ClearBridge Investments

Global Growth Strategy

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Key Takeaways

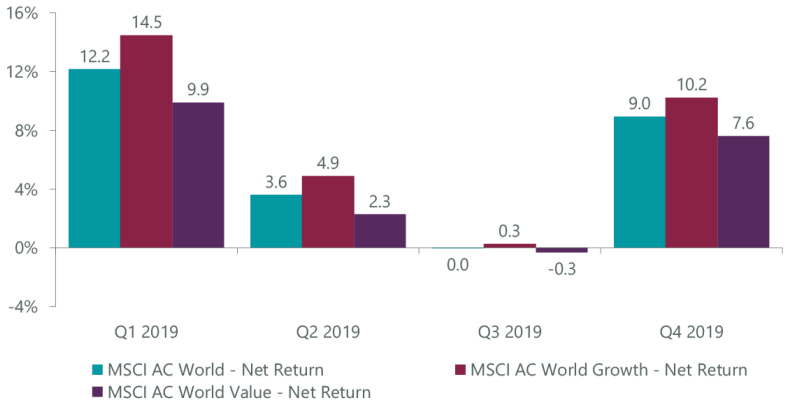
- A scaling back of economic and geopolitical uncertainty combined with easing global monetary policy sparked a global equity rally to close the year.
- The portfolio delivered strong relative and absolute performance for the quarter and the year, supported by contributions from a diversified group of growth companies.
- Attractive valuations as well as positive technical and currency trends should enable the long-running bull market for global growth stocks to continue.

Market Overview

The mood turned positive in global markets in the fourth quarter as several actions removed a measure of uncertainty that plagued investor sentiment for most of 2019. Equities delivered strong results, with the benchmark MSCI ACWI Index producing a gain of 8.95% and the MSCI Emerging Market Index rising 11.84%. Global growth stocks maintained an advantage over their value counterparts with the MSCI ACWI Growth Index up 10.23% for the quarter compared to a gain of 7.62% for the ACWI Value Index (Exhibit 1).

The fourth-quarter rally was driven by the beneficial impact of rate cuts by the U.S. Federal Reserve, optimism on a conclusion to phase one of a U.S.-China trade deal, signs of global growth stabilization and an apparent resolution in the United Kingdom as the Conservative Party won a majority in the latest election, marking the beginning of the end of Brexit uncertainty.

Exhibit 1: MSCI Growth vs Value Performance



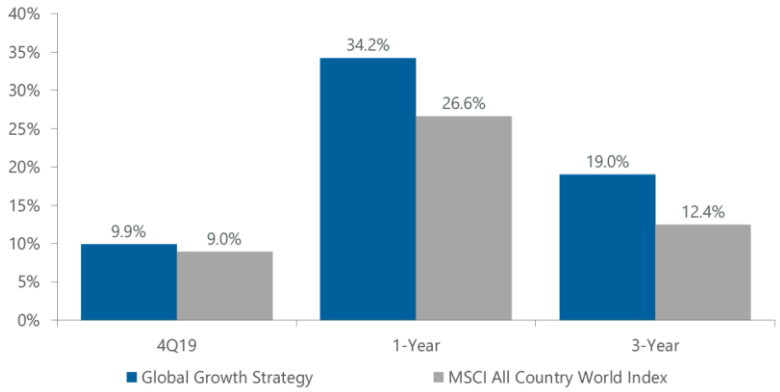
Data as of Dec. 31, 2019. Source: MSCI.

On a regional basis, emerging markets (+11.9%) delivered the best returns followed by the UK (+10.6%). North America (+8.8%) lagged slightly as did Europe Ex-UK (+8.2%), Japan (+7.6%) and Asia Ex Japan (+6.3%).

On a sector basis, information technology (IT, +14.5%)and materials (+9.3%) outperformed, reflecting a bid to cyclical stocks from a better global economic outlook as well as a preference for companies with the most visible growth prospects. Health care (+13.7%) also outperformed for the second straight quarter as abating headwinds related to an overhaul of the U.S. health care system supported better overall sentiment for the sector. Yield-oriented consumer staples, real estate and utilities as well as energy lagged in a strong up market.

Amidst this backdrop, the Strategy outperformed the benchmark for the fourth quarter, completing a strong year of absolute and relative performance (Exhibit 2). Our valuation approach to growth applied across a broad spectrum of growth companies with strict attention to risk management enabled us to weather general market weakness in the third quarter and still participate in more momentum-oriented periods, including the fourth quarter.

Exhibit 2: Recent Performance vs. Benchmark



Data as of Dec. 31, 2019. Source: FactSet.

Electric vehicle manufacturer Tesla was a leading contributor during the quarter, boosted by better than expected third-quarter earnings results. While investors have been concerned about the company's cash burn, the latest results show that Tesla is reaching the point of self-funding its growth with margins moving higher. It is also making aggressive inroads into China with the opening of its Shanghai Gigafactory which is slated to start producing its Model Y SUV in summer 2020. Chinese e-commerce and payments conglomerate Alibaba also rallied late in the year with the apparent thawing of trade tensions between the U.S. and China. Both Tesla and Alibaba are direct plays on the Chinese consumer, which is where we see the best near- to medium-term growth trends in the world's second-largest economy. Both companies fall in our emerging growth bucket of companies with disruptive business models and above-average growth profiles that can also carry a higher degree of risk.

Secular growth companies make up the bulk of the portfolio. These are long-term compounders with established business models, leading market positions and strong balance sheets to weather difficult conditions. The portfolio's semiconductor holdings – Nvidia, Taiwan Semiconductor, ASML and Samsung - performed strongly, driven by improving trade sentiment and what that might mean for future activity in China and other Asian markets. U.S. companies Apple, Microsoft and JPMorgan Chase as well as French luxury goods maker LVMH also drove performance in the secular bucket.

For portfolio balance and to ensure we are not overlooking non-traditional growth opportunities, we also target stocks that we consider structural growth stories. These are companies that are either in a cyclical industry that is coming out of a trough period or are involved in a restructuring or similar change that should lead to a step change in earnings. Here we are seeing good results out of Swiss pharmaceutical makers Roche and Novartis as the drug development thesis begins to play out.

A valuation approach to growth enabled us to weather market weakness and participate in more momentum-oriented periods.

Portfolio Positioning

We took advantage of post-IPO pricing pressure to add to our emerging bucket with the purchase of Swedish music streaming service Spotify Technology and Teamviewer, a German developer of cloud software that allows connectivity solutions for remote access, monitoring and control as well as sharing/communication and collaboration. The company has been aggressively de-leveraging since its third-quarter IPO and is early in the penetration of new clients globally. Adyen, a Dutch-based global payment service company with major advantages in technology, was another new addition within emerging growth. Adyen's built from scratch platform enables merchants to operate on omni channels with higher speeds and higher acceptance rates versus the competition. The company has already attracted such clients as Spotify, Facebook, Netflix and Uber and is adding additional geographies for its client base.

We upped the portfolio's structural growth exposure during the quarter with the purchase of Thomson Reuters and Credit Agricole. Thomson Reuters (TRI) is the market leader in providing information services for the legal and tax industries. We believe the Street is underestimating the company's earnings power over the next five years. TRI was undermanaged for years, which led to underinvestment in new products and a less optimal margin structure. It recently sold off a majority stake in its finance and risk business Refinitiv to LSE, which should enable it to focus on expanding its core products and cutting costs.

France has among the best loan growth in Europe and French financial services firm Credit Agricole is a good self-help story in this market. It has been divesting non-core divisions to reinvest in its higher-yielding existing core businesses. The company is seeing improvement in its investment bank and holds a stake in the solidly growing asset manager Amundi.

To make room in the portfolio for companies with better top-line growth stories, we sold out of seven positions during the quarter. We exited our stake in Pfizer due to increasing risks around their Chinese health care business while media and communications software developer Amdocs was sold as it approached our price target. On another positive note, we sold our stake in Dutch data center operator Interxion after the announcement of its acquisition by a competitor.

Outlook

We see reasons for optimism in 2020 that are underpinned by policy moves. The European Central Bank has resumed a measured program of quantitative easing and the U.S. Federal Reserve has lowered interest rates. China and Japan continue to

stand ready to provide liquidity to their economies should there be signs of economic weakness. In past cycles, increasing money supply has supported stock values after a several month lag, with the manufacturing sector picking up soon after. International manufacturing PMIs seem to have stabilized with China's PMI showing improvement. With a short-term truce in the U.S.-China trade war, which would be supportive for developed and emerging markets, we are setting the stage for a broad-based recovery by the second half of 2020.

International equity valuations remain attractive, particularly in the United Kingdom and Europe compared with U.S. equities. European stocks are at 50-year lows versus the U.S., which has represented a good entry point the last two times performance dispersions became this extreme. Near-term risks in Italy are contained for now with a new moderate government in place. Fiscal stimulus is being discussed within the EU, which would be a clear positive, while the Brexit saga appears near an end.

Within the U.S., we are focused on owning companies with innovative business models and an ability to build leadership positions in markets that can grow for an extended period of time such as cloud software, electric vehicles, athletic footwear and online advertising to name a few. While they may appear expensive on current year valuations, we believe the multiples of these companies are consistent with their above-market growth rates.

We are aware that the bull market is in late stages, but with central bank stimulus and very low interest rates, the markets can continue to perform. Often the last one-to-two years before a recession are strong performance periods. The risks for 2020 are more geopolitical or tied to the potential for central bank policy errors. The latest Middle East developments involving the U.S. and Iran will likely have no major impact in the short term, but could create trouble for the world economy if oil prices spike and sustain levels which impede global growth. In this ever-changing environment, global growth stocks have held up well and our team remains focused on our valuation approach to growth. With this market backdrop, we believe that growth as a category continues to outperform other areas as investors seek growth that is not predominantly economically driven.

Portfolio Highlights

The ClearBridge Global Growth Strategy outperformed the benchmark MSCI ACWI Index for the fourth quarter. The Strategy delivered gains across all nine sectors in which it was invested (out of 11 total), with the primary contributors coming from the IT, consumer discretionary and financials sectors.

On a relative basis, overall stock selection and sector allocation contributed to performance. In particular, an overweight to IT as

well as stock selection in the consumer discretionary and financials sectors drove relative results. Conversely, stock selection in the consumer staples, health care and communication services sectors detracted from relative performance.

On a regional basis, stock selection in Europe Ex UK had a positive impact. Japan, a market that had been very strong through the first nine months of the year, weakened during the fourth quarter, underperforming the market overall.

Our emerging markets exposure allows us to find strong growth opportunities that provide higher and more sustainable growth ideas than ones we can find in developed markets, particularly Japan. Our positions here are largely oriented to growth in Asia and China, two areas which performed strongly for the quarter.

On an individual stock basis, the largest contributors to absolute returns in the quarter included Apple, Tesla, Microsoft, Nvidia and Alibaba Group. The greatest detractors from absolute returns included positions in Twitter, Shiseido, Hansa Biopharma, Elastic and Arco Platform.

In addition to the transactions mentioned above, we initiated positions in Euronext and Truist Financial in the financials sector, Chewy in the consumer discretionary sector and Arista Networks in the IT sector. We also closed positions in PNC Financial Services in the financials sector, Slack Technologies in the IT sector, IHS Markit in the industrials sector and Rogers Communications in the communication services sector.