TRANSCRIPT

ClearBridge Investments

PM Perspectives: Aggressive Growth Update and Outlook

December 4, 2018

With Portfolio Managers Richie Freeman (RF) and Evan Bauman (EB) and Client Portfolio Manager Bayley Davis (BD)

BD: Good afternoon, everyone. Welcome to the ClearBridge Investments Aggressive Growth and Multi-Cap Growth Portfolio Update.

Again, my name is Bayley Davis and I'm part of the specialist team at ClearBridge. Before I introduce our guest speakers, please allow me to thank you, our trusted partners and friends for your support of the strategies we are speaking about today. We are fully aware you have many competitive options in the marketplace and we appreciate your support and partnership.

Today, I have the great pleasure of introducing my longtime friends and colleagues, Mr. Richie Freeman, who needs no other introduction. With over 40 years of investment experience, he is the founder and co-portfolio manager of the ClearBridge Aggressive Growth Fund and Multi Cap Growth separately managed account portfolio. Richie is joined by his co-manager on the strategies, Mr. Evan Bauman. Evan, as you know, has now worked as a co-portfolio manager with Richie on the strategies for 15 years and has been with the firm for 22 years.

Now, as a high active share manager, we recognize that the two portfolios that we're speaking about today can go through some periods of performance volatility as compared against the Russell 3000 Growth benchmark. Some of the cyclical sectors, notably energy, have gone through underperformance and we'll take plenty of time to address that in relation to specific stock performance and thoughts on the energy patch itself. We would really like to keep this call though conversational and spend the most time answering questions online from you as it pertains to everything from positioning in the portfolios to questions on specific stocks and sectors within the two strategies.

Guys, as we tally up a list of questions online, I'd like to start off with a couple to set the stage for today's call. And I'm to start off with Richie. And Richie really wanted to talk more about the broader market. Richie, as we get very few opinions on the overall stock market itself these days, I know you've been a student of the markets going back to the early 1970s and as recently as the first quarter of 2016 you wrote a piece talking about your conviction in the market going higher following that extreme volatile period in the market.

I guess my question is a bit twofold right now. Are we surprised by the latest bout of volatility that we're experiencing in the market? And two, what is your view on the current backdrop of the markets -- meaning does this period that we're currently experiencing remind you of any other past markets that you've seen during your long history? Richie?

RF: Really appreciate the introduction, plus most importantly appreciate the comments that we've gotten from so many (F.C.s) and the support that we've really gotten since 1983. So I'll take your question and I'll try to anticipate some of the others in the body of what I'll say.

You're right, I've been watching the market for quite some time. Actually in the mid-1960s. But the market that I really cut my teeth on education-wise was in 1974. And the story I really haven't told but will tell now is I went to business school.

The one thing that I learned in school that was worth probably 10 times what the tuition was in a class -- (Douglas Bellmore) was our teacher back in 1974. First economics class I ever took. And the first day of class, October '74 he said the stock market's going to be making a major bottom this year. And we looked at him and said how could you possibly forecast that. And he said simply, markets make bottoms every four years. He went back to 1962 with the Cuban missile crisis, 66, 1970 was a major bottom, and he said it'll be very similar 1974.

So we listened and said OK, fine. Then the market plunged into October '74, had a huge rally in November of 1974 and we said, boy, this guy is a genius, we're going to listen to everything he says. And then it started coming down again and it went to a lower level in December 1974 than October of '74. And we said see, it's impossible to call the stock market, he did not know what he was talking about. Lo and behold the market never traded lower than the bottom of December 1974. And I've always looked for parallels between that kind of market and other markets.

And (very simply), you alluded to what we wrote back in February of 2016. Evan and I had a pretty good condition at that time that what we were seeing was not that dissimilar, just from the action of the market -- we're not talking about the economic backdrop and interest rate environment -- was pretty similar back in 2016 to what we -- what I went through watching in 1974 (again). The flash crash in August of 2015, then a big rally, and then again in January into February of 2016 you had a decline and that decline went to a lower level than it did when the market had that flash crash in 2015.

And pessimism was pretty rampant at that time. People said it's going to continue going down yet the overall market itself was acting a lot better than what the averages were implying. And we said we would not be surprised if this will be categorized as a new bull market, and we actually mentioned that it wouldn't shock us to see the market over 20,000. Clearly it did that, it went far beyond what would have dreamt at that time. But that's history. How does that relate to now? Well, almost very similar. You had a rally and the market was quite strong, the averages were quite strong, you made new highs as late, I think, as September in the DOW.

And then you dropped. And then you had another rally back, and then you declined again until two weeks ago and the market went to levels that were actually lower than they were back in October of 2018. People got very pessimistic. It's very easy to measure it. And I've always told people if you're on a desert island, you can only have one number to get that will help you in judging the stock market, just get the investors intelligence numbers that come out every Wednesday.

My daughter Robin has given them to me religiously every Wednesday. And we've said anytime that number gets over 60 percent of stock market letter writers being bullish, invariably it's been a high-risk juncture in the stock market. And we saw that in January this year, we've seen a number of times this year. Conversely, anytime that number goes below 40, invariably has been a better buying opportunity, it's been a lower risk juncture. Back in 2016 we actually saw that number under 30. And as most recently as last week, we saw the number down below 40 once again.

It doesn't guarantee anything, but it tells you that the market climate has changed, risk has started to be priced in, pessimism is rising, so we felt more optimistic when the market came down two weeks ago than we had earlier in the year. And you can give all kind of different reasons -- we're not going to make any kind of forecasts on the economy, on interest rates, on politics, we're just taking a look and saying that markets psychology tends to repeat.

The individual reasons might differ, but anytime you have quick panics that set it and people fearing the downside and becoming much more panicky when markets decline even one or two percent and feeling more nervous than when markets rally one or two percent, to us those are preconditions that you need for some kind of bottom be put in place. If we did this call a couple of weeks ago, it might have been a little more dramatic. We would have said the same thing we're saying now.

We think that the (areas of) levels that the stock market reached a couple weeks ago may very well represent important bottoms of which the stock market can rally fairly significantly over the next couple of years. Assuming history repeats itself and we have that every four-year cycle -- it's been as good as any that I've seen over the last 50 years, presidential -- off-presidential cycles tend to represent pretty good bottoms to stock markets. But we're not going to be risking capital just based on cycles.

We would rather do it -- and Evan's going to go into a lot of detail about specific areas and the reason why we feel optimistic about the individual holdings that we have. So going to make -- making the case that from a stock market standpoint -- and we've seen it before -- we think that the areas that were reached a couple weeks ago may represent very, very important levels of bottom for the stock market.

Would not shock us nor disappoint us to see us retrace some of this rally, which is been fairly sharp over last two weeks of rally; it's probably 1,500 points. One of the catalysts was obviously Powell's speech which I think has taken off (the Fed tightening) cycle out of the equation.

I think people are now going to take a look at the economy and those that worried about an overheated economy and those -- I keep reading people saying about how strong the economy is and how overheated it is. I think that might have been true six months, I don't think that's the case right now. If anything, I think the economy has been slowing rather dramatically and that's not been lost on the Fed and I think that's going to be factored into their targets for the year coming up. So we don't think if rates are going to be going up anywhere near what people think, wouldn't be shocked to see just a one and done scenario.

And obviously the market had a very short-term blip with the trade dinner over the weekend; that still remains to be seen. To me, Powell is the most important thing in Powell recognizes a slowing economy. And stock markets can rally when economies slow. The market, as I mentioned, made its bottom in December of 1974, yet the economy didn't really bottom until the middle of 1975. We were in the middle of a very, very sharp recession when the market actually made its bottom.

So more important to look out six months from a stock market standpoint and we think that the stocks always tend to lead, they lead in both directions. We think the weakness that is been evident over the last few months has been reflecting a slowing economy. And if we're correct about the market being at a low risk juncture, we would not be surprised to see the economy, at least start -- companies that we care about -- showing better business conditions maybe six months out from now.

So that's a very long-winded answer to your question, Bayley, but I just want to -- if I can, we looked over all the questions before hand. We've always, we try to hit exactly what is on people's mind. We talk about the elephant in the room, let me discuss what has clearly been the most difficult stock in portfolio for some time, which is Weatherford.

People asking what's happening with the company specifically? I'll talk -- I'll segue to two things. One is fundamentals and the other is stock price which obviously go hand-in-hand, but I think one is being dramatically exaggerated because of the time of the year that we're in.

From a business standpoint, this company is clearly levered. They have too much debt. They have had too much debt for many years. The thing that probably has surprised me is that the cycle itself has dragged on for as long as it has. We thought that you would have had clearly a pickup in capital expenditures in the oil service (patch) over the last few years, but you really didn't, and they needed that to grow into that debt.

Fortunately, there was a management change of April of 2017. You had the former CFO at Halliburton became the CEO at Weatherford, highly respected, a numbers guy. And first job that he did was, he said he want to delever this company and he said that there's far too much duplication within the operations, hard supplies et cetera, et cetera. He worked with McKinsey the consultant, to come up with a package, a plan which is called the transformation plan, which the goal being to increase earnings before taxes and dividends to $1 billion by the end of 2019.

These are all things that are within Weatherford's control, not just depending on the price of oil. And if they're successful and to date, they're actually ahead of their schedule that they've laid out, they will be able to be cash flow positive by the middle of next year throwing (all) free cash flow which will enable them to be paying down debt.

The company was in a meeting as late as a week and a half ago, they said is out as of then, they're on target to meet their earnings target for the fourth quarter, free cash flow generation. Based on the -- based on that and based on the fact ironically, and unlike some of their competitors, they haven't had to downgrade their earnings guidance -- earnings before taxes' guidance for this year.

The only problem is, which is a huge problem, they have far too much debt and they have to earn $1 billion dollars to pay down that debt load. It appears based on information we have right now and based on the liquidity that the company has, and we've added up the liquidity in the un-drawn bank lines, which is important, the cash is coming in from operations that have been sold, including $100 million which hit on Monday, this company is -- we do not think this company is a -- has liquidity squeeze right now.

They clearly need to start -- the transformation process has to work, it has to start showing results clearly next year. If they are successful in that, we would think that this company has significant upside. And down here, it's basically a call option. The time of the year is clearly hurting the stock price. You've had a substantial selling -- tax loss selling. This is still early December, not shocking to see it continue. But premised on the fact that their business internally is still good and with we're about higher revenues than the prior year, and the fact that their liquidity profile still remains positive, it's a name that -- which has clearly hurt us – it's a call option which we own and we're going to see what happens.

The price of oil is -- will be important for the year for the industry itself. It has been very difficult to forecast, December 6 is an important meeting where OPEC will decide if they're going to be cutting back production. It remains to be seen how that goes. So Bayley, I'm going to take a sip of water and...

BD: Great, thanks, Richie. Evan, anything you'd like to add?

EB: No, I think Richie talked at length about both the market and the one position in Weatherford. I mean, just to echo everything that he said and reiterate, this is one company that we own, and it's obviously been a mistake and we've never hid from our mistakes. If there are follow-up questions specifically about that name, and Richie laid out the liquidity scenario which gives them a couple years of liquidity, just with cash on hand and access to credit lines which were recently negotiated, and these asset sales, we think the likelihood is that clearly tax loss selling and end of year portfolio positioning, window-dressing is exacerbating the stock price decline.

But always come to us if your clients that have specific questions. We're always available and I think that the key to today's call is to start the discussion and review what's been challenged two years in a very strong 35-year track record. But just reiterating what Richie said about the strategy and process and the philosophy and the two of us being in place together.

For the last 20 years, we're always worrying more about the problem stocks than the good ones, but today's call is again, just to start the discussion and always comes to us with specific questions or client concerns. So I know Bayley, you had some other questions you wanted to...?

BD: Sure. Great, thanks. Well, thanks for all that perspective on energy and Weatherford and the market.

Clearly if we want to shift directions a little bit here, we always talk about valuation and clearly the lower valuation, better free cash flow, stronger earnings growth rate type names, really haven't been as rewarded in the marketplace like the momentum stocks. Most notably, the FANG names over the last couple of years. And Evan in fact, I remember on a call we did this past summer, you commented at the time that the market cap on Netflix was actually higher than the Comcast market cap at that particular time. You and Richie have always prided yourselves on being high conviction, bottom-up stock pickers with long holding periods in these individual stocks. Do you think we're beginning to see a change in the risk reward dynamic between momentums versus the lower valuation, higher free cash flow type names in the marketplace today?

EB: Yes, I think it's starting. Clearly, I guess it was seven, eight weeks ago or early in the fourth quarter when the market was really at all-time highs and you had clearly, I think significant crowding in certain areas of the market. You made reference to the Comcast, Netflix example, and it's not that we're (long-short) managers. We're long-only managers. We've owned Comcast for, I guess it's going on 33 years now, and the goal as I said earlier of this program is to buy companies with great balance sheets that generate a lot of free cash flow, with great franchises.

And just made the point that what was being rewarded in the market up until about the first week in October was more so momentum and concepts at the expense of those types of companies. As you said, you weren't being rewarded for being contrarian; you weren't being rewarded for having a more value sensitive portfolio.

And the analogy that with the Netflix, Comcast example was the fact that Netflix was actually at one point, had a bigger market cap than Comcast, was trading at 42 times book value, 200 times cash flow and had no free cash flow. and with the smaller market cap, Comcast -- this was just after the Sky acquisition -- was trading at about two times book versus 42 times, trading at about 7.5 times cash flow and had north of $10 billion in free cash flow per year. And yet when I got the question I talked about I'd rather own the business that has valuation support, that has diversity.

Where obviously Netflix has spent a lot of money on content, a lot of that content is accessed solely over their systems, where Comcast is really benefitting from the growth of high speed data, broadband, and their own content acquisitions -- first NBC Universal, and then obviously what they've done with Sky which gave them immediate scale and diversity overseas which they didn't have previous.

So when you look at this type of product despite the name of the strategy being growth, we're very value conscious and if you have the deck in front of you, if you look at slide six you see that in the market over the last three years there was really this (flight) to momentum, away from the types of businesses, in many cases -- that we focus on.

And I remember 22 years ago when I started working with Richie he had a great slogan which was, "if you buy great companies and you don't overpay, eventually they become great stocks." And there are a lot of great stocks in the market that we're never going to own, or we're going to miss where valuations are excessive, and they don't necessarily equate to great businesses or great companies. You can think about the .com bubble at the end of the '90s, and I think what we had today, up until a few weeks ago was not a bubble but clearly a rise in momentum and the benefit of (ignoring) valuations at the expense of stock prices.

So you look at the valuation of our strategy -- as companies were actually growing double digits, in many cases they saw their P.E. price to free cash flow, and price to book multiples compress down to levels versus the market, that we hadn't seen at any point since the late 1990's that similar period of the tech bubble. It was a very (tech-y) market, again, up until recently. And the fact that you look at -- and slide seven just shows at the bottom of the page where the valuations of our strategy sat vis-à-vis (that the) index and the benchmark -- we look more like a value product at the end of the third quarter than an aggressive growth, or a multi cap growth type product. And doesn't mean you get monetized overnight, it doesn't mean that that equates (inaudible) immediately. But what I think we've seen in the last eight weeks or so is clearly a very different type of environment.

You know, you look at the Comcast/Netflix example, and pay it forward. And today Comcast has, I think at $52 billion market cap advantage, or is an (excess) market cap versus Netflix, and actually has risen during the period when the market has had this 10, 11 percent broad-based correction.

I think the other interesting thing is that the (NBX) and that is the Nasdaq 100 which we spoke about earlier this year, resembling in a lot of ways that kind of bubble up of the March 2000 period when nobody saw an 80 percent crash coming. And we don't think the same level exists, but you clearly have levels of crowding in some of the mega cap, tech and internet names. You've seen the NASDAQ 100 correct more (than) 15 percent while the broad DOW and MS&P correct about '10, '11. And some names -- even some of the big stuff is off 20 to 50 percent during that same time.

So I think what we've always tried to focus on is good businesses with strong balance sheets, and (price to book) speaks to the levels of cash on a lot of our balance sheets. And as the market kind of normalizes as we're starting to see a rotation, in to some of these beaten down sectors, and subsectors like media, like health care, even parts of the energy space -- especially in the E&P space companies like Anadarko where valuations have compressed and yet they've been able to grow production and free cash flow significantly, I think we're starting to see a normalization.

I think the likelihood is moving forward we're going to see a lot of consolidation in certain areas, I'm sure there are questions about M&A and why we haven't seen that many deals in some areas, but in other areas we have.

But realistically, to your question (Bale), they were -- we're starting to see the very early days of a rotation, and generally when you get this type of real market correction, and what Richie talked about in terms of a four year -- (off) presidential election year bottom when the market starts its next advance, it's generally not the same leaders of the previous market.

In over 10 years post credit crisis, we're 10 years plus in to the (bull) market now. The market has quadrupled, and I think (what the) slide seven on the bottom there really indicates in our view is there are some very crowded parts of the market right now -- there's some very expensive still, parts of the market and excesses that need to be worked off. It's not a bubble in terms of a valuation bubble the way ('99) was viewed -- but they're clearly -- if you look at a lot of other growth products, it's real consensus thought and a lot of that resides in the mega caps and the (FANG) stocks, and the mega cap internet names.

And you have a good chunk of the market right now -- you can see on the top where our big sector bets lie that are really undervalued. And the one thing -- I started out my comments by saying one thing you can always expect from us is consistency in philosophy, process, discipline and strategy. And I think, when I was in Europe in the early part of October, I heard more and more institutional clients speaking about other managers that were (capitulating) as it pertains to FANG.

Those that hadn't owned the subsector of the market, feeling pressure to buy those stocks because they represented a quarter to a third of the benchmarks in the growth space, and they had done so well that they felt the need, or the pressure to own those names.

And I said, "if you're going to do that you can still lose client capital," and our job is as Bayley started out the call by saying we're business owners, we don't pay attention to the benchmark, it's probably hurt us that in terms of assets that the growth benchmarks have done so well. But I think that we feel -- Richie and I feel a lot better about buying a group of undervalued businesses, with great balance sheets, the potential to monetize the business either slowly through significant buy-backs or through M&A, or ultimately I think the market is in the early, early days of new leadership rerating some of these sectors higher and others I think have still -- still have significant potential to disappoint.

So I think it's still the early days of a rotation. I think the leadership the next couple of years it'll look very different from the last couple and if we didn't believe that, we would change things up. But again, just looking at that slide six one last time -- just by holding on to the companies we own we've gone from a premium to the market on a valuation basis to a significant discount. Last time that happened was 1996 and the subsequent five years were the strongest in the strategy's history, doesn't guarantee anything. In fact, it's not a promise of a repeat, just saying that I think there's a lot that can go right for certain chunks of the market and there's risk in others.

BD: Great, thank you. Thanks for all that, Evan.

Kind of keeping on those lines, you touched on M&A, and we've seen a few deals in the portfolio this year on the healthcare, the media side, the energy side even. Companies like a Bioverativ, L3, Nuance Communications -- as you mentioned, Comcast doing the deal with Fox on the international side. But now with estimates of roughly $1 trillion in cash sitting on corporate balance sheets today, and in private equity itself -- do you think this M&A cycle maybe starts to pick up a little bit more? We're starting to see more bolt on kind of deals, but do you think we do start to see more on the M&A front?

EB: Yes, I'll take the first crack -- this is Evan. And then Richie, you can jump in.

I mean, this has been a very -- historically been a very M&A friendly portfolio, I think we've had over 100 companies acquired over the life of the strategy going back to the '80s. It's not that we seek out take-over targets, it's really the idea, again, if you buy undervalued growers -- companies growing double digits where multiples are compressed eventually -- that have strong, durable franchises -- eventually other companies are going to look for those same types of attributes.

And I think in fact if you look at historically, some of the stocks that we had that were acquired were surprising. Areas -- biotech companies with expensive drugs, or earlier stage companies that got big multiples for their franchises.

And my sense is, what we've seen in media where good properties are getting actually multiple bids from interested parties like Sky and Fox -- that's a sector that's undergoing, again early days I think of true consolidation. Where you've seen mergers of equals, you've seen programmers getting together and a lot of the distributors hunting for content to fend off those over-the-top competitors and they're actually acquiring a lot of the content guys.

So media is kind of rolling up as we speak -- I think health care's been surprising in that we haven't seen as many deals in the last seven, eight, nine months as maybe you would've expected. Post tax reform there were a lot of take-overs. Companies repatriated cash, you had a couple of deals -- Sanofi as you said, bought a company from us, they bought another couple of smaller names. You had Celgene buying a couple of companies. We saw more early-stage take overs, and even recently yesterday, Glaxo announced a relatively early-stage deal for a cash value about $7 billion when they bought Tesaro. They've been smaller deals, and then you also had I think a real pause kind of from that February period up until recently where companies haven't done a whole lot. I think some of that has to do with the geopolitical environment being so noisy, and there's been so much macro noise out there in healthcare, its drug prices and other areas.

It's simply the trade war and ultimately lack of visibility into economic growth. So what we've seen more than M&A is more -- and you also had the midterms coming up, it -- rather than M&A you've seen a lot of buybacks.

I think companies understand that their own shares are cheap. We've seen a number of companies in the portfolio like some of the big health care names buy back their own stock at what we would argue are very attractive value levels.

Companies like Biogen and Amgen and Allergan, even some of the energy names where the balance sheets are in fantastic shape like Anadarko, is in the process of buying back $5 billion in stock. And we've even seen it from some of the tech names like Seagate, which has even with reduced earnings estimates trades at sub 10 times earnings and they're taking stock off the market at what we feel is close to the low point of the cycle.

But the M&A theme hasn't really I think kicked in yet, I think possibly the resolution of the midterms, possibly again more clarity on policy and less noise as it pertains to the trade war. My sense is -- I talked early about valuation dislocations in the market, yes, there's not only a ton of money on balance sheets but there's a ton of money in private equity hands as well that's really been doing nothing.

So there's areas like energy that can see a real proliferation of private equity money coming in. So there's a lot that can go right as it pertains to M&A. As I said earlier, we don't buy stocks with the hope they get bought out. We often look at dual pads to monetize the business, but certainly I think with valuations where they are in the portfolio, there's probably some deals on the horizon in the next couple of years.

RF: What I found -- what I've found now over 35 years of doing this is one -- the deals that happen normally totally catch me by surprise. I mean I was the most surprised guy in America when I saw Chiron got the bid back a number of years ago from Novartis or when Genzyme got the bid, Millennium got the bid, you just go down the list. Bioverativ, as Evan mentioned. The companies that are rumored continuously that they're going to be involved with deal talks, those are the ones that never get taken over and the ones that catch you out of the blue, that's actually where it's been -- where it's happened.

So all you can do is -- you hope you're going to be involved in it, and Evan probably said, if they have the same kind of characteristics, great franchises that could be attractive to larger companies, not so much great balances but really a great unique product, that's what has been the -- that's what is attractive to many of the corporate buyers, particularly in biotech over the years.

I cited and article in September, probably four years ago now that John Malone did. He was -- John Malone was clearly the great architect of the cable industry, basically built it over the last 30 years. A number of years ago he said he wanted to see a consolidation within the cable industry. Well I think he clearly is -- was one of the architect of why Charter is where it is right now, and he owns 25 percent of Charter through Liberty Broadband. I think that was another reason why Cablevision was acquired. John Malone has great foresight, and as I mentioned a number of years ago he did an interview in the Wall Street Journal saying that he thinks that there should be a consolidation within the programmers.

You don't get rich betting against a guy like that, and yesterday I noticed that Charter was at a conference and said they're also looking to do deals in the cable industry. So it's an area that we know has been right with consolidation, the stocks themselves, the best catalyst is very, very cheap valuations that are not believed by the street.

And we -- that's one of the reasons why we feel as good about the areas we do. You own companies, in some cases (you're) selling at free cash flow yields of 15 percent, that's attractive. And they're either attractive as standalone operations in the stock market, or they're attractive to corporate acquirers. So a lot of our companies do have a commonality and that's one of the reasons why, as you said, we did have over about 100 companies taken over, over the life of the -- of our fund.

BD: Yes, it's certainly been a terrific trend in the strategy over the years, great track record in terms of M&A in these portfolios.

I'm going to try and aggregate some of the questions we're receiving online, but in terms of tackling a few, we're getting some questions on -- mainly on some of the bigger health care companies that we own in the portfolio today. So most notably Biogen Idec, United Health -- are two names that we're getting some questions on what are your thoughts, and then on some of the other biotech companies like Vertex and even the Ionis.

If we could maybe -- I could split it up a little bit between the two of you, but if you want to make some comments on the health care names, that would be great.

RF: You could lead off, Evan.

EB: Yes, I think it's not that we -- going back to slide seven, which shows the big overweight to health care, we don't set out to target an overweight in healthcare. I think we target innovation and we target sustainable, innovative businesses and I think -- I referenced earlier this sort of obsession that growth managers have with tech and they always feel like they don't understand the biotech space.

So they only buy those companies at kind of the end of a momentum cycle. But we could say going back to 1983, this is a sector that we've understood, we have found no other area in the U.S. where you have these levels of innovation and today you actually have profitability that you've never had in the past for a lot of business that Bayley made reference to.

Biogen generating over $26 per share of earnings with now $5 billion drugs, one of the most successful rare disease drug launches in history and yet you're paying about 12 times earnings for that base business. You're getting optionality in their pipeline, which has really broadened out over the last few years to where they now have two later stage Alzheimer's drugs in a six-drug pipeline for Alzheimer's alone. A number of other compounds for neurology, including a couple for ALS and Parkinson's and I think there's -- again, I talk about noise and geopolitical noise and headline risk around risk around drug prices.

I think what -- if you listen to -- listen to Commissioner Gottlieb at FDA, I think what he's really tried to say is anywhere you could have generic drugs, let's have them. Anywhere you could bring down price through competition, let's have them. But let's also continue to foster innovation, and that really I think benefits a lot of the names that you referenced, Bayley.

Vertex, which has the potential to treat 90 percent of cystic fibrosis patients with a triple combo regimen of drugs that'll be the first in history to target the underlying cause of the disease, if the company would spend billions on R&D that's going from losing money to what could be north of $7 of profitability within the next two years.

These are the types of businesses that we think are unique, they're durable, the government really enables you to have exclusivity, versus -- sure we'll talk more about I.T. and technology, but versus an I.T. company where there's a ton of competition and very economically sensitive markets.

Names like Ionis, which is a rare disease company with a unique mechanism and antisense, Vertex, Biogen, even what Amgen is doing with their pipeline in areas like migraine and then some of the earlier stage companies that we own like ImmunoGen and some of the other incubator sized positions we have in the strategy in areas like gene therapy.

There's more scientific breakthroughs happening today than we've seen at any point in history, you could say that, because going back to 2001, when they sequenced the genome, a lot of those discoveries then are now coming through the clinic today and targeting rare disease and open-ended growth markets like we've never seen. And it's exciting stuff, treating rate inherited retinol disorders essentially genetic blindness with a one-shot cure, seeing companies, god willing, within a couple of years of maybe treating Alzheimer's, even if it's not the entire patient population.

I think one of the things that again FDA is really focused on is getting the innovative drugs to market sooner in disease progression. A disease like Alzheimer's, treating somebody after 15 years is never going to reverse the cause.

But if you can genetically screen who might be at risk of developing the disease and get safe drugs to market sooner, that's exciting to us and you have the potential for multibillion dollar durable growth franchises in all of these companies because of some of these scientific breakthroughs.

The irony is again, you're paying 10 or 12 times earnings for these companies today. And you're paying 30 or 40 times for device companies or trillion dollar market caps for tech companies. I think it's only a matter of time before a company like Roche or Pfizer or somebody else in the -- in the big pharma space realizes that to stimulate further growth over the long term, they need to be buying some of the businesses we own.

So it's -- I know you referenced a lot of them -- the commonality is even United Health Group, which is obviously not therapeutics company but has grown earnings north of 20 percent for the last number of years has become part of the health care system solution in bringing down costs. They trade at -- (they're) essentially a market multiple for much better, more sustainable growth in their market. Not that we're wedded to health care. We've owned it for a long time, I think we clearly understand it well, but I think right now point in time as we speak, I think the health care sector is really an overlay. It's really undervalued relative to a lot of other parts of the market.

BD: Great. Maybe change gears a little bit in terms of sectors, but we're getting some questions on -- not necessarily in healthcare, but now on some of the storage stocks, like a Seagate and Western Digital and some of our technology names.

Do we have any broader thoughts on the storage stocks, specifically Seagate and Western Digital? I know it's been a bit of a tale of two cities between those two stocks. One is up on the year and one has traded down on the year. Clearly there is a duopoly in place in the in the storage space, but maybe we could just a little bit of color in terms of what we're seeing in these two particular companies?

RF: Let me make a comment on the on stock themselves send the little bit on the industry.

First, I think what's clearly hurt the memory stocks is what's happening right now Apple. Apple obviously a great iconic company that is clearly -- if you read their statements or if you read the with the suppliers are saying -- is having somewhat of a sales glitch right now in their phones. And the customers, the suppliers to the phones are clearly affected by that. And I think it's affecting our flash memory prices which is having a direct negative effect on Western Digital right now after they made the SanDisk acquisition within the last couple of years.

I think that's one of the major reasons why you've seen the pressure Western Digital seen the pressure in Micron, which we don't own. Some of the capital equipment companies like an Applied Materials. So you're probably going to be hearing, as the quarter goes on, companies seeing where they end the quarter out, you've seen preannouncements. Not shocking to see even the drive companies. They have not said anything yet, but I think this is a weak period. And I think what's really important is a short-term glitch or is it a major change to the long-term fundamentals of the business.

I still am hard-pressed to see -- when I read about the birth of the cloud, the growth in the cloud and so many companies like an Amazon or a Microsoft talking about the growth in this business, you still have to store information on something. The most cost-effective way to store data is still with the hard disk drive. You've seen Seagate and Western go really two different directions.

Western Digital is a diversified to -- as I said, with the SanDisk acquisition. Seagate is primarily almost solely a drive company that did a deal with Toshiba to get their flash memory business. And they were one of the backers of it. They have a billion-dollar preferred issue through that company -- through that deal and that's a very, very low risk way to benefit from growth in that business longer term.

I think we're looking at a cycle bottom within the next couple of quarters. We think that we're talking about earnings power, companies bottoming it -- they usually bottom at 10 times earnings and I think that's where they are right now. They're clearly going to be levered to benefit from the cloud -- the growth in the cloud. I don't think that growth in the cloud is something which is a short-term solution, I think it's a long-term important business. And I think these are very, very important companies that are going through -- we think a cyclical short-term downtrend, which we've seen many times in the last 25 years. Evan, you want to add anything.

EB: Yes, I think you hit everything. I'll just reiterate. I think tech is cyclical. And investors hate to believe that and they love to own big tech and when it's going up, it's great. But as you said, even with (handsets), we've seen so many previous cycles where companies had significant market share and mind share and big market caps and they missed a product cycle or there was a product cycle transition.

And they lost meaningful market share, plus the fact that as you said, with the software -- excuse me, the storage companies -- if you believe in data growth and the growth of the cloud and the fact that many of the companies like Microsoft and Amazon speak to the fact that data is going to grow tenfold over the next 10 years and it needs to be stored ultimately on drives and with flash memory, these are companies that that are essentially going through a transition from on-premises PC storage or stored on the device to off-premises and near line and cloud storage.

And you go through transition, sometimes with lumpy. I think the most important thing Richie made reference to is you're within a couple of quarters of the low point of the cycle and at the low point, these companies are generating -- (each) Seagate and Western Digital, they're both generating free cash flow -- meaningful free cash flow, a billion plus. They have dividend yields now that are approaching five, six percent and above for Seagate. They're actually -- I referenced earlier the Seagate buyback. They're taking advantage of shrinking the float during what we think is a low point of the cycle.

And it's clearly -- they've been disappointing this year, but I think you have to look at what to do now and I think these are names -- you all see probably the sell side downgrades them, everybody gets negative at the point where the stocks are already discounting worst-case. And there's a likelihood that you could see either meaningful upside -- you've seen one of these companies go private before. Or you could even see a strategic investor get involved at these types of multiples.

But as long as the companies are generating meaningful cash, as Richie made reference to -- there's basically two in the industry, they're is a virtual duopoly with 90-plus percent market share between them. And most businesses go through some period of transition. And I think the markets today -- everybody's very shortsighted, nobody's willing to be patient and look past these periods of near-term lumpiness, but if you have a longer-term time horizon, I think there's real opportunity in both of them.

BD: That's great.

RF: And make a statement that's beyond just these two stocks. The only way you really know that you're at a bottom for a group of stocks that's been under pressure is if and when they do report disappointing results and the street lowers numbers and the stocks don't go down, then we'll give people a lot more confidence. It remains to be seen if that's the case. But if we really are transitioning in terms of the market and if the market itself is at a lower risk juncture, many companies whose stock prices have gone down, they've been going down in anticipation of something.

They've been going down in anticipation of estimates coming down. And oftentimes when the estimates come down even lower than where people think they're going, you very often get stocks that resist it. And when stocks resist negative news, (invariably) that signals that you're at a bottom. Conversely, when stock's reporting terrific news and they no longer go up, that invariably indicates a top. And I'm going to cite an example with that. I remember when Evan put Autodesk on the list. That was a lot of years ago.

They had just reported -- I think earnings were somewhat disappointing and the stock didn't go down. In fact, that week it was up maybe 10 or 15 percent. Where was it t then, Evan? On the 15? Before...

EB: I think it was six or seven (adjusted).

RF: That's a great indicator. When stocks resist a decline on negative news. And the same thing with the stock market. If a stock market resists going down on negative news, that tells you something. So it's -- (Granville) said it best -- it's not so much the news but the stock market's reaction to the news that's all important.

BD: Thank you. That's great. I know we're bumping up on an hour, but I just want to get a couple more questions from the field in while we have everyone on. Evan, you touched a little bit earlier on in terms of this rotation that we've seen in the NASDAQ and we're receiving some questions on -- especially from some of the newer entrants into the strategies. But turnovers is low, it's historically been low. I know the last new name we added into the strategy was Twitter.

But with this big pullback in rotation we've seen in the NASDAQ as a whole. Does any of the FANG type stuff, even some of the FANG names themselves, maybe, but more so in the NASDAQ. Are we see opportunities, do you think, emerging on individual names there? With that, you touched on the declines we've seen and anywhere from 20 to 40 percent in many cases have been pretty steep. So are we seeing some potential opportunities?

EB: Yes and no.

I think clearly the volatility is -- for a manager who's going to maybe buy a couple names a year, volatility's good. It gives us opportunity maybe to buy some areas that we might have missed or we've been doing work on. We have 30 analysts that support us here and we're always looking for new names.

I think if you look at the history of the strategy, historically turnover annualizes at single digits, (but barriers where it's) much higher and there are other periods like we've gone through recently where turnover is very, very low because we like what we own, the valuations are incredibly good. And we haven't been rewarded on a lot of that, and some chunks of the market are very expensive and way outside the bounds of what we would typically do.

And I think when you look at the -- again, the philosophy, generally we're buying companies in their early days. I mean, the most recent additions within the strategy have been kind of small and midcap names, Twitter is a name where the market cap at the time was about $10 billion ex-cash, maybe a little smaller. But we're also incubating some very small names in the (40 act fund).

So it's not that we won't -- first of all I don't look at Fang as one entity -- each of those companies are very different there are characteristics of some that are attractive even if they're mega cap. There are others where valuations -- we talked earlier about one of them where the valuations are way outside the bounds of what we would traditionally pay for growth.

So I think clearly right now you've been in a market that's -- in my cases been Fed by flow of funds to passive. This bidding up of mega cap names, in some cases even by active managers who are chasing or capitulating and feeling pressure to buy those. So I'll never say never to anything, but I think clearly there's more opportunity right now in more of the small, (and beta) and the earlier stage large cap space just speaking asset allocation-wise where we're finding opportunity.

There's some of the earlier stage health care names -- even some names in the technology space, but they're way down on the market cap spectrum in terms of new additions, or new potential additions right now would be more in that part of the market. I still think there's -- it's not crowding, certainly many -- much in terms of consensus thought amongst the big stuff.

We've seen a correction, but you're still talking about three companies with almost $900 billion market caps, and down this cap spectrum I think there's a lot of opportunities even in technology. It's just not the big stuff. So again, in conclusion volatility is good it gives us the chance to buy some new names, but it's unlikely at this stage to be in the very big stuff.

BD: Great. One other name that we're getting some questions on, and I like the question because it has been a terrific turnaround candidate, and I think it also highlights an area of the portfolio that we don't often talk about, and we reference it quite a bit but when we talk about the electric vehicle market, the self-driving vehicle market -- one name that doesn't often get associated with that is a company that's called Cree.

And Cree historically has been known as a LED lighting company, but as you all know this company has gone through a bit of rerating, new management team. So maybe we could touch for the listeners, a little bit -- some bullets on Cree and then we'll look to -- move to some closing comments and end the call.

EB: Yes, I'll make a quick comment.

Again, it's not that we (want) on tech, right? Cree, and Dolby, and BroadCom and we have Twitter and a number of companies (within) the space, I think what we're looking for in technology, and it even goes back to the days of SanDisk before Western Digital acquired them is companies with patents, companies with I.P. and durable franchises, and little or no competition on certain markets.

And here was a case, as Bayley, you said, they were in a more cyclical area which is LED's and LED chips and LED lighting -- but they had this hidden gen in terms of the silicon carbide power business embedded in a piece of the business that that was called Wolfspeed which was again, servicing the electric vehicle market and has really, a very durable defensible franchise.

They supply 25-30 percent of the silicon carbide market, they also have R.F. chips that involve also gallium nitride and silicon. So there's real upside in that part of the market -- what it took, it's funny. Because we always talk about franchise, or brand one balance sheet two and management three. In this case, after owning a company for more than a decade and having mixed success, it took, as you referenced -- new management to come in and really, I think refocus the business on where the opportunity set was.

They still have the LED business, still generates nice cash, but this E.V. market for them is growing rapidly with real barriers to entry and they're putting a lot more money in to it. And we've seen in many cases companies that we own, spin-off pieces of the business because they weren't getting enough investment. Or as I said, sometimes it does take a new management team to come in and refocus on the more durable, or sustainable growth piece of the business.

And that's a name that's moved up -- it remains a name that we continue to like. I think it's a real opportunity, LED lighting is clearly a big market, but there's a lot of low-cost competition. And potentially in more volatile economic times I don't think that they were ever fully rewarded for their premium product.

But obviously with the new management and the refocus attention to Wolfspeed and power chips, I think they've gotten great upside. And we've seen that from other companies like TCON Activity which is a connecter business, also getting big upside from their E.B. business, AutoDesk's a name it's getting upside from other (tertiary) businesses of their like virtual reality and augmented reality.

So we like to have good businesses generate good amounts of free cash flow, profitable at down points in the cycle, and then sometimes you get lucky and you get upside from a part of the business that was underappreciated by the market. And that's when we've gotten a nice boost from that.

BD: Terrific, thank you.

Well, folks, I know we're bumping up on an hour's time. For those in your offices that were not able to listen to today's call please let them know that we will have a replay available shortly in the coming days which will be sent out also with all the information on that particular replay number itself.

To end the call, thanks -- thank you so much for dialing in to the call and going online in to the webcast itself. Hopefully we've covered enough topics as it relates to the portfolio itself. We are quite optimistic, as you can hear -- going forward with this particular strategy, and we think that we're positioned for success moving ahead.

So again, any other questions that come up please don't hesitate to contact myself or any of the other members on the specialist team here at Clear Bridge and we'll be sure to respond to those questions that you may have. So happy holidays to all of you, and thanks for dialing in -- all the best.

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