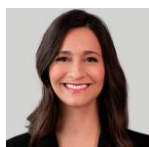




Growth Strategy



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Key Takeaways

- ▶ The broad market rose modestly in the third quarter, though a July unwind of crowded AI trades, surging Treasury yields and higher oil prices weighed on cyclical areas of the Strategy's mid cap benchmark.
- ▶ The Strategy outperformed due to strong stock selection within the IT, industrials and communication services sectors, slightly tempered by a lack of exposure to energy and an overweight to industrials.
- ▶ We used AI-related volatility to scale positions in networking companies like Lumentum, Credo Technologies and Astera Labs, broadening our AI exposure within technology.

Market Overview

U.S. equities posted modest gains in the third quarter, but the advance was narrow. While the broader Russell 3000 Growth Index rose 0.5%, mid and small cap growth stocks moved lower. The benchmark Russell Midcap Growth Index declined 5.8% while the Russell 2000 Growth Index lost 9.4%.

AI was the main source of volatility during the quarter. A sharp momentum selloff in July unwound crowded positions in certain semiconductor and AI-exposed industrial stocks as investors questioned the durability of and payoff from capital spending. These concerns resurfaced in September after a coordinated call among the AI labs to slow the pace of frontier model development.

Macro forces also meaningfully shaped sector returns within the benchmark. Continued conflict with Iran drove oil prices higher, making energy the benchmark's best-performing sector. The Federal Reserve's first rate increase since 2023 and a sharp rise in Treasury yields weighed on rate-sensitive and cyclical stocks, leaving utilities and industrials, where AI power and infrastructure names also pulled back, as the weakest sectors.

Performance Overview

The ClearBridge Growth Strategy held up considerably better than its Russell Midcap Growth benchmark during the third quarter, as strong stock selection, particularly in information technology (IT) and industrials, more than offset the drag from our lack of exposure to energy and our overweight to industrials. CrowdStrike, Shopify, Vertex and Freeport-McMoRan were among the largest contributors, reflective of a core advantage of the Strategy: rather than being forced to sell

The selloff in AI and AI-adjacent companies created attractive entry points in areas such as networking.

these names as they scaled past mid cap thresholds — as a pure-style mid cap growth mandate would require — the Strategy allows these holdings to compound for clients over multiyear time periods. Because these companies sit outside of our benchmark, they also give the portfolio a source of return distinct from the index, which we believe adds diversification.

IT was the largest contributor to relative performance. Information security provider CrowdStrike led the way as several of our software holdings rebounded after coming under pressure in the first half of the year. The rebound was concentrated in both security companies and software makers, including Cloudflare and Snowflake, once feared to be vulnerable to AI disintermediation but now appear positioned to benefit from the proliferation of AI agents. E-commerce platform Shopify was another leading contributor after strong second-quarter gross merchandise value growth and forward revenue guidance, with a sharp rise in AI-driven traffic and orders at stores on its platform.

In health care, Vertex Pharmaceuticals contributed after raising its full-year revenue guidance on continued strength in its cystic fibrosis (CF) franchise. The stock also rallied after a Phase 2 trial from a potential CF competitor failed to meet its endpoint, reinforcing the high bar for Trikafta and further protecting the company's leadership position. Natera, a leader in molecular residual disease (MRD) testing for cancer recurrence, also contributed positively after reporting an increase in quarterly MRD test additions and raising its full-year guidance. In materials, copper producer Freeport-McMoRan gained as copper prices reached a record high in early September on tight near-term supply and the potential for U.S. tariffs on refined copper imports.

We saw greater dispersion among our industrials holdings, including those indexed to AI infrastructure. Stock selection was additive, with contributions from uniform and workplace products supplier Cintas and commercial HVAC services provider Johnson Controls. These contributions offset headwinds for Vertiv, a power, thermal management and digital infrastructure solutions provider for data centers, due to a revenue shortfall management attributed to project timing and supply chain congestion. Additionally, MasTec, a specialty contractor serving communications, power, energy and civil infrastructure markets, detracted on weakness in its communications business tied to pushouts in both wireless and wireline projects. We view this as a timing issue and believe the company remains a multiyear beneficiary of secular trends around AI driven power demand, broadband universalization and the energy transition.

In communication services, AppLovin, which operates a leading AI-powered platform for mobile application marketing and monetization, detracted as an expected step-up in model performance shifted from the second quarter into the third, leaving results short of the company's own guidance. As with MasTec, we see the shortfall as a matter of timing as engineering enhancements can be lumpy.

Portfolio Positioning

We remain bottom-up investors, focused on delivering a diversified portfolio with a balance across sectors and the spectrum of growth we target. As patient investors, we used the quarter's volatility to initiate new positions and scale up smaller ones we had been looking to increase.

The selloff in AI and AI-adjacent companies presented buying opportunities in areas such as networking. Lumentum and Credo Technology were new additions in the second quarter, and we took advantage of the pullback to scale both positions. We also initiated and built a position in Astera Labs, which provides high-speed connectivity solutions that help enable data to move quickly and reliably between GPUs, CPUs, memory, storage and networking components within AI data centers. Astera is evolving into a broader AI connectivity platform and could be a beneficiary of Amazon's ramp of its Tranium AI accelerator chips. Together, these positions diversify our AI exposure as AI value capture broadens beyond logic chips.

In industrials, we added to MasTec during its pullback and exited W.W. Grainger, a global distributor of maintenance, repair and operating products. Grainger remains a high-quality distributor with a strong competitive position, but recent results raised concerns about the durability of its margin expansion as freight and private-label pressures became more evident, and the unexpected departure of its CFO added near-term execution risk. We reallocated capital toward Fastenal, whose internally managed distribution and trucking network allows for better control over freight costs. We also were attracted to Fastenal's greater leverage to a potential recovery in short-cycle industrial activity, while still demonstrating the ability to take share in a softer environment. Likewise, in financials, we exited Cohen & Steers to pursue more attractive, higher-conviction opportunities.

Outlook

AI is still in the early innings of reshaping a wide range of industries, and we expect that this technology evolution will both disrupt businesses as well as create new winners beyond the hyperscaler names. Times of change and uncertainty create opportunities for us as bottom-up stock pickers as the market often has a habit of painting industries and subindustries with a broad brush. We saw this play out as the software sector was sold indiscriminately over much of the last 12 months. Our selectivity, holding through the noise in names like CrowdStrike and adding where conviction was high to names like Snowflake and Cloudflare, has served our clients well. Just as importantly, exiting positions with greater vulnerability, such as application software maker HubSpot, has benefited performance.

We would not be surprised to see bifurcation in the market as earnings reveal the ability for AI to either accelerate near-term business momentum or erode it. We are positioning the Strategy to take advantage of this — spending time identifying the companies in areas most likely to be winners and losers as AI's implications broaden.

Portfolio Highlights

The ClearBridge Growth Strategy outperformed its Russell Midcap Growth Index benchmark during the third quarter. On an absolute basis, the Strategy had positive contributions from four of the eight sectors in which it was invested (out of 11 sectors total). The leading contributors were the IT and health care sectors, while the industrials sector detracted the most.

On a relative basis, overall stock selection contributed to performance, while overall sector allocation detracted. Stock selection in the IT, industrials, consumer discretionary, communication services and utilities sectors benefited performance. Conversely, a lack of exposure to the energy sector, overweights to the industrials and communication services sectors and an underweight to the health care sector weighed on relative results.

On an individual stock basis, the biggest contributors to relative returns were CrowdStrike, Shopify, Vertex Pharmaceuticals and Freeport-McMoRan, as well as an underweight to Astera Labs. The largest detractors from relative returns were Vertiv and AppLovin, as well as not owning Marathon Petroleum, Atlassian and Everpure.

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