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Large Cap Value Strategy

Key Takeaways

- ▶ U.S. equities delivered solid gains in a quarter marked by a return to AI market leadership, benefiting Strategy top contributors, while stock-specific headwinds in health care and industrials challenged relative results.
- ▶ As markets churned in the quarter we saw openings in some attractive areas that looked temporarily out of favor and initiated new positions in energy, industrials and consumer staples.
- ▶ Value has historically recovered following periods of sizeable underperformance versus growth such as during the first quarter of 2025; we view the current market opportunity to be particularly favorable for disciplined long-term-focused stock pickers with a focus on value stocks.

Market Overview

U.S. equities bounced back from a first-quarter correction and survived tariff and growth scares as well as geopolitical concerns to deliver solid gains in the second quarter of 2025. The rebound following April's tariff-induced Liberation Day selloff was marked by a return to AI market leadership, with hyperscalers showing their commitment to high levels of AI-driven capex. Semiconductor companies also benefited amid solid earnings and renewed expectations of widespread adoption of AI.

This trend was positive for our main contributors in the quarter such as Broadcom. Renewed enthusiasm for AI buildouts has benefited Broadcom tremendously as its custom-designed chips have continued to gain broader adoption with hyperscalers as an alternative to Nvidia's dominant graphics processing units in AI applications. Broadcom shares also rallied with the reduction of retaliatory tariffs between the U.S. and China, which had weighed on semiconductor manufacturers.

Elsewhere within IT, the portfolio benefited from the strong financial results of Microchip Technology, a leading manufacturer of analog semiconductors and microcontrollers used for automotive, industrial, consumer electronics and aerospace and defense applications. After the recent return of long-tenured CEO Steve Sanghi, Microchip has gained momentum in its early turnaround efforts while also benefiting from a long-overdue cyclical rebound.

Also buoyed by its AI leadership position, Meta Platforms shares rose as its latest earnings showed continued secular digital advertising

We continue to position the portfolio for all macro environments, prioritizing stock-level decisions.

share gains across its leading social media networks, with AI benefiting both engagement and monetization across its platforms.

Stock-specific headwinds led to overall underperformance in the quarter, however, especially within health care and industrials. UnitedHealth Group continued to underperform as higher utilization rates, primarily among its Medicare Advantage business, weighed on its insurance and provider network businesses. Concerns of poor execution were exacerbated by the resignation of its CEO and federal lawsuits against pharmacy benefit managers such as UnitedHealth's OptumRx. Medical devices, laboratory equipment and diagnostic products maker Becton Dickinson reported marginally slower than expected organic sales growth across its portfolio, in part driven by headwinds from its China operations and by a lower global research funding environment for its biosciences division; a slight reduction in expected earnings resulted in a dramatic multiple contraction. Thermo Fisher Scientific, which provides life sciences solutions, analytical instruments, specialty diagnostics and laboratory products and biopharma services, lagged due to concerns around spending cuts in the academic/government and biopharma segments due to regulatory fears from tariffs and most-favored nation drug pricing. Conversely, drug distributor McKesson was a strong contributor, as it continued to benefit from strong U.S. pharma and specialty distribution fundamentals, including prescription volumes and stable pricing.

In industrials, we are positioned away from some high-flying AI power-related stocks and a narrow group of historically high-multiple stocks which led to relative underperformance during the quarter. Strong performance of less-than-truckload freight company XPO, diversified industrial and aerospace company Parker Hannifin and agricultural equipment maker Deere failed to make up for the portfolio's AI underweight in the sector.

Portfolio Positioning

As markets churned in the quarter we saw openings in some attractive areas that looked temporarily out of favor. Commodity weakness weighed on Exxon Mobil, a new position that we believe is well-positioned as a secular grower capable of thriving through the industry's cyclical swings. Exxon Mobil is simultaneously lowering its cost per barrel and reducing its emissions intensity while growing its production: a powerful combination. New position Boeing is finally starting to ramp 737 production back up after more than three years of addressing safety problems. In our opinion Boeing's new CEO is taking the steps necessary not only to recover from the 737 issues, but more importantly to restore Boeing's position as one of the great technology companies in the world. Guidance for positive free cash flow this year — well in advance of previous expectations — bodes well for the stock.

We also bought Procter & Gamble, which has traded down with consumer staples stocks amid fears of inflation, tariffs, pricing weakness and a recession. Procter & Gamble is a higher-quality name, however, and with guidance and estimates recently reset and the stock trading at a valuation discount rather than its usual premium, it should serve as ballast to the portfolio in a choppy environment and support steady growth as conditions improve.

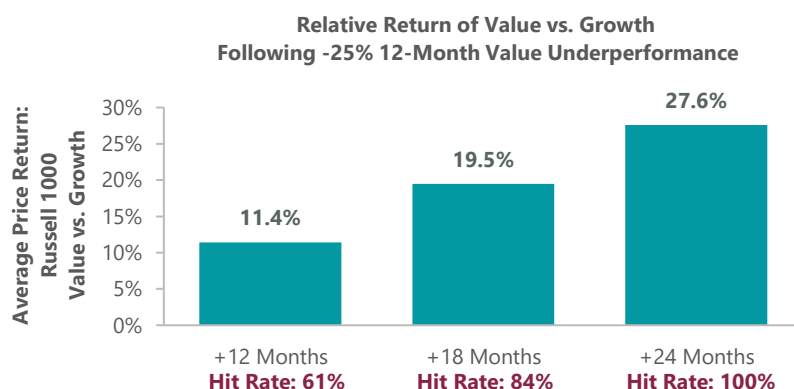
Other positioning moves included swapping out of Merck, which faces the end of its patent exclusivity on its most important drug Keytruda in 2028. We see limited opportunity for vaccines to fill that earnings hole given competition in China and an anti-vaccine stance in the U.S. We replaced Merck with AstraZeneca, a multinational pharmaceutical and biotech company with a deep and diversified late-stage pipeline.

Outlook

We recognize we are in period of elevated geopolitical and policy uncertainty, and during such periods raised perceptions of risk can shorten the time horizon over which investors make decisions. We caution against doing this, however, and stick to our process of finding best-in-class franchises trading at attractive valuations that can offer compelling, risk-adjusted returns over the long haul. We continue to position the portfolio for all macro environments, prioritizing stock-level decisions as opposed to those based on factor bets or macroeconomic predictions.

The strong recovery, in particular for momentum stocks, following the “Liberation Day” tariff selloff has widened the valuation disparity not only between growth and value stocks but also between the “sainted few” and the rest of the value universe to levels not seeing in decades. We believe such valuation gaps are unlikely to persist over the long term. Value has historically recovered following periods of sizeable (~25%) underperformance versus growth; this threshold was triggered during the first quarter of 2025 (Exhibit 1).

Exhibit 1: Value Down but Not Out



As of June 30, 2025. Russell 1000 Growth, Russell 1000 Value, reflective of period from 1979 – present. Source: FactSet, Russell.

Thus, we view the current market opportunity to be particularly favorable for disciplined long-term-focused stock pickers with a focus on value stocks, and we continue to use the opportunity to recycle capital from stocks that have benefited from recent factor-based trends into high-quality companies that we expect to do well over the coming years.

Portfolio Highlights

The ClearBridge Large Cap Value Strategy underperformed its Russell 1000 Value Index benchmark during the second quarter. On an absolute basis, the Strategy had positive contributions from six of the 11 sectors in which it was invested for the quarter. The IT and financials sectors made the main positive contributions, while the health care and energy sectors were the main detractors.

On a relative basis, overall stock selection and sector allocation detracted from performance. In particular, stock selection in the industrials, health care, energy, consumer staples and consumer discretionary sectors and a health care overweight weighed on relative returns. Conversely, stock selection in the IT and communication services sectors was beneficial.

On an individual stock basis, the largest relative contributors were Broadcom, Microchip Technology, JPMorgan Chase, Meta Platforms and Microsoft. Positions in Becton Dickinson, UnitedHealth Group, Enterprise Products Partners LP, ConocoPhillips and PepsiCo were the main relative detractors.

During the quarter, besides portfolio activity discussed above, we exited a position in Venture Global in the energy sector.

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