ClearBridge Investments

Webinar: PM Perspectives: Aggressive Growth and Multi Cap Growth 2Q Update

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With Aggressive Growth and Multi Cap Growth Portfolio Managers Evan Bauman (EB) and Richie Freeman (RF) and Portfolio Specialist Corey Hardie (CH)

CH: Great, thank you, Michelle, and good afternoon, everyone. Welcome to the Aggressive Growth and Multi Cap Growth Update Conference Call. Again, my name is Corey Hardie. I'm a member of the Portfolio Specialist team here a ClearBridge Investments, and I'll be your host for today's call.

Joining me, I have the co-portfolio managers of the Aggressive Growth Fund, and the Multi Cap Growth separately managed account: Richie Freeman and Evan Bauman. Richie has over forty years of investment industry experience, and he's been managing both the fund and the separately managed accounts since their inception. Joining him is his partner and colleague Evan Bauman, who has over twenty years of investment industry experience, and has been working with Richie as a co-manager on the fund and the SMA for fifteen years.

As a quick refresher on the strategy, Richie and Evan strive to deliver authentic, active management through meaningful investment in a concentrated number of companies that they believe will exhibit strong growth characteristics over a long term. The result is a high active share, high conviction, low turnover portfolio that they feel will generate returns that are very differentiated from the benchmark.

Today, Richie is going to kick off the conference call by providing some thoughts surrounding the challenges and opportunities of the current market, and Evan's going to provide an update on the portfolio's current positioning, as well as an outlook for the strategy.

After their prepared remarks, we'll move to a Q&A format. We do have a couple questions already queued up for the PMs to answer, so thank you to all of you who submitted questions in advance to give us direction for today's call - we really do appreciate that. Please keep in mind, however, that if you have not submitted questions to this point; we invite you to do so and submit them through our web-based platform, and we'll try to get through as many of those as we can over the next hour or so. With that, I'm going to pause there and turn it over to Richie for his outlook on both the market and the portfolio.

RF: Corey, thanks very much. I'm going to quote Mel Allen; "Hello everybody, it's always great to do these calls." We've been doing them...roughly we try to keep it on a quarterly basis, and what we always try to do - I ask for the transcript of the prior calls to see if the parameters that we're using back then are still valid right now.

Surprisingly, very little has changed from what we laid out back when we did the December call. If you remember, at that time I said that we thought that the market was making a major bottom. Actually, we thought it did it in November. Didn't see the fifteen-hundred-point implosion after that which was

Fed- aided. But, ironically, it was the Fed's last hike of interest-rates which caused that decline, which is sowing the seeds of this powerful bull-market.

The market I think, because the Fed raised rates back in December, is probably going to lead to a stronger recovery - stronger rally - much stronger bull market than otherwise would have been, because - for the first time now in probably a decade - the Fed has indicated that they might actually be cutting rates.

Also indicated back then, and I think it's very valid to say that stock markets tend to bottom every four years in powerful, powerful bottoms. I cited the bottom that we saw back in sixty-two, sixty-six, seventy...just keep enhancing that roughly every four years. And it happens in the off-Presidential election cycle. I think it's very valid. And depending on the psychology of the investor going into that, you can either have a modest rally - thirty percent - or you could have one that's substantially more than that.

But I've read numbers that, coming off one of those four year bottoms - this is the only cycle that I actually talk about because it's worked for the last fifty years. It works until it doesn't work, but coming off of that you tend to get rallies that sometimes they're as much as fifty percent and you've never had one that's been less than thirty percent.

That's all well and good - it's what you own that's going to be most important. I looked at it back what we said in April, and we talked about the relative valuation of the portfolio compared to the market, because it's always, understandably, a lot of concern about what is your benchmark doing - do you hug a benchmark? Why don't you own some names? Why are you owning certain names?

I do not remember a time - I've mentioned back in April - where the valuation of the portfolio, compared to the market - that's the one time I'll talk about 'compared to the market' - was as relatively attractive as it was back...I'd have to go back maybe to the nineteen-ninety-six period, or maybe back to the beginning of two-thousand-and-three, which will not guarantee that we're going to do well, but it tells me from a starting point I think the risk reward is significantly in our favor.

The one thing I remember saying - and Tom Sharpe cited me on this one - "I didn't remember a time when we had more potential companies in the portfolio that had the potential to rally between fifty and one-hundred percent," which sounds rather outlandish, but if you take a look at the starting point valuations, I really don't think it's that crazy.

We did the call probably right after Anadarko got a bid made by Chevron for them. Anadarko was trading in the forties, Chevron made a bid in the sixties; it was eventually upped and accepted when Occidental Petroleum made a bid in the seventies, so. For a stock that was languishing; they became monetized and a lot of performance happened all at once.

Another name that we've seen, also, was Allergan. Allergan was lagging poorly until AbbVie came along and monetized it. We never know if our companies will be acquired, but we've always said the probabilities will increase; that you will have acquisitions in your portfolio, if companies are selling at ten times earnings or less, throwing off a lot of free cash flow, buying back stock, reinvesting in business.

And stocks, a lot of times when you own them, there's almost a feeling of despondency. "Why aren't these stocks doing well? The street has to know something. Why is Allergan at one-fifteen? There has to be some kind of problem. Why is Anadarko at forty-six? Clearly there's something wrong."

But a lot of other companies, they don't care what investors think if they can take advantage of it, and in that case Occidental as well as AbbVie did take advantage of it in the process of acquiring them. It's an area that we have right now in the market. I think is why it's still conducive to being a powerful bull market is, you're at a point right now where the market is almost forgiving cyclical companies that are

going through earnings pressure, because you're looking towards the other side.

If the Fed were not indicating that they would be lowering interest rates, that would be a different story, but you've seen it now with some of the storage companies, some of the semiconductor and memory companies that've been missing expectations, yet the stocks have been very resilient. That's a hallmark of a powerful bull-market. Because, on the other side of that, when rates are lowered - and rates are going to be lowered per what the Federal Reserve has said - then you start to improve business conditions and you start to see the other side of the earnings estimates eventually rising.

That's why markets like this usually don't peter out in six months - they tend to last really for a couple of years or so. That's the underpinning of how we feel. I don't think that the valuation of the stock market right now - even though the S&P is at three-thousand which is at an all-time high - I don't sense that the overall valuation is anywhere near as egregious as it was back in two-thousand. We've gotten a lot of questions, "Do you think there's a bubble?" I think valuations are far from that.

However, there's an amazing dichotomy between valuations of companies that sell at six, seven, eight times earnings, nine times earnings, and other companies that are selling at multi-hundred-billion dollar market caps. I mean, clearly, they're great companies, but eventually you reach a limit as to what a company should be valued at versus its cash flow, etc.

I'd rather go to sleep owning companies that are selling at six, seven, eight times cash-flow, where we can have an upward readjustment of valuation, where companies are...I'll call them, "out of favor" in the stock market, and companies are taking advantage of it. To me, I think that's the tried and true traditional way to make money in the stock market. Short term, I can't tell you what they do, and that's exactly what I said back in April. We can't tell you where the next ten or twenty percent move in the stock will be, but if you're starting from valuation points...

We saw a good example today was Biogen, which was a very crowded passive long if you want to talk statistics. Very few people - very few active managers have owned this stock. It's been sold down, it's clearly been disappointing with their Alzheimer's failure this year. You get down to a level where you're trading at seven times earnings, buying back your own stock, it doesn't take much of a positive surprise to see an upward revaluation in a name like that. And it's not just Biogen you can go down. There's a myriad of companies that we have. That's part and parcel.

Evan can talk about the numbers; he has some great statistics, but net-net I think the bull market is clearly under-way. I think it's a powerful bull-market. The best thing would be if we have periodic five - eight percent corrections. We had one a couple of months ago. They tend to perpetuate a bull-market as oppose to terminate them.

You'll know it's over when you have over sixty-five percent of stock market letter-writers bullish. Traditionally euphoria tends to end bull markets with a little bit of a lag. You're not near those levels right now. I think there are some crowded trades I think could be subject to some meaningful declines, but we feel very good. I feel great about the overall position of this portfolio.

So, Evan, why don't you take over the reins, now?

EB: Yeah, thanks. Sticking with the Mel Allen Yankees theme, I guess I'm Mickey to your Yogi; but as a new kid only here twenty-five years.

But I think what Richie talked about - it's important to just review a few of the points. I think when we joke about how long we've been doing this, and, legitimately, I think when you look at a strategy that's been around since nineteen-eighty-three with a very consistent team - very few managers have been doing this as long as Richie and have a junior guy who's been part of the team for over twenty years with a consistent process and philosophy and, really, a product philosophy which has worked in all different markets in terms of growing client assets and building wealth.

For newer clients, particularly, it's important to review, a little bit, the process, and speak about how we manage money - what makes us so different from many, more traditional, style-box-pure or benchmark-sensitive growth funds and strategies and SMA's today, where we really do think of ourselves as long-term business owners.

Richie made reference to a number of companies - some of which are involved in M&A and some of which are companies which are larger cap in nature today; established companies with profitability like Biogen, that we've known for decades - we've owned for over, in that case, twenty-seven years. And I think in today's environment - which is...we always speak about the short-term nature of the trading environment today - the idea "What have you done for me lately?" in terms of performance, and what's the next great stock for tomorrow?

I think, when we look at the way that we built client wealth over the long term - it's really consistent today with the way that it was done years ago. It's focusing on innovation, focusing on business models that have the ability to generate meaningful amounts of free cash flow and grow the cash on a durable, sustainable basis. We're looking for intangibles like IP and patents, and companies that are - in many cases - and again we'll talk in specifics about today's environment - but I think we're really looking for mispriced companies in the public markets. Companies that can be monetized over time the way some of our names have been, you know buying them small and made and riding them into the later, larger stages of growth or by other companies.

I think one of the big themes Richie touched upon - Allergan and Anadarko - is as important to today. I'm sure there are questions about those deals and we'll hopefully hit on that, but the fact that since nineteen-ninety-six we've had about eighty companies acquired; so almost four per year on average in the portfolio. It's not that we seek out companies to be acquired, but when you look at environments like today were you have not just undervalued businesses in areas like healthcare, media, non-FAANG tech and obviously what's happening in energy, you have under-valued businesses generating a lot of cash with cash on balance sheet where you also have growth.

And I think one of the things that gets lost with the strategy like ours, particularly over the last couple of years - you know - newer clients look at multi cap growth or the aggressive growth strategy and they say well you guys are "core-ish" or you're value managers, and I think when you have to think about how we define ourselves, we are truly growth managers.

We're long term, looking for long term business models that can stand the test of time with big addressable markets at their behest where they have unique products and services that change the way medicine is prescribed or the way that products are used that are disruptive. We're just looking not to overpay for them.

So I think what's interesting and important to frame today's discussion is, you have a lot of the growth universe that is really undervalued today - it's not that we're owning necessarily traditional value areas like banks or autos - we're owning companies that are across the board, on average, growing double digits, that happen to be trading today - in many cases - at single digit or low double-digit multiples of earnings. Trading at big free cash-flow yields, trading actually at dividend yields that today are higher in the market. Something we never focused on.

And obviously, I think what's happening in areas like health-care and media, which are two key important areas where we have overweights is indicative of longer term trends, where larger companies, which are generating cash - which many of them themselves are trading at discounts to history - are looking to the stock market right now as a means of accreting growth over the long term: buying companies, trading at multiples which are equal to or less than themselves, which gives them the ability to extend the runway of cash flow.

That's what's happening with the AbbVie / Allergan proposed deal - I think that's what's happening in the energy complex around the exploration space, and longer term I think that's an important trend that's happening. Richie mentioned that. We're in an S&P right now that's within a short shot of all-time-highs. The multiple on the S&P is certainly not near or close to bubble levels. Sentiment is still very negative in most of the market.

You speak to executives and boards in areas like energy and healthcare, and they'll tell you that the political rhetoric and in some cases the headline risk in areas like energy have suppressed multiples significantly, to the point where the best way to create value for shareholders is through buybacks; through reinvesting in the business, but if there's a bid out there - and I know we'll get into more of the M&A discussion moving forward, but if you have a real bid at a forty or sixty percent premium, it's certainly worth considering. I think that's what's starting to happen in certain areas of the market.

What Richie and I spend the majority of our time doing is engaging with managements - with, in some cases, boards, and saying, "What can we do? In an environment where we're not getting paid for the growth that you're delivering, are there things that can be done?" And I think you're going to see more creative type deals, I think you're going to see a lot more M&A, even after these deals.

It wouldn't be unlikely to see more and more consolidation in certain areas, because frankly the market is - at this point - the overall stock market - it's similar, as you said, Rich, it's not the nineties in terms of a true traditional asset or valuation or sentiment bubble, but you certainly have crowding. You have, I think, a lot of growth managers feeling more and more pressure to own fewer and fewer stocks that are dominant in the indices.

Remember, we're in a point right now where the growth indices have a third of their assets in ten stocks. A quarter of their assets in five stocks. That to me is a case where you have. A lot of stocks where there's complacency, there's crowding, and then you have a lot of the market that's really miss-priced right now.

Our sense is - and this is an important point just to finish on, and then we'll go to Corey for questions - we always say to ourselves; if we were starting a portfolio today, what would we buy? And importantly, the answer is these companies, at these multiples, with this type of growth, in the areas that we own.

If we were doing this for ourselves, what would we do? And I think we always make the point that our single largest personal at-risk investment is this strategy, and we wouldn't do anything differently for ourselves then we're doing for you as the client.

I started out by talking about consistency. Look: results of a portfolio that manage with this type of active share, that's ninety-six percent? The results are not linear. The results are really not correlated to traditional growth strategies, but I think thirty-five, thirty-six years is a pretty good testing period. You've been through every type of market environment including the most recent five years, which have been disappointing on a relative basis, even though we've made money for clients.

If history is any indicator, ultimately the reversion to the mean in terms of multiples - the reversion to the mean caused by consolidation in certain areas is in the early days of starting to occur, and as we always say, "Look, we feel good about what we own" as Richie said, "Right now, point in time, today, we probably feel better about what we own, just given where the statistics and the characteristics look than any point in the recent history, and let's get into some of the detail on the What and Why's of some of that background.

CH: Great. So, sticking with the M&A theme, both Richie and Evan touched on M&A in their prepared comments; but as you mentioned, some of these names are depressed, like Anadarko for example when that bid comes in. So, how do the two of you decide what's a fair price for a company to pay for

a stock like that in the public market, when you think the private valuation is deeply discounted?

And then as a follow-on question; we've got this through the portal: one of the questions was around, "How do you guys decide whether to own or sell the acquiring company when you do see that M&A activity happen?" So, if you could touch on both of those, sticking with that M&A theme I think the listeners would appreciate it.

EB: Yeah, it's Evan, I'll take the first crack just because I'm warmed up. I think there's good M&A as there's bad M&A. M&A is a by-product of everything we described in terms of the process. We're not publicly speaking about our investments, we're speaking to you, the clients. We're not going on TV and saying a company should sell itself. We're not buying an investment. With the short-term hope that they get sold.

I think it really is where, if you buy companies early and you buy them when you feel like the public markets are miss valuing the cash flow streams, and you buy good IP and you buy good forward-looking management's with balance-sheet strength, other companies should be targeting those same types of characteristics.

And we've had periods - you know you look at a period like two-thousand-twelve to two-thousand-fourteen, I think we had ten takeovers in a very tight period in less than three years. we've had other years in the market post-tax-reform, you didn't have a lot of takeover, so we had some smaller deals, but the market itself really wasn't going through a lot of M&A. More companies were doing buy backs than M&A.

But I think if you look at the history, I think they're definitely cases where you get full value for your shares, right? and of course it depends what the structure of the deal is. Some are cash, some are a combination, like the two most recent deals; and some are all stock - more merger types where we've held the combined company like a Broadcom Avago deal or a Medtronic Covidien, where our company really used that as the next leg of growth for the acquiring vehicle.

Those are certain deals - we get others where we feel like we're getting full value. When Danaher bought Pall-Corp they paid cash and we thought we had a really good price that they were paying for our assets, so it depends on the deal, Corey. It depends. We look at every deal uniquely, and I think that at the types of multiples the overall portfolio is trading at, I think there are companies that we own were you wouldn't want them to be acquired - even at a reasonable premium.

I think there are a number of names, for example in the media space, where a company trading at a rich multiple that's a streamer - an over the top video type service could buy some of our programmers at twice where they're trading, and it would still be massively accretive to their own cash flow profile, so it's going to be interesting to watch and see what happens - I think.

In the two deals we discussed earlier, I think, as we made reference to, it's a good deal even at the forty-to-sixty percent premium. These could end up being very good deals for the acquiring company, and I think that in the therapeutic space - for example in the biotech space - unless we got a meaningful significant premium, we'd rather see more creative structures in terms of deals. Maybe a company takes an investment in one of our names at a meaningful premium - takes a stock or an equity investment.

So, yeah. I mean, the reality is, in areas like energy, you're going to see more deals. It's the only way I think that you start to close the arbitrage between public and private market values. But I think for us as shareholders, we're really looking to create value over the next ten or twenty years. You know, you don't necessarily always want to deal.

The famous one was Chiron in two-thousand-six. We had held the name since nineteen-eighty-six, and I'll quote Richie to himself, who said, "If I don't get full and fair value for all of my shareholders, I'll vote against the deal," and we actually did that publicly and ended up getting a meaningfully higher final price in the deal.

So, we think long term, and we think about not just making a quick buck, but obviously trying to accrete as much value to us as the shareholder, and our clients as is possible.

RF: That's a great point. And the Chiron thing is a great illustration of we call ourselves passive investors, we're not activists, we don't stir the pot. However, and the big however is, if we do have meaningful stakes in companies and we don't agree with the price, we're not afraid to publicly file forms and as we did with Chiron, as we also did with ImClone if you go back also over a decade ago. But sometimes the price will be so attractive that you have to be crazy not to take it.

I remember a Saturday afternoon this year sitting in the Port Washington diner, I saw the rumor coming across that Roche is going to buy Spark Therapeutics at more than twice the price. That, to us, was a surprise. The price itself was, we thought, terrific and it wasn't a question, are we going to play arbitrage to catch the last eighth of a dollar. That was a very pleasant surprise and we took advantage of it. That was a cash deal, which, to-date, still hasn't closed yet. We're glad we took the money on that.

CH: Great. So, healthcare is a huge part of the portfolio and we've seen some of the deal activity we've been talking about like the Allergan being taken over by AbbVie for about sixty-three billion dollars, we've seen at an activity there. But a lot of investors are worried that there might be an overhang on healthcare as we enter this US presidential election cycle. So, how are the two of you thinking about your healthcare exposure, given those two conflicting themes within that space?

RF: I guess, let me take a first crack at it. There has been concern about healthcare stocks and health care earnings, I want to say, really since nineteen ninety-three when President Clinton was president and Hillary Clinton was going to revamp the healthcare system. And if your member at that time the stock sold off dramatically and it was a great buying opportunity. And we saw when President Obama won, it was also a lot of concern, is there going to be single payer, stocks got down to very cheap multiples.

I remember United Health Group stock got down to, Evan, it was probably the teens at that time before it's moved into the two hundreds right now. So, it clearly does have negative psychological connotations. At this time, it seems that both parties are for lowering healthcare costs and they want to prevent costs from continuing to escalate the way they have been. And in one respect, I think the jawboning that President Trump has been doing has kept price increases down significantly.

Price increases on drugs, with a few exceptions, are the lowest level that we've seen in quite some time, with the exception of some often drugs. And I think companies are afraid to be the first one out there raising price, being the one to raise the price by fifty percent, you don't have that anymore. And I think jawboning has succeeded in keeping pricing down.

Now, whether he's going to pass anything that's going to be much more draconian, it's sort of flies in the face of what he also tried to accomplish, which is to try to get more innovation to try to get drugs approved earlier.

What incentive is there for a company to develop a drug that could cost, in a sense, over a billion dollars if you don't have the ability to price it attractively and If they're going to be clamping down on some of your existing drugs, which have been approved, and say you want to lower the price those drugs twenty or thirty percent, that would clearly have a very negative impact on a company's earnings. And it would I think it would be a hindrance to spending more on R&D.

So, it's really sort of an oxymoron, it really runs counter to each other, it's going to have to be a balancing act. What I like to see is more jawboning. I think from this point on if they want to put some kind of a cap on future price increases to inflation or something over that, I think that would be very palatable and I don't think that would have a very negative impact on future drug activity.

But it's very important, now more than ever, when you've had so many terrible diseases; ALS, Alzheimer's, where there are no cures, this will be the exact wrong time to disincentivize people to be spending more in R&D. The best way to do that is keep lower prices, I think that runs in the face of exactly opposite of what the administration really longer-term would like to accomplish.

EB: Yeah, the only thing I'd add is I think investors are finding every excuse not to own healthcare and every excuse to own tech and that's where the similarities with the nineties come in. I think if you look at the earnings, it's not just cheap. I think it's important to talk about the earnings of these companies remains strong with Biogen's report today. I mean, Allergan had beat a number of quarters in a row before the acquisition and the market would find every reason to sell the stock and not want to own a name that actually had north of sixteen dollars per share of earnings. It was trading at about a hundred and fifteen bucks a share.

UnitedHealth Group, same thing, incredibly strong. They've taken years to build up a business that's vertically integrated that's incredibly scalable and diverse and is actually part of the solution in bringing down prices to the consumer on a number of fronts, including cost of drugs. But each time they reported the stock would sell off because of the "political risk" and the environment around some of their peers were falling further and further behind UNH in terms of market share in terms of the diversity of the business.

And then, what Richie touched upon, in terms of unmet needs. There's so many right now in rare disease and neurology and even in cancer still, where you have companies down the small end of the portfolio, some of the very small names that we own trading at basically the cash on the balance sheet. You have other names like Ionis and Vertex, which are sustainably profitable for the first time in history versus when we bought them years ago better still trading at attractive multiples.

And then you have the big names, which if you look at the big companies that are generating a lot of free cash flow, I think slide seven just shows how big the gap has gotten, sorry, slide five, between the mid-tier and then the big profitable biotechs that are generating a ton of free cash flow. They're at huge discounts to where they've historically traded vis a vis their peers. So, you still have big addressable markets out there.

As Richie said, FDA, more so than the congressional and the administration talking about pricing, FDA is very forward-thinking on innovation and bringing drugs to market sooner in disease progression in diseases like Alzheimer's, ALS, and Parkinson's by genetically figuring out who might be at risk for these diseases and getting safe efficacious treatments on the market. And then bringing down prices with more generics that impacts much more so the pharma companies that we don't own, which are those that have really been in the market to acquire the innovators.

So, I think there's a lot of positive things happening both at the fundamental level; earnings have been strong, multiples are compressed, M&A is certainly starting to accelerate. And realistically scientifically you're getting areas like gene therapy where Richie mentioned Spark, which got almost a five billion dollar price tag because of the innovation in gene therapy they were providing. And that's a big number for a very early stage company.

So, scientifically there have been a lot of advances and, obviously, you're not paying for that in the market right now. But I think a lot of generalists, they're afraid of the headlines, they're afraid of the political environment. We've owed the space for thirty-five years, it doesn't mean that you get paid

tomorrow. But at these types of valuations I think the risk reward is incredibly compelling in that space.

CH: Richie, Evan, both of you used the word innovation in describing your healthcare holdings. And one of the questions we get pretty frequently and we're getting on the platform right now is regarding the FAANG holdings; Facebook, Amazon, Apple, Netflix, and Google, and are we missing out on innovation by not owning those companies in the portfolio? So, can you speak a little bit about the portfolio's tech holdings, how you view tech, and how you feel like you're playing some of those trends, like maybe internet of things and 5G?

RF: You can take that, Evan.

EB: Yeah, I'll start. I mean, I think we are playing them. I think we're just not playing them through the trillion-dollar consumer facing big name. And, look, those are great companies, I made an important point earlier that this is not the nineties where you had companies at ten, twenty-billion-dollar market caps that never should have been public, that were out of business three months after the Nasdaq crashed. These are great companies, many of them actually generate meaningful amounts of cash flow, and they're great businesses.

I think the point that we're making is underlying those five or six stocks, there's also some great opportunities within technology supporting a lot of the growth of those companies, areas like the cloud couldn't grow without Western Digital and Seagate supporting the storage in data centers and nearline storage, which supports the cloud. And yet you were paying six times earnings with six, seven percent dividend yield earlier this year for a couple of those names.

Which Western Digital, quietly, is up fifty plus percent this year and it's still trading at less than ten times mid-cycle earnings. Same with Seagate is up I think twenty-five to thirty percent, as well. And you just can't have the growth of the big stuff, areas like connectivity where Broadcom and 5G they're a major player in building out the infrastructure of all these next generation technologies.

TE Connectivity and Cree, which are really big beneficiaries of the growth of electric vehicles and the growth of connectors and sensors and content that goes into these vehicles. Broadcom is, as well, in some of their discrete microprocessors.

So, it's not that we're adverse to tech, it's just that we've made the point for years that I think technology, particularly consumer and internet, they're competitive markets. And I think what you had recently is so much flow to passive and so much active crowding in these names where if you're of growth portfolio manager and you don't own FAANG and you're getting graded versus an index and those five stocks are up again over thirty percent on average and comprise a quarter of the index, you're probably at this point chasing. You're buying them essentially to neutral weight the holdings there.

And we don't we don't necessarily think about what's in the index, we know what's in it, we know what we're getting rated verses but we have some very good, actually some great technology companies that are not necessarily household names that are supporting, again, the storage, the connectivity, the speech recognition, and a lot of the growth of the backbone of the internet through the infrastructure space.

So, again, I think when you look at the weighted average cap of our portfolio, we're down around fifty-five to sixty-five billion. The index right now is about three hundred billion, it just speaks to, while these all might be great companies, I think you have to look at what else is in the market that's not being reflected in terms of the opportunities.

And the market doesn't have to turn on a dime and shift leadership, but if it broadens out beyond the five hundred billion to trillion-dollar companies, that could be a good flow of funds into some of these areas like mid cap tech where there's some good opportunities that are not being fully monetized right now.

CH: So, you'd spoke a little bit about the flow toward passive and how that's creating this crowding into a handful of names. There's a lot of investors out there who will draw the parallel between today and the tech bubble as a result of that crowding being mostly in those big consumer facing tech companies. Can you speak a little bit about how you think about today versus the late nineties and if there's anything in the portfolio that you guys are doing to provision for that?

RF: I had mentioned before that I think there's such an amazing dichotomy, though, between some companies which we think are you know fully priced and others which are egregiously underpriced. I don't have any sense that it's anywhere near, in total, the same kind of valuation level that you saw back in in two thousand. At that time you had pets.com, etc., etc.

You had companies that were in the new issue market opening up three to five hundred percent with very few exceptions, you don't have that right now. The fact that some of the ride sharing companies, while they had hyped IPOs, actually traded down afterwards. I actually view that constructively showing that euphoria is nowhere near what you had back then. So, you're always going to have some stocks that are going to be dramatic outperformers.

The people that have missed the market are always need be comparing it to prior tops, hoping that there's a parallel. I don't see it yet I think you have to have much more euphoria, which you really haven't had yet. I think you have to get multiples significantly higher, you have to get the Fed easing for a more prolonged period of time, and you have to get a period of over valuation and almost parabolic moves upward before I think that you can start drawing parallels to back then.

It doesn't mean that there aren't some companies they can't go down forty or fifty percent that have been here to for some of the best stocks in the market. It's going to be on us to try to own the ones that we think of the best risk reward. I know you're probably tired of hearing of it, but we've been here before.

I just think it's an overlay in many of our companies, it doesn't make sense, to me, how a lot of our companies are remaining private selling at six seven eight times earnings going up this cash flow. But Wall Street's going to wake up or somebody's going to monetize them. But I don't see the strict parallels to two thousand right now.

EB: Yeah, the only thing I'd add is we always say it but the toughest thing is timing. So, you can make a lot of money in buying very expensive, you could make a ton of money in the bubble if you sold at the right time. What happens with a strategy like ours, what we started at the beginning by talking about, is the people, the process, the philosophy of the product being consistent.

We're going to do what we do well and, unfortunately, with a strategy like ours, money is typically coming in after periods where our numbers are top across every period and it comes out after a period like the last few years where, on a relative basis, we haven't kept up with the index. And in March of two thousand, even the most bearish on the tech sector, no one thought the Nasdaq would drop eighty percent. And, again, you only knew in hindsight that you had that type of massive bubble.

But we were sticking to our guns, even with good returns in ninety-eight, ninety-nine, we were losing money to the hot dot. And I think what's important to today is you're not going to hear us say, "Well, things have permanently changed, now, we need to own benchmark companies and we need to manage to an index." If we're right, you'll know in hindsight, then we're going to produce results in the environment, which is the next three to five years.

And we've given you a few reasons why we think we're in the stages of that starting to swing back towards some of these undervalued growth areas. But I think that is the key to what we do is staying consistent to ourselves, a discipline that's worked for thirty-five years and not reacting to what's been, obviously, a very hot growth tape. And a lot of that has been driven by fewer and fewer names.

So, totally different environment in the nineties, sentiment is still very negative. Valuations, as Richie said, the S&P is half of where it was back then, we're not saying it's that. It's more a matter of I think we try to remain consistent to what we do well in terms of owning good undervalued businesses.

RF: I mean back in two thousand, if you remember, Nasdaq had a major crash, we made money for people, money started flooding in. And then, we what wound up raising the minimum on our product to try to discourage hot money from coming in because we thought it was poor timing.

We encourage money to come in when we think that the risk reward, the valuation of our stuff is egregiously attractive. We try to discourage it if we think it's the other way. And we just thought that the climate towards us became euphoric as the market itself became very panicky. And we'd rather keep people in to our product when we feel very good about it, this is one of these times.

CH: All right, great. And then, one final question before we let you guys go. And we actually addressed this last time, but I think it's important to go over quickly again because we got it in from the portal a couple times.

But the question was, did you ever own FAANG in your portfolio? And if so, when and when did you exit? I think that going over this does a good job of highlighting how you two think about buying names in the portfolio.

EB: I would just - go ahead, Rich.

RF: No, give them Facebook.

EB: Yeah. I was going to say and we bought a meaningful position in the Aggressive Growth Strategy in Facebook in the fall of two thousand twelve. And we've gone through this, but it was only seven years ago, it feels like forever. But at the time the company was being, the analogy was Myspace, media was portraying it as a zero, talking about why a social media is a fad not a trend. We look at the business, the balance sheet, and the opportunities for growth when the stock was trading in the low twenties on its way down to the mid-teens and we thought that was great opportunity there.

We took stock at eighteen and I remember our trader Lisa [Utasi] saying, "At eighteen you could buy as much as you want," because there was so much stock for sale six months after the IPO and there was so much negativity around the business. Well, you flash ahead five six years, and the stock was trading between a hundred and fifty and two hundred, it was a top five position then for virtually every growth manager and we took meaningful profits in the name.

We've redeployed, as many of you know, a lot of those funds into Twitter, which is still a name which is a fraction of the market cap it's less than a tenth of the size of Facebook and Amazon, actually a twentieth of the size that has great opportunities, great engagement. And accelerating engagement and monetization of the platform in the very early stages of growth where they're seeing great relationships with a lot of the content providers like the sports leagues and a lot of the entertainment providers a lot of the content guys that we talked about in media starting to use Twitter more.

And that's a name where we still think you're in the early days of growth and still it's a very unloved, a very underappreciated, and certainly under owned by generalists type of name versus some of the big stuff. So, we look at them all, we've looked at Apple since the eighties, we've looked at these names. In a lot of cases we've chosen to own, again, the underlying enabling technologies; the storage, the connectivity, the speech recognition, and the backbone of the internet, which benefits any of the

providers of consumer devices and growth of tablets and phones as opposed to the consumer company itself.

So, yeah, we're certainly looking at all those types of companies early. We looked at Facebook well before they were public and, again, only bought the name when the valuation and the stock price look very attractive to us in the fall of two thousand twelve.

So, we'll look at anything. I think the goal is to make money. We talked earlier about making money without taking undue risk and investing alongside of our shareholders. But it's just a point in time here in late July where I think a lot of those names are now consensus longs and a lot of the rest of the market is very unloved.

CH: All right, great. So, with that, we're getting close to the top of the hour here, so, I want to be mindful of everyone's time. I did want to take a second say thank you very much to everyone who took time out of their day to dial into today's call.

As quick housekeeping item, I did want to mention that there will be a replay dial in for this call and if you're registered for today's call you'll automatically receive that via an email. But that information will come out to you as soon as it's available. Please feel free to share that with any of your colleagues that maybe didn't have the time to dial in today's call.

In addition, if there are any lingering questions that were not answered on today's call, please feel free to reach out to your Legg Mason wholesaler or the ClearBridge specialist team and we'll be happy to get you whatever you need. So, on behalf of Evan, Richie, and myself, I want to say, "Thank you very much for the partnership and thank you all for dialing to today's call." Have a great day.

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