

# ClearBridge

## Investments

## Large Cap Value Strategy



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### Key Takeaways

- ▶ Strong markets and broader leadership were tailwinds for the Strategy, which outperformed in the second quarter.
- ▶ Inflation concerns remain central but were less acute as manufacturing PMI growth steadied and yields and some commodity prices moderated after rising quickly in the first quarter.
- ▶ Our companies' ability to adjust to higher inflation would be a relative strength, in our view.

### Market Overview and Outlook

U.S. equities generated healthy gains in the second quarter driven by a strong economic recovery and moderating concerns of sustainably higher inflation. Investors are closely monitoring the Federal Reserve for signs of when it might begin slowing its asset purchases from its staggering monthly pace of \$120 billion. The benchmark Russell 1000 Value Index rose 5.2% during the quarter bringing its year-to-date return to 17.1%. While trailing the Russell 1000 Growth Index's second-quarter performance of 11.9%, value maintained a 400 basis point lead for the year through the second quarter.

Inflation concerns remained front and center for investors, but were less acute as manufacturing PMI growth steadied and some commodity prices moderated. For example, after a meteoric 280% rise during the first quarter, lumber fell 43% from April to June. However, iron ore and copper continued to move higher during the quarter, albeit with a fair amount of volatility. Similarly, as global economies have begun reopening, oil has continued its ascent, finishing the quarter at a post-pandemic high of over \$73 per barrel of WTI crude, up 25% during the period.

While commodities are important to keep an eye on as gauges of inflation, they tend to be volatile, often selling off as dramatically as they rise. Wages, on the other hand, tend to be much stickier and typically receive a lot of attention from the Fed, and deservedly so. There has been noticeable wage inflation, particularly at the lower income level and more pronounced within the industries tied to reopening, such as restaurants, travel and leisure, to name a few. Multiple factors are at play here, including the Fed's ongoing policy of aggressive monetary accommodation, viewed as one way to combat income inequality. Other factors may prove to be transitory. For example, fiscal

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stimulus including \$300 per week in enhanced federally funded unemployment benefits and lingering COVID-19 concerns may also be contributing to labor shortages, at least temporarily.

The double barrel of extraordinarily aggressive fiscal and monetary policies continues unabated, with the Fed keeping interest rates low (at least for now) and the federal government budgeting \$5.3 trillion in stimulus to date, with more spending commitments anticipated.

Cyclical sectors continued to outperform in the second quarter, with energy (+11.8%) among the leaders again, though down from its 31% gain in the first quarter. The Russell 1000 Value Index saw a broadening out in leadership. The real estate sector performed well, with health care, financials and materials also making strong showings.

Broader market leadership was a relative benefit for the ClearBridge Large Cap Value Strategy, which outperformed the Russell 1000 Value Index in the second quarter. Strong contributions from industrial holdings such as Vertiv and UPS contributed to relative performance. Vertiv, which makes cooling and electrical power equipment for data centers and enterprise customers, has executed well since being spun off from Emerson in 2016. We initiated a position in 2020 and have subsequently added opportunistically. We've been pleased with management's strong execution and the company is benefiting from attractive end markets as hyperscalers such as Amazon.com, Microsoft, Alphabet and Facebook continue to build data centers needed to support cloud migration and broader digital transformation across various industries. We believe there is still substantial upside potential for margins over time.

United Parcel Service posted very strong sales and earnings results, with excellent operating margins in its U.S. and international segments, during a quarter that is typically hurt by weather. The shipper has been executing phenomenally well under new leadership, with robust volume growth, pricing gains and a laser focus on margins and returns. Separately, Raytheon Technologies benefited from an improving health outlook that is contributing to a faster than anticipated recovery in air travel, which should drive stronger results for Raytheon's commercial aerospace business.

Portfolio holdings in the communication services and financials sectors also made strong contributions. Dish Network continues to make progress on the buildout of its greenfield 5G network, with Las Vegas slated to become the first market launched later this year. The company gained credibility, and its stock reacted favorably, after it announced a partnership with Amazon to deploy a 5G cloud-native network using AWS's cloud infrastructure. While the stock has been volatile in recent quarters, we continue to feel

confident in Dish's long-term prospects, which include competing as a fourth U.S. wireless carrier. Charter Communications has been executing well and benefiting from the growth in residential broadband, which has been accelerated by COVID-19 and should see further support from the Biden Administration's infrastructure bill, which earmarks \$65 billion for broadband buildout. In addition, we expect the company to continue to grow its wireless business, leveraging its mobile virtual network operator (MVNO) relationship with Verizon. The company continues to generate strong and growing free cash flow and deploys it toward consistent and material share buybacks.

In financials, American Express has done an excellent job demonstrating the resiliency of its franchise in the midst of a global pandemic that drove a 60% decline in its core travel and entertainment business. The company's spend-centric model has been helped by fiscal stimulus ensuring a flush consumer, while management continues to execute well by adding millions of new consumer and small and medium business accounts, which should benefit the franchise over the medium to long term. We remain optimistic regarding the company's prospects as travel and entertainment activity rebounds, adding to our position in the quarter. Capital One has also benefited, at least indirectly, from government stimulus that has strengthened customer balances sheets and driven credit losses to record lows. Capital One should also benefit from a reopening of the economy and increased discretionary spending.

The moderation of the recovery trade meant a pause in shares of some companies that saw early gains following positive vaccine announcements in November. Online travel agency Booking's exposure to a slower recovery in Europe weighed on share prices as Europe's vaccine rollout lagged that of the U.S. and the U.K. Agricultural, construction and forestry equipment manufacturer Deere lagged in the quarter after generating extraordinary performance over the preceding 12 months driven by strong execution and its leadership position in precision agriculture, the adoption of which has been picking up pace in core geographies. In light of the stock's strong performance, we view recent investor profit-taking as healthy. Leading off-price retailer TJX has proved resilient through the pandemic, benefiting from customer appetites for bargain hunting. Here too investors took some profits in the second quarter amid near-term concerns that wage inflation would weigh on gross margins, though we believe long-term fundamentals remain robust and increased our position during the quarter.

Transitory or not, cost pressures have been real, whether in the form of wage inflation, higher commodity prices or supply and demand imbalances as supply chains cope with a quick recovery. We invest in competitively advantaged companies that we believe

will be able to absorb these pressures, recover their costs and grow profitability over time.

We remain vigilant in monitoring for risks related to inflation and higher interest rates that might result from a normalization of Fed policy. While these risks would be challenging for markets, our companies' ability to adjust to higher inflation would be a relative strength, in our view. This view is expressed in our overweight to interest-rate-sensitive financial services, for example, as well as our underweight to consumer staples, where slow-growing businesses with high valuations are potentially more vulnerable to a higher-rate environment.

### Portfolio Highlights

The ClearBridge Large Cap Value Strategy outperformed its Russell 1000 Value Index benchmark during the second quarter. On an absolute basis, the Strategy had gains in nine of 11 sectors in which it was invested for the quarter. The strongest contributions came from the financials, industrials, communication services and information technology (IT) sectors. The utilities and consumer discretionary sectors were detractors.

On a relative basis, overall stock selection contributed to performance, while sector allocation detracted. In particular, stock selection in the industrials, IT, communication services and financials sectors added to relative returns. Conversely, stock selection in the consumer discretionary and health care sectors and an overweight to IT weighed on relative results.

On an individual stock basis, the largest contributors were Vertiv, American Express, United Parcel Service, Dish Network and Capital One. Positions in Deere, Booking, Edison International and Amgen were detractors. Organon, shares of which the Strategy received but did not retain following its spinoff from portfolio holding Merck, was also a modest detractor.

During the quarter we closed a position in Reynolds Consumer Products in the consumer staples sector.

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