ClearBridge Investments

Aggressive Growth Strategy

Evan Bauman
Managing Director, Portfolio Manager

Richard Freeman
Managing Director, Portfolio Manager

Key Takeaways

- Broadening market participation, highlighted most recently by the rebound of health care, is enabling quality undervalued companies to be monetized.
- As long-term business owners, we maintain confidence in the strong competitive positions and growing end markets of our technology holdings.
- We are encouraged by the improved relative performance of the portfolio over the last several months.

Market Overview and Outlook

After absorbing some disappointing U.S. manufacturing data, U.S. equities delivered positive returns in October, driven by improved sentiment on trade and solid third-quarter corporate earnings. The S&P 500 Index finished the month up 2.17%, touching new all-time highs along the way. While more value-oriented stocks have gained ground recently, growth stocks resumed their leadership in October, with the Russell 3000 Growth Index returning 2.82%, beating the 1.47% gain of its value counterpart.

Corporate earnings reported in October were broadly better than expected: even amid year-on-year declines, 75% of the companies in the S&P 500 Index that posted results had exceeded expectations as of October 30th, according to FactSet. The five-year average of companies exceeding earnings expectations is 72%. Health care companies' earnings created a moment of respite for these stocks, which have otherwise been burdened by regulatory concerns. Meanwhile, the Federal Reserve cut the federal funds rate for the third time this year; shortly thereafter the S&P 500 closed at a record high. News of an approaching agreement between the U.S. and China on a "phase one deal" in their trade discussions also helped the rally.

Oil prices ended the month largely flat, reflecting a mixture of geopolitical concerns in the Middle East and skepticism on trade conflict resolutions. A barrel of WTI Crude ended the month up 11 cents, at $54.18.

Information technology (IT) stocks have gained 37.5% year-to-date while the communication services sector is up 26.9%. Most of the mega cap FAANG stocks reside in these two sectors and have been pushed higher by the resumption of the passive momentum trade, after a brief selloff in the third quarter. For valuation and

business competition reasons, the portfolio has negligible exposure to the FAANGs, which has been a significant headwind to relative returns. As we have stated regularly, however, we like where our exposures lie in more mid cap IT names with strong intellectual property (IP) and greater valuation support.

We believe intellectual property is a key differentiator among our health care holdings that is beginning to be recognized through new drug approvals.

Several of our IT holdings are seeing a resurgence in performance after suffering short-term weakness earlier this year, including data storage provider Seagate Technology. As the flash memory market continues to work off its excess supply and hyperscale cloud providers re-accelerate spending, Seagate and portfolio holding Western Digital remain well positioned. Communications chip maker Broadcom, which continues to expand its product set through accretive acquisitions, has also been a strong performer and should see continued growth as a supplier for the rollout of 5G.

Health care, an area of weakness earlier in the year due to negative sentiment related to potential changes to the U.S. healthcare system, is also beginning to find its footing. The sector was the strongest performer in the benchmark and the portfolio in October, led by several of our biopharmaceutical holdings. Biogen, whose shares sold off after initially canceling a key clinical trial for its Alzheimer's treatment aducanumab in March, rebounded powerfully this past month after announcing additional clinical data has led it to seek FDA approval for aducanumab. Vertex Pharmaceuticals also rose when the FDA approved its triple combo therapy for cystic fibrosis five months ahead of schedule.

What Biogen and Vertex share in common with strong year-to-date biopharmaceutical performers Allergan and Amgen is innovative science that is bringing treatments to the market for rare and unmet diseases where they can command pricing power. We believe this intellectual property is a key differentiator among our health care holdings that is beginning to be monetized through new drug approvals and industry consolidation.

Media, like health care, has been hurt by uncertainty around how users choose to consume video content and the fear of cord cutting. This changing landscape has compressed multiples for programmers like AMC Networks, but as companies adapt their business model to new means of distribution we believe their IP will be monetized. This is already happening through consolidation with portfolio holdings CBS and Viacom deciding to merge in August. This deal comes on the heels of Comcast, one of the portfolio's largest positions, already seeing benefits from their 2018 acquisition of Sky. We believe Comcast is uniquely positioned in both content and high-speed data to benefit in this rapidly evolving environment.

As active managers and long-term business owners, we see opportunity in change and uncertainty. We have always believed that by owning financially sound companies generating significant free cash flow, plenty of things can go right.

Portfolio Highlights

The Aggressive Growth Strategy outperformed its Russell 3000 Growth Index benchmark in October. On an absolute basis, the Portfolio had gains across four of the eight sectors in which it was invested (out of 11 sectors total). The primary contributors to performance were in the health care sector.

Relative to the benchmark, overall stock selection and sector allocation contributed to performance. In particular, stock selection in the health care sector, overweight allocations to the health care and communication services sectors and underweights to the consumer discretionary and industrials sectors drove relative results. Conversely, stock selection in the communication services sector detracted from performance.

On an individual stock basis, positions in Biogen, UnitedHealth wwere the greatest contributors to absolute returns during the period. The largest detractors included Twitter, AMC Networks, World Wrestling Entertainment, Western Digital and TE Connectivity.

During October, we closed positions in Liberty Media Liberty Braves in the communication services sector and New York Community Bancorp in the financials sector. We also received shares of Cerence in the IT sector following its spinoff from portfolio holding Nuance Communications.