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Large Cap Value Strategy

Key Takeaways

- ▶ Following recent highs, both the S&P 500 and the Nasdaq Composite entered correction territory in March, while the benchmark Russell 1000 Value Index, with a positive quarterly return, handily outperformed its growth counterpart.
- ▶ Over the past few quarters, we've taken advantage of the run-up in expensive, momentum-driven stocks to reallocate capital into areas of the market where valuations are more reasonable, yet fundamentals remain stable and defensive.
- ▶ We expect continued volatility in the face of geopolitical and policy uncertainty, but that volatility should create opportunities for best-in-class franchises trading at overly discounted valuations that can offer compelling, risk-adjusted returns over the long haul.

Market Overview

An escalating tariff war and a rotation out of the AI-related tech stocks that dominated 2024 sent markets lower in the first quarter of 2025, with the S&P 500 Index declining -4.3% and ending its five-quarter streak of positive gains. Following recent highs, both the S&P 500 and the Nasdaq Composite entered correction territory in March. Amid a tech-led selloff, the benchmark Russell 1000 Value Index (+2.1%) handily outperformed its growth counterpart (-10.0%) in the quarter.

Over the past few quarters, we've taken advantage of the run-up in expensive, momentum-driven stocks to reallocate capital into areas of the market where valuations are more reasonable, yet fundamentals remain stable and defensive. While this positioning helped us outperform the S&P 500 in the quarter, some of our more defensive holdings faced idiosyncratic challenges that caused us to lag the value benchmark.

One area where we've increased exposure in recent years is the utilities sector, where the combination of rising electricity demand, highly stable cash flows and attractive valuations has made the space overlooked relative to higher-flying AI plays. While utilities typically perform well in volatile markets, our holdings in Edison International and Sempra were negatively impacted by the tragic wildfires in Southern California, which caused billions of dollars in damages. In particular, Edison materially de-rated on concerns about future liabilities, as one of the fires overlapped with its service footprint. However, we remain confident that California's Wildfire Fund and

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protective legislation will be sufficient to mitigate long-term financial impacts. Semptra's issues were compounded by a large earnings reset due to unexpected regulatory changes in California and the company's shift of capital toward Texas, where, while it is a higher-growth market, profitability is being pressured in the short term due to higher costs. While this negatively affects near-term earnings, we believe the decision is right for the long term. We maintained positions in both companies, as we believe their valuations have been overly discounted for businesses with defensive characteristics and high-single-digit earnings growth.

Weakness in communication services was driven primarily by Alphabet, which traded lower as the market rotated out of AI leaders. Part of the decline followed the unveiling of Chinese AI startup DeepSeek, whose new foundational and reasoning models — reportedly offering similar performance to leading U.S. models at lower compute costs — triggered a broader selloff in the AI ecosystem. Additionally, concerns are rising that Alphabet's dominance in search could be challenged by startups like OpenAI or large platforms like Meta Platforms, which may leverage their AI capabilities to enter the search market. While Alphabet remains a highly cash-generative business trading at a reasonable multiple, we reduced our position during the quarter due to the increasing competition in its core business.

We remain very selective with our AI exposures, as we believe some of the market froth is likely to fade. Oracle's core database business remains highly resilient and has shown impressive cloud growth in recent years — particularly in its Oracle Cloud Infrastructure offering with clients like TikTok and OpenAI. However, stretched valuations and exposure to unprofitable AI startups present risks if capital markets tighten. As a result, we exited our position in Oracle during the quarter. Conversely, despite a selloff in Broadcom, we maintained our position, as we believe the company is well-positioned to gain share with its AI-focused custom application-specific integrated circuit (ASIC) solutions for customers like Alphabet and Meta. These exposures should remain more resilient even if overall AI spending moderates.

In energy, we participated in the January IPO of Venture Global, a liquefied natural gas (LNG) exporter, although the stock failed to garner investor enthusiasm. Its inaugural earnings report also disappointed, showing weaker margins, lighter volumes and higher operating costs, as global LNG prices declined. While Venture Global still has the potential to become a leading LNG player, given its fast, low-cost, modular approach to LNG facility construction, recent macro and geopolitical uncertainties, which appear to only have grown in recent days, create an increasingly more challenging backdrop for the company, and we are actively re-evaluating our position.

Stock selection in industrials, financials, consumer discretionary and health care, meanwhile, contributed meaningfully.

In industrials, defense names RTX and Northrop Grumman led performance as geopolitical tensions remained elevated. Both companies have moved away from fixed-price contracts, and as those contracts have diminished as parts of their business, should see margin expansion over the next few years. European countries have also pledged to increase their spending on defense, which, given the lack of capacity available for European defense companies, should benefit U.S. defense primes.

In financials, property and casualty insurers have historically passed through inflation via higher premiums and tend to be less economically sensitive. Holdings in Progressive, Travelers and Berkshire Hathaway performed defensively, as expected, during the volatile period.

In consumer discretionary, tariffs on auto imports created a favorable backdrop for the auto repair market. This benefited auto parts retailers like O'Reilly, given its leadership position and the relatively inelastic demand for its products. The company should also benefit from weakened competitors like Advance Auto Parts and Napa, both of which have much less margin to absorb cost inflation if O'Reilly decides to be more aggressive in the marketplace.

In health care, CVS Health was a top contributor. The stock rallied on the perceived benefit to its managed care segment following an announcement by the Centers for Medicare and Medicaid Services of a proposed 4.3% average increase in government payments to Medicare Advantage plans in 2026. CVS also beat both revenue and earnings expectations for the fourth quarter, supporting hopes for a turnaround in its Aetna insurance segment and stabilizing profits in its pharmacy operations. Drug distributor McKesson also outperformed, benefiting from strong U.S. pharmaceutical and specialty distribution trends.

We initiated a new position in Novo Nordisk, the global leader in diabetes care and one of two dominant players in the fast-growing GLP-1 diabetes and obesity drug market. A slowdown in prescriptions for Novo's GLP-1 drugs, combined with confusion surrounding a clinical trial of its next-generation candidate, CagriSema, caused a significant pullback in the stock. We saw this as a buying opportunity. We believe the GLP-1 market remains vast and that Novo (alongside Eli Lilly) is well-positioned to maintain a duopolistic structure for years to come, given the complexity of manufacturing, differentiated intellectual property and brand strength. We also expect growth to reaccelerate as supply ramps up following its acquisition of Catalent and as regulators crack down on unlicensed compounders.

Outlook

While 2024 was defined by a narrow market dominated by a small set of momentum stocks, 2025 has ushered in a much more diversified environment. The valuation gap between growth and

value had reached historically extreme levels, making a reversion long overdue. Combined with recent market volatility, this sets the stage for high-quality, value-oriented portfolios like ours to outperform. We expect continued volatility in the face of geopolitical and policy uncertainty, but that volatility should create opportunities for best-in-class franchises trading at overly discounted valuations that can offer compelling, risk-adjusted returns over the long haul.

Portfolio Highlights

The ClearBridge Large Cap Value Strategy underperformed its Russell 1000 Value Index benchmark during the first quarter. On an absolute basis, the Strategy had positive contributions from seven of the 11 sectors in which it was invested for the quarter. The health care and financials sectors contributed the most, while the utilities and information technology (IT) sectors were the main detractors.

On a relative basis, stock selection in the utilities, communication services and energy sectors detracted the most, while stock selection in the financials, industrials, consumer discretionary and health care sectors proved beneficial.

On an individual stock basis, the largest contributors were CVS Health, McKesson, Berkshire Hathaway, Chevron and Progressive. Positions in Sempra, Venture Global, Edison International, Broadcom and Microchip Technology were the main detractors.

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