ClearBridge Investments

Large Cap Growth Strategy

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Mid-Quarter Update

Performance

Large cap growth stocks retain market leadership as we approach the midway point of the fourth quarter, driven by robust earnings results and fears of stagflation that have motivated investors to stick with companies sporting the most visible growth profiles.

The portfolio's software and semiconductor names, led by Nvidia, Microsoft, Qualcomm, Adobe and Salesforce.com, have driven recent performance. Health care has also been a significant contributor, led by UnitedHealth Group and Zoetis.

Relative to the Russell 1000 Growth Index benchmark, performance has been weaker among our communication services holdings, with Facebook among the primary detractors. Payment-related positions in Visa and Fidelity National Information Services have also been a headwind to relative results.

Positioning

We remained active in upgrading the portfolio and diversifying growth exposures with the October addition of Nike. Nike enhances our consumer exposure and provides a quality growth addition to the stable bucket with a strong ESG profile. We sold Nike in early 2016 due to concerns over growing competition and growth of its non-U.S. and apparel businesses. We were motivated to repurchase shares by the moves of a new management team led by CEO John Donahoe focused on controlling the Nike brand through better management of distribution, including an ongoing migration into the direct-to-consumer (DTC) channel.

We also added to existing positions in newer holding Netflix as well as enterprise software maker Workday.

On the sell side, we exited a long-term position in Anheuser-Busch InBev (BUD). While BUD has some of the most recognized global beer brands and will benefit from a post-COVID recovery in the on-premise channel, we have other reopening exposed holdings in the portfolio and BUD may need further investment to reignite sales growth in certain more mature markets.

Outlook

The Fed is giving us probably an incomplete picture on inflation with the view that current price pressures are transitory. Our portfolio companies are telling us quite the opposite and that inflation may not settle for six to 12 months. At this point in the cycle, if the economy has generally healed, it's completely normal to expect rates to rise. We would argue that on a normalized basis, inflation is going to be even higher and would expect rates to gradually move higher. We have seen inflation scares twice during the COVID recovery and both times growth stocks significantly underperformed. We believe this is the most likely scenario on a go forward basis.

We tend to be most active in these periods of volatility and during drawdowns. We haven't seen many drawdowns since COVID hit, but our base case is for volatility to continue because all the stimulus and liquidity that have supported equities to this point will gradually cease to exist.

We are spending our time thinking about the next three to five years and making sure that our portfolio construction and our whiteboard of names to buy are robust. As we look out to 2022, probably the largest scale risk to the market is policy error on the part of the Fed. Investors are hanging on every last word of Fed Chairman Powell, and we think that will continue.