ClearBridge Investments

Aggressive Growth Strategy

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Key Takeaways

- Higher yields as well as uncertainty over inflation, supply chain constraints and the passage of an infrastructure bill have sparked the type of volatility that we as active managers can leverage.
- Building on portfolio construction changes outlined previously, we continued to add exposure to the disruptive growth category as well as broaden out the portfolio's industry weightings.
- Our active approach also applies to being disciplined in managing positions in companies in more cyclical industries and taking profits during stronger periods of each cycle.

Market Overview

Volatility rose to close the third quarter as the spread of the COVID-19 Delta variant, troublesome inflation signs and a subsequent jump in yields pressured U.S. equities, which delivered mixed results. The S&P 500 Index fell sharply in September but managed to eke out a gain of 0.58% for the quarter while smaller cap and value stocks suffered losses for the full three months. The benchmark Russell 3000 Growth Index rose 0.69% as investors returned to the relative safety of mega cap growth stocks, outperforming the Russell 3000 Value Index by 162 basis points. Value continues to lead year-to-date and over the last 12 months, reflecting the tremendous amount of stimulus still working its way through the U.S. economy.

The performance of the ClearBridge Aggressive Growth Strategy has followed a similar trajectory, with a strong period of relative results from late 2020 through the first half of this year. While the resumption of FAAMG leadership that started midway through the second quarter has been a headwind, the recent backup in bond yields as well as macro uncertainty over inflation, supply chain constraints and the passage of an infrastructure bill have sparked the type of volatility that we as active managers can leverage.

As discussed in last quarter's commentary, the evolution of our portfolio construction process has led us to become more tactical and opportunistic in seeding the portfolio with a broader set of attractive growth companies. We seek to own disruptive

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companies early on in their lifecycle with long runways for growth ahead, while balancing these high growth stocks with allocations to durable compounders, cyclical growers and improving growth stories. Increased macro-driven market volatility provides greater opportunities for us to initiate and scale positions into these companies at what we view as attractive valuations. We look to invest in companies with superior products and services, a large and increasing competitive edge and the potential to generate strong profitability as their business models scale.

Portfolio Positioning

We continued to add exposure to the disruptive growth category and broaden out the portfolio's industry weightings in the third quarter with the purchase of HubSpot (HUBS), a leading provider of customer relationship management software-as-a-service (CRM SaaS) for small and mid-market businesses (SMB). With 121,000 customers today vs. the roughly 3 million companies in North America and Europe with between 10 and 2,000 employees, we believe HUBS is still considerably underpenetrated relative to its addressable market. In addition to increasing its product breadth, we also see significant room for growth within the company's existing installed base. Furthermore, we believe HUBS is well-positioned to benefit from accelerated digital transformation efforts and an improved economic environment for its customers. Though management is investing heavily, we are encouraged that the business is free cash flow positive and see a significant runway for future operating leverage. The company's focus on the SMB space makes them less susceptible to competition from large enterprise vendors. Likewise, while some of HUBS' customers required relief in the recent macro downturn, we were encouraged the business was more resilient than feared.

Similar to how we built up our DocuSign position earlier in the year, our strategy of leaning into weakness also enabled us to scale a position in Match Group, a new addition in the second quarter. Shares of Match, the leading online dating platform globally, were under pressure during 3Q as management issued conservative second-half guidance in light of waning reopening tailwinds. Additionally, management's discussion of spending to integrate the recent acquisition of Hyperconnect, as well as technical factors related to disappointment that the company was not added to the S&P 500 Index in August, weighed on shares. The stock has since rebounded as it was ultimately added to the S&P and stands to benefit from the U.S. District Court's ruling in September that Apple's requirement for developers to use their in-app payment method is anticompetitive. If upheld, the ruling means app developers like Match would be able to offer lower fee payment options and circumvent the 30% commission it currently

pays Apple, which could yield a meaningful tailwind to the company's gross margins.

Our active approach also applies to being disciplined in managing positions in companies in more cyclical industries and taking profits during stronger periods of each cycle. We closed a position in steel maker Nucor during the quarter after the shares had more than doubled over the last year as a direct participant in the recovery of the U.S. economy and rebound in industrial activity. At this point in the cycle, we no longer view the risk/reward as compelling and feel more confident in deploying the proceeds in more attractive areas discussed in this and previous letters.

Innovation within the health care sector has long been an area of focus in the Strategy and we plan to continue to maintain a meaningful overweight to the sector. That said, we expect this will be reflected in more diversified exposures beyond therapeutics companies. Some of the emerging areas of interest include diagnostics, life science tools, labs and other related services, where we own liquid biopsy leader Guardant Health and are working to build new holdings.

As we look forward, we also see e-commerce, enterprise software, and payments as subsectors ripe for investment. These are areas we continue to research and de-risk companies, building out a robust pipeline of potential additions to the portfolio while awaiting attractive entry points in related stocks.

Outlook

The Aggressive Growth Strategy continues to apply the same high-conviction, high active share, and relatively low-turnover philosophy to growth investing that we have for over 35 years. We believe the portfolio construction evolution we have been implementing this year is consistent with the original intent of the Strategy in seeking to purchase dynamic businesses early in their growth trajectory. Today, we pair these disruptors with more established and attractively priced growth companies capable of compounding free cash flow and earnings over long time periods.

Given the many uncertainties facing investors in the current environment, we would not be surprised to see continued volatility going forward. Regardless of whether market leadership broadens again from the mega cap growth names, we expect to be opportunistic during market and short-term stock dislocations to continue to seed the portfolio with attractive growth businesses that can thrive regardless of investor flows or general sentiment. Companies like DocuSign are becoming an essential part of the anywhere economy and it is these types of growth stocks we see helping position the Strategy for long-term success.

Portfolio Highlights

The ClearBridge Aggressive Growth Strategy underperformed its Russell 3000 Growth Index benchmark in the third quarter. On an absolute basis, the Strategy generated losses across seven of the eight sectors in which it was invested (out of 11 sectors total). The lone contributor to performance was the financials sector while the main detractors from performance occurred in the communication services, information technology (IT) and health care sectors.

Relative to the benchmark, overall sector allocation contributed to performance but was offset by negative stock selection effects. In particular, stock selection in the communication services, IT and health care sectors hurt results. On the positive side, stock selection in industrials and an overweight to communication services contributed to relative performance.

On an individual stock basis, positions in Madison Square Garden Sports, Broadcom, Nucor, HubSpot and TE Connectivity were the leading contributors to absolute returns during the period. The primary detractors were Biogen, Cree, AMC Networks, Twitter and Vertex Pharmaceuticals.

In addition to the transactions mentioned above, we established positions in 10X Genomics and Charles River Laboratories in the health care sector and closed positions in Intel and Nuance Communications in the IT sector, Qurate Retail in the consumer discretionary sector, MSG Networks and Liberty Media Liberty Formula One in the communication services sector and Alkermes in the health care sector.