



Large Cap Value ESG Strategy



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Key Takeaways

- ▶ U.S. value stocks advanced despite an oil-driven rise in inflation expectations and bond yields, with energy leading a mixed quarter for sector performance.
- ▶ The Strategy trailed in the quarter as weaker stock selection in IT, health care, energy and materials outweighed positives from stock selection in industrials and financials and underweights to real estate and consumer staples.
- ▶ The growth of AI and data centers increasingly depends on managing power, water and community impacts, creating opportunities for companies providing more sustainable infrastructure.

Market Overview

U.S. stocks continued to rise in the third quarter, with returns shaped by two major macro forces: the oil supply shock stemming from tensions in the Middle East driving oil prices higher and, partly a result of this, higher inflation expectations and bond yields. The benchmark Russell 1000 Value Index returned 2.6%. The Fed raised interest rates for the first time since 2023 in September and grew more hawkish in its forecasts, implying another hike in 2026; the 10-year Treasury yield finished the quarter up over 80 basis points at 5.3%. Sector performance in the index was mixed, with energy leading on higher oil prices, information technology (IT) and communication services lifted by hyperscaler strength, health care continuing its rebound and consumer and rate-sensitive sectors flat to down as a result of inflation and rate pressure.

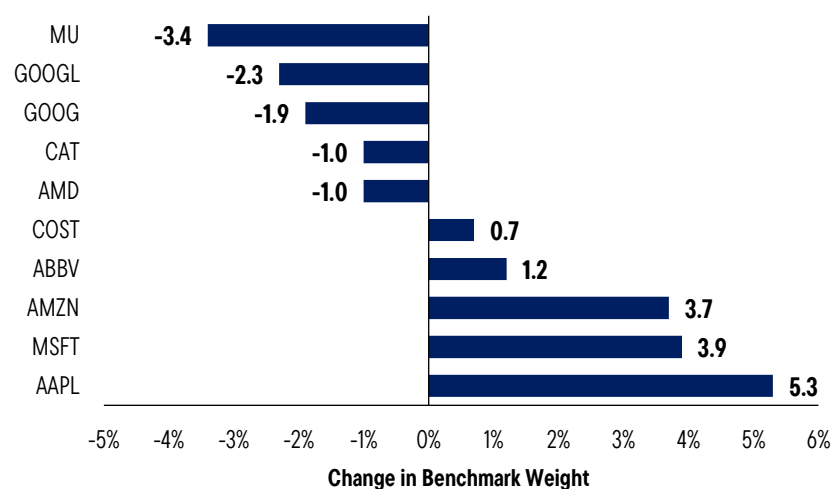
Performance Overview

The Strategy trailed in the quarter as weaker stock selection in IT, health care, energy and materials outweighed positives from stock selection in industrials and financials and underweights to real estate and consumer staples.

The portfolio seeks to outperform over a full market cycle, including both normal and difficult markets. It can lag, however, when gains are unusually narrow and concentrated in higher-beta securities. The last nine months have exhibited many of those characteristics. High-beta and lower-quality stocks have outperformed their lower-beta, higher-quality counterparts, while a narrow group of AI-related memory, storage and optical-networking companies has generated particularly strong returns.

The Russell's rebalance in June added some relative performance challenges (Exhibit 1), as names like Micron rose sharply inside the value benchmark — costing anyone who didn't own them — then left the index at the June rebalance and subsequently declined. The index captured their full run-up; managers who avoided them on quality grounds took the relative pain on the way up, with no offset on the way down. That is an index-construction issue, not a stock-selection issue, in our view, although it has ramifications on portfolio turnover, which has been elevated as a result.

Exhibit 1: Russell 1000 Value Rotation within AI



Source: Aladdin Russell 1000 Value snapshots at June 1, 2026, and June 26, 2026. Ticker matching; corporate actions can affect apparent additions and deletions.

Along these lines, our underweight to Microsoft was a top relative detractor in the third quarter as strong Azure growth and increasing Copilot adoption reinforced confidence in the company's ability to monetize AI investment. We added to our position following Microsoft's significant increase in the index yet remained underweight following the stock's ~400 basis point jump in index weighting.

In health care, CVS Health shares weakened despite strong second-quarter results and increased 2026 guidance as investors focused on management's warning that pressure in its 340B business would persist into 2027. The federal 340B program allows qualifying hospitals and clinics serving lower-income communities to purchase outpatient drugs at substantial discounts, with CVS participating by administering claims and dispensing prescriptions through Caremark and its pharmacy network. Changing manufacturer restrictions and reimbursement arrangements are pressuring the fees and margins CVS earns from this business, while expected Caremark membership declines and litigation concerning 340B specialty-drug reimbursements added further uncertainty. We maintain our overweight as we see a likely path to margin expansion as CVS recovers profits in its Medicare Advantage business.

Health care holdings were also among top relative contributors. Thermo Fisher Scientific, a high-quality life science tools company with a broad portfolio gaining wallet share among biopharma customers, rose on

stronger-than-expected results, improving customer activity across its end markets and an increase in full-year guidance that reinforced expectations for a recovery in life-sciences demand. McKesson gained on similar strong results and a raised outlook, supported by higher prescription volumes and strong growth in its oncology, multispecialty and specialty-pharmaceutical businesses. Waters, to which we added in the quarter, is generating encouraging early synergies from its acquisition of Becton Dickinson's biosciences and diagnostic solutions businesses. Medical devices and supplies maker Becton Dickinson, meanwhile, delivered a second consecutive quarter of core growth, with improving free cash flow, capital allocation, execution and forecasting credibility adding to sentiment.

Industrials and financials holdings also contributed positively. Deere advanced after reporting stronger-than-expected earnings, raising guidance and indicating that 2026 could represent the bottom of the agricultural equipment cycle. Travelers outperformed on a large second-quarter beat driven by favorable reserve development, light catastrophe losses and better underlying margins.

In materials, Martin Marietta Materials declined despite better-than-expected quarterly results as investors focused on weaker aggregates pricing and gross profit per ton, acquisition-related margin pressure and concerns regarding its planned acquisition of Lhoist North America, a major lime producer in the country.

Portfolio Positioning

As a result of Russell 1000 Value rebalancing, the benchmark weight of semiconductors and related areas has declined materially, resulting in our decision to reduce our exposure to Broadcom, Microchip Technology in the second quarter and Taiwan Semiconductor in the third. We partially offset that by moving even further up on the quality curve and initiating a new position in Nvidia, the leading developer of graphics processing units used in generative AI, gaming and enterprise application. Nvidia is a very high-quality, cash-flow-generative franchise with strong competitive positioning that is returning substantial cash to shareholders. The company's valuation has grown more attractive in recent months both on an absolute basis and relative to the rest of the industry, offering an attractive entry point, particularly in the face of robust earnings growth over the coming years.

We trimmed our overweight position in Intel early in the quarter, then later took advantage of the stock's meaningful selloff to add back some exposure. We continue to be impressed with the progress the company is making under its new CEO, both on product and foundry sides of the business. The company should be one of key beneficiaries of agentic AI adoption over the coming years.

In addition, while still maintaining overweight positions, we reduced exposure to Alphabet and Meta in the communication services sector (the latter late in the second quarter). We added to Amazon in consumer discretionary and Apple in IT. All four companies are strong durable franchises with defensible moats and strong balance sheets.

These changes were mostly made as part of risk management to address Russell rebalancing.

In consumer staples, we exited PepsiCo, initiating a new position in Coca-Cola. Price cuts at PepsiCo have not been able to stimulate volume growth in its Frito Lay North America operations, challenging our investment thesis. We bought the higher-quality Coca-Cola, a global beverage leader with strong brands, a global footprint and robust pricing power.

Outlook

We continue to adhere to our philosophy of seeking quality businesses with durable franchises, strong balance sheets and proven management teams, purchased with valuation discipline and assembled through risk-aware portfolio construction. We believe this discipline is particularly important given elevated valuations and the market's increasingly narrowing focus on lower-quality AI players, which up until the June Russell rebalancing represented a meaningful and growing part of the benchmark. Over the past year, the outperformance of high-beta, lower-quality, more commoditized stocks over lower-beta, higher-quality stocks has produced what we view as a historic low-quality, or "junk," rally.

While that environment has obscured the portfolio's defensive characteristics, we like the setup going forward. If the economy accelerates, the quality franchises we favor should be positioned to compound earnings, while improved investor confidence could help close their valuation discounts. If the economy weakens, their durable business models, balance-sheet strength and earnings resilience should provide downside mitigation after a period in which those characteristics have received little recognition from the market.

We do not have a strong conviction that either economic scenario must prevail; our positioning reflects our view, rather, that the current combination of narrow market leadership, unusually strong performance of speculative stocks and rapidly expanding valuations among cyclical AI beneficiaries will not persist indefinitely. In a market with broader leadership and greater emphasis on earnings durability, cash generation and balance-sheet strength, we believe the Strategy's diversified quality orientation should become increasingly valuable and apparent.

Portfolio Highlights

The ClearBridge Large Cap Value ESG Strategy underperformed its Russell 1000 Value benchmark during the third quarter. On an absolute basis, the Strategy had positive contributions from five of the 10 sectors in which it was invested (out of 11 sectors total). The leading contributors were the health care and IT sectors, while the materials and utilities sectors detracted the most.

On a relative basis, stock selection in industrials and financials contributed to performance. A lack of exposure to real estate and an underweight to consumer staples also contributed to performance. Conversely, stock selection in IT, energy, materials and health care

detracted from performance. An underweight to energy also weighed on results.

On an individual stock basis, the largest contributors to relative returns were Thermo Fisher Scientific, Waters, Danaher, McKesson and not owning IBM. The largest detractors were CVS Health, XPO, Williams, WEC Energy and an underweight to Microsoft.

During the quarter, besides activity discussed above, we exited a position Honeywell Aerospace in industrials.

ESG Highlights: Investors Reinvigorated About Climate

Held annually in New York alongside the United Nations General Assembly, Climate Week brings together investors, companies, policymakers, researchers and civil society organizations to discuss climate risks and solutions. ClearBridge attends these events to deepen our understanding of emerging sustainability issues, compare perspectives with experts across industries and identify developments that could be material to our portfolio companies.

This work complements the company-level research and engagement performed throughout the year by ClearBridge analysts and portfolio managers. We seek to understand how environmental and social factors affect costs, competitive positioning, access to resources, regulatory exposure and long-term value creation.

Our overarching observation from this year's Climate Week was that investors appear reinvigorated about climate. Conversations focused on the mechanisms through which climate and sustainability issues are already affecting businesses: energy affordability, resource efficiency, infrastructure resilience, insurance availability, community acceptance and economic competitiveness.

Not surprisingly, AI was central to almost all of these discussions. Participants debated not only the environmental footprint associated with data-center growth, but also AI's potential "handprint": how the technology might enable scientific advances, optimize power systems, improve industrial processes and accelerate the development of lower-carbon technologies. Energy efficiency was a key pillar of AI's potential positive effects on climate, although we acknowledge projections far out into the future remain highly theoretical. All in all, while stakeholders debate the pros and cons of AI center development — and headlines over the summer have overwhelmingly highlighted the cons — AI infrastructure is on track to be built: the question for investors is how it can be built responsibly.

Food Security and Responsible Mining Remain Material

Although AI and data centers dominated the week, sustainable food and human rights in mining were also important areas of focus for ClearBridge.

For sustainable food, the central question is what happens when geopolitical disruption and climate variability affect agricultural inputs at the same time. Recent disruptions to fertilizer production and trade illustrate the issue. Nitrogen-based fertilizer must be available during

relatively inflexible planting windows; a delayed shipment cannot necessarily be recovered later in the growing season. If fertilizer shortages or higher prices coincide with an El Niño-related disruption to rainfall and temperature patterns, the effects could extend from farm input costs to crop yields, commodity prices and food inflation.

This is an example of climate acting as a threat multiplier. It also highlights the importance of supply-chain diversification, soil health, efficient fertilizer use and agricultural technologies that help farmers adapt to more volatile conditions. For investors, historical weather and production patterns may be less and less useful for assessing agricultural risk. At Climate Week we discussed how JPMorgan's food-security analysis emphasizes how fertilizer disruptions, planting windows and climate variability can combine to create longer-lasting food-system pressures.¹ AI is a potent source of innovation in this regard: ClearBridge holding US Foods, for example, uses AI-driven inventory forecasting to cut food waste.

For mining, the key question is how investors can connect community-level impacts to the companies in their portfolios and turn that information into actionable engagement. This is particularly important in industrial parks and complex mineral supply chains, where responsibility may be distributed among mine owners, operators, tenants, suppliers, customers, lenders and public-sector partners. Investors need information that sometimes embodies a complex balance: comparable across portfolios but sufficiently detailed to identify specific harms, responsible parties and potential remedies. Discussions focused on the Indonesian nickel supply chain in light of the EU Battery Regulation, which requires greater supply chain traceability, carbon footprint disclosure and environmental and human rights due diligence for battery materials sold in the EU and is relevant for EV and battery companies that source nickel such as China's CATL and Tesla.

Sustainability Is a Key Gating Factor for Data Centers and AI

The scale of anticipated AI infrastructure development is intensifying pressure on power systems and local resources. BloombergNEF estimates U.S. data-center power demand could reach 118 gigawatts by 2030 and that data centers could account for roughly one-fifth of U.S. electricity consumption by 2035 (Exhibit 2).

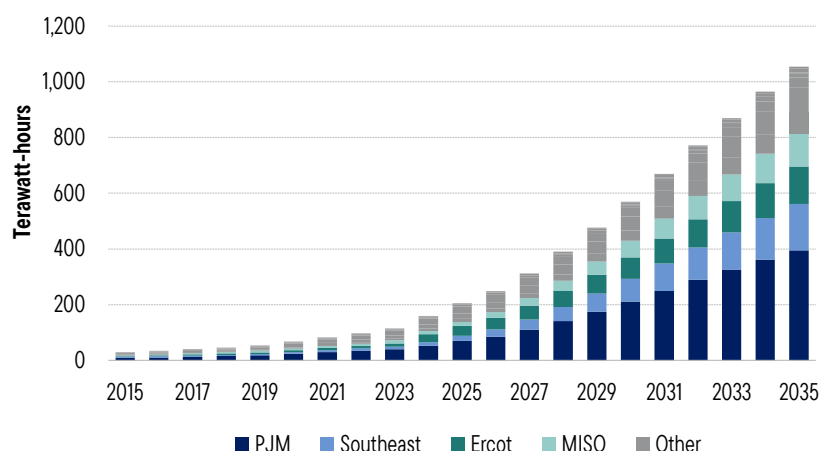
Meeting that demand will require substantial new generation and grid infrastructure. Yet long interconnection timelines, transmission constraints and equipment shortages are already affecting where and how quickly projects can proceed. Developers are exploring nuclear power, on-site generation and other behind-the-meter solutions, but each option introduces its own cost, emissions and community considerations.

Power is not the only constraint. Communities are asking whether data centers will increase electricity bills, consume scarce water, create persistent noise or require infrastructure whose costs are ultimately borne by residents. They also want to understand the local

¹ Dr. Sarah Kapnick, "Climate Intuition: Food security under pressure: Iran conflict disruptions and a brewing El Niño." May 21, 2026.

benefits, including employment, tax revenue and investments in public infrastructure.

Exhibit 2: Data Centers' Growing Electricity Consumption



Source: BloombergNEF, DC Byte. Note: Pipeline includes capacity under construction, committed and early stage. MISO is Midcontinent Independent System Operator, Ercot is Electric Reliability Council of Texas and PJM is Pennsylvania-New Jersey-Maryland Interconnection.

These concerns can delay or prevent development. Sustainability is therefore becoming a practical requirement for translating demand for AI into operating data-center capacity.

Microsoft Raises the Standard for Development

Microsoft, a holding in several ClearBridge portfolios, offers a good example of how hyperscalers are responding. Its community-first infrastructure framework addresses several of the issues that can determine whether a project earns local support. The company has committed to paying the electricity and grid-infrastructure costs associated with its facilities rather than passing them through to residential ratepayers. It is working with utilities to forecast demand, contract for new generation and fund necessary transmission and substation improvements. The company is also targeting a 40% improvement in data-center water-use intensity by 2030 and has begun deploying closed-loop cooling designs that do not require potable water for cooling.

The framework extends beyond environmental performance to include social dimensions. Microsoft has committed to paying full local property taxes, supporting workforce training and investing in schools, libraries and community organizations. It also plans to provide greater local transparency about water use and replenishment.

These measures don't eliminate every impact associated with data-center development, but they illustrate the higher standard increasingly required of developers: mitigate costs, provide measurable local benefits and engage communities early. Microsoft's community-first framework reflects the growing recognition that technical capacity alone is insufficient to secure a project's social license to operate.²

Data center
sustainability
and economics
are becoming
closely aligned.

² <https://blogs.microsoft.com/on-the-issues/2026/01/13/community-first-ai-infrastructure/>

Equinix Focuses on Long-Term Community Trust

A recent engagement with Equinix, another ClearBridge portfolio holding, provides the perspective of a data-center owner and operator. In September 2026 we asked whether faster anticipated capacity growth threatened Equinix's goal of covering 100% of its power consumption with renewable energy by 2030. The CEO told us the commitment had not changed, noting both Equinix's own priorities and demand from customers seeking to meet their sustainability commitments.

We also discussed community opposition to new data centers in general. Equinix views itself as a long-term neighbor rather than a temporary developer because it expects to own and operate its facilities for decades. This creates an incentive to establish durable relationships with local stakeholders.

Equinix also distinguishes its average approximately 65-megawatt retail colocation facilities from the hundreds-of-megawatts — and sometimes gigawatt-scale — campuses attracting the greatest scrutiny. While that difference does not remove the need for responsible development, it shows why investors should consider a facility's scale, design and operating model when evaluating community risk.

Johnson Controls Improves Cooling Efficiency

ClearBridge's recent engagement with Johnson Controls (JCI) highlighted how equipment suppliers can help address the physical constraints on data centers. JCI's thermal-management offering includes cold plates, coolant distribution units, chillers and air-cooled technologies. Because it owns several major cooling subsystems, the company can optimize the entire cooling architecture rather than focusing only on the efficiency of an individual component. This system-level approach becomes more important as computing density rises and cooling represents a larger share of facility power requirements.

JCI's technologies can also respond directly to local environmental concerns. Its cooling solutions can generally be configured for zero-water operation. Magnetic-bearing technology can reduce mechanical noise as well as energy consumption, while major product lines are available with low- and ultra-low-global-warming-potential refrigerants. In certain applications, absorption chillers can use waste heat in place of electricity as a primary energy source.

The engagement reinforced that data center sustainability and economics are becoming closely aligned. Reducing the power, water and noise associated with cooling can lower operating costs while making projects more acceptable to utilities, regulators and neighboring communities.

Vertiv Helps Make Power-Dense AI Feasible

As AI chips increase rack-level power density, data centers require tightly integrated power and thermal-management systems. Vertiv's closed-loop cooling technologies are well suited to higher-density computing and can reduce dependence on continual water consumption. Its broad offering also allows customers to integrate cooling and power systems

more easily — an increasingly important consideration as infrastructure becomes more complex.

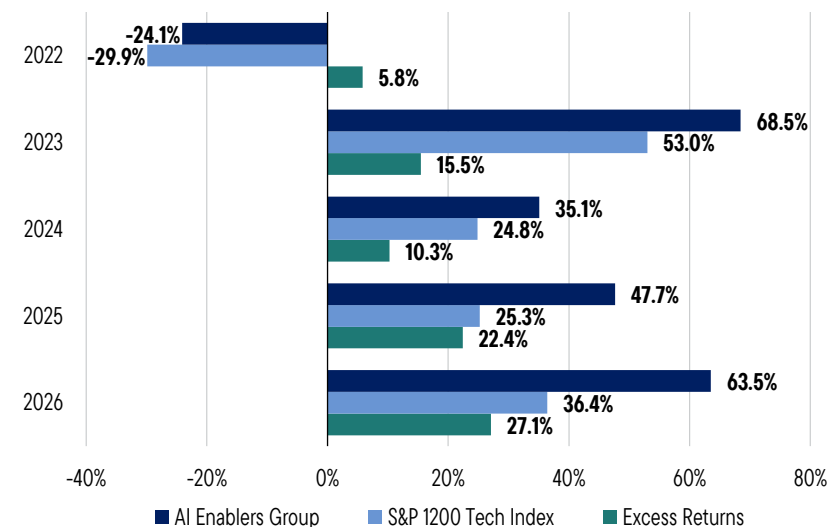
Modular construction is another part of the solution from Vertiv. Its prefabricated OneCore platform brings multiple systems together before they reach the construction site, reducing on-site complexity and helping customers bring computing capacity online faster. Its global service network, real-time monitoring and predictive maintenance capabilities support reliability and efficient operation over the facility's life.

Vertiv's example illustrates that the sustainability of AI infrastructure is not limited to how electricity is generated. It also depends on how efficiently power is delivered, heat is removed, water is managed and complex facilities are constructed and maintained.

Conclusion

AI's rapid expansion is creating investment opportunities across technology, utilities, construction and industrial infrastructure. As it is also exposing physical and social constraints, the need to deploy more efficiency could be a tailwind for AI Enablers (Exhibit 3).

Exhibit 3: AI Efficiency Enabler Group Returns by Year



As of September 22, 2026. Source: Bloomberg Intelligence.

ClearBridge's research seeks to understand these constraints across the data-center value chain. With developers and operators, we ask whether energy and water commitments can keep pace with growth and how local communities will share in the benefits. With equipment suppliers, we examine total system efficiency, water requirements, refrigerants, noise, reliability and speed to deployment.

A common thread: sustainability is increasingly the mechanism connecting AI demand with practical development. Companies able to lower resource requirements, protect ratepayers, address community concerns and deliver reliable capacity may be better positioned to support — and benefit from — the next phase of AI infrastructure growth.

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