for three to five years from the date of issue, if an issuer calls its obligations during periods of declining interest rates, the Investment Manager may find it necessary to replace the investments with lower-yielding securities or other income-producing instruments, which could result in less net investment income for the Fund. The premature disposition of a high yield investment due to a call or buy-back feature, the deterioration of an issuer's creditworthiness, or a default by an issuer may make it more difficult for the Fund to manage the timing of its income.

High yield securities or other income-producing instruments may not be as liquid as higher-quality securities. Reduced liquidity in the secondary market may have an adverse impact on market price of a security or instrument and on the Fund's ability to sell a security or instrument in response to a specific economic event, such as a deterioration in the creditworthiness of the issuer, or if necessary to meet the Fund's liquidity needs. Reduced liquidity may also make it more difficult to obtain market quotations based on actual trades for purposes of valuing the Fund's portfolio.

The Fund may buy securities that are sold without registration under the federal securities laws and therefore carry restrictions on resale. While many securities have been sold with registration rights, covenants and penalty provisions for delayed registration, if the Fund is required to sell restricted securities before the securities have been registered, it may be deemed an underwriter of the securities under the Securities Act of 1933, as amended (the "1933 Act"), which entails special responsibilities and liabilities. The Fund may also incur special costs in disposing of restricted securities, although the Fund will generally not incur any costs when the issuer is responsible for registering the securities.

The Fund may buy high yield securities during an initial underwriting. These securities involve special risks because they are new issues. The Investment Manager will carefully review their credit and other characteristics. The Fund has no arrangement with its underwriters or any other person concerning the acquisition of these securities.

The Fund will rely on the Investment Manager's judgment, analysis and experience in evaluating the creditworthiness of an issuer. In this evaluation, the Investment Manager will consider, among other things, the issuer's financial resources, its sensitivity to economic conditions and trends, its operating history, the quality of the issuer's management and regulatory matters.

The credit risk factors above also apply to lower-quality zero-coupon, deferred interest and pay-in-kind securities. These securities have an additional risk, however, because unlike securities that pay interest throughout the time until maturity, the Fund will not receive any cash until the cash payment date. If the issuer defaults, the Fund may not obtain any return on its investment.

The Fund may purchase certain high yield securities and other income-producing instruments at a discount to par value. These investments, when held to maturity or retired, may include an element of capital gain. The Fund does not generally intend to hold these investments solely for the purpose of achieving capital gain, but will generally hold them as long as expected returns on the investments remain attractive. The Fund may realize a capital loss when a security or other instrument is purchased at a premium (that is, in excess of its stated or par value) and is held to maturity, or is called or redeemed at a price lower than its purchase price. The Fund may also realize a capital gain or loss upon the sale of securities or instruments, whether purchased at par, a discount, or a premium.

*Ratings.* Independent rating organizations rate debt investments based upon their assessment of the financial soundness of the issuer. Generally, a lower rating indicates higher risk. Ratings assigned by the rating agencies are based largely on the issuer's historical financial condition and the rating agencies' investment analysis at the time of the rating. Credit quality in the high yield debt market, however, can change suddenly and unexpectedly, and credit ratings may not reflect the issuer's current financial condition. For these reasons, the Investment Manager does not rely principally on the ratings assigned by rating agencies, but performs its own independent investment analysis of securities and other income-producing instruments being considered for the Fund's portfolio.

In its analysis, the Investment Manager considers a variety of factors, including:

- the experience and managerial strength of the issuer;

- responsiveness to changes in interest rates and business conditions;

- debt maturity schedules and borrowing requirements;
- the issuer's changing financial condition and market recognition of the change; and
- relative values based on such factors as anticipated cash flow, interest or dividend coverage, asset coverage, and earnings prospects.

### **Collateralized Obligations**

The Fund may invest in any tranche (other than the equity tranche) of collateralized debt obligations.

Collateralized debt obligations and similarly structured securities, sometimes known generally as CDOs, are interests in a trust or other special purpose entity ("SPE") and are typically backed by a diversified pool