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## Select Strategy

### Key Takeaways

- ▶ The Strategy underperformed in a risk-off period where heightened geopolitical risk and negative sentiment toward software was most felt among our technology holdings.
- ▶ We continued to take advantage of volatility-induced selling to initiate 12 new common stock positions and exit six others while expanding our private market exposure to innovative companies involved in AI.
- ▶ Capital markets activity appears to be accelerating, with IPO activity improving and M&A volumes rebounding — an environment historically favorable for the Strategy.

### Market Overview

Surging volatility pressured U.S. equities to start 2026, as rapidly evolving macro conditions, a sentiment shift away from AI and the outbreak of a military conflict in the Middle East contributed to a sharp market selloff. A broad-based decline among more liquid, larger cap holdings put pressure on the Russell 3000 Index, which declined 4.0% for the quarter, while mid cap growth stocks fared worse, with the Russell Midcap Growth Index declining 6.3 %.

Importantly, market behavior during the quarter was driven more by macro forces than company-specific fundamentals. Periods of indiscriminate selling impacted both cyclical and defensive sectors, creating dislocations often disconnected from underlying business performance. This environment reinforced the importance of maintaining a balanced portfolio with durable compounders offsetting weakness in higher-beta disruptors and idiosyncratic evolving opportunities.

Growth stocks lagged their value counterparts as the AI trade lost momentum and investors began to question when billions of dollars in capital spending would lead to a meaningful return on investment. The Russell 3000 Growth Index dropped 9.5% for the quarter, underperforming the Russell 3000 Value Index by nearly 1,200 basis points.

The ClearBridge Select Strategy underperformed the benchmark through an ongoing rotation away from growth and momentum names that was exacerbated by the Iran conflict. This led to sharp dislocations in the information technology (IT) sector that weighed meaningfully on relative results versus the Strategy's core, predominantly large cap benchmark.

In IT, AppLovin and ServiceNow were caught up in a sentiment-driven selloff in software stocks due to increasing fears that generative AI could put their business models at risk. The launch of Anthropic's Claude Cework and other generative AI tools has heightened concerns that AI-native solutions could alter competitive dynamics, increase pricing pressure or compress long-term growth rates. As a result, a sector historically viewed as stable and durable due to high recurring revenue and strong retention has experienced broad-based multiple contraction. This dynamic has impacted nearly all software companies, including those we believe are relatively well-positioned to benefit from AI or are less susceptible to disruption.

Meanwhile, e-commerce enablement platform Shopify, which has largely been insulated from AI disruption fears thanks to its partnership with OpenAI, felt more of that pressure to start the year. That said, third-party e-commerce data suggests that Shopify's momentum and market share gains are continuing.

In communication services, Reddit was down on a research report that pointed to slowing new advertiser growth as well as competitive concerns as user engagement increases on AI apps like ChatGPT.

Health care was also a detractor due to weakness among several disruptors. Insulet, a maker of insulin pumps for diabetes patients, declined on a product recall, while Doximity, a digital platform for medical professionals, fell on a weakening outlook for health care advertising.

The bright spots for the quarter were in the Strategy's durable compounders in the cyclical industrials and energy sectors. Industrials holdings that provide essential services to data centers were among the best performers. These included Vertiv, a manufacturer of power, precision cooling and infrastructure management systems primarily serving data centers benefiting from the generational data center infrastructure investment, and Comfort Systems, a commercial HVAC provider seeing a record backlog for its sophisticated cooling systems that have driven better than expected earnings and forward guidance. Meanwhile, defense contractor L3Harris delivered solid performance amid sustained global defense spending trends.

In energy, oilfield equipment supplier Baker Hughes and exploration and production company Diamondback Energy were up strongly as crude oil prices rose more than 70% for the quarter as the Middle East conflict escalated and supply became constrained.

### **Portfolio Positioning**

We initiated 11 new common stock positions in the quarter while exiting six others. Among larger additions was ASM International, a Dutch semiconductor capital equipment company in the IT sector focused on deposition of layers of material on wafers etched into semiconductors. It has a leading position in several deposition categories with 80% of revenues from foundry/logic customers and the remainder in memory.

We also took advantage of recent sharp selloffs in online gaming platform Roblox and audio streamer Spotify to establish positions. We participated in the IPO for York Space Systems, a designer and manufacturer of defense satellites that we had previously owned as a private investment. We also added a private placement in Anthropic, one of the leading LLM developers.

While we believe application software companies are making appropriate investments to augment their offerings using AI, we significantly reduced our exposure to the industry as the time to monetize these investments is taking too long. This activity included exits from HubSpot and SailPoint and reductions in ServiceNow and Microsoft.

### Outlook

The macroeconomic and geopolitical backdrop remains highly fluid, with the first quarter marked by a rapid and often disorienting pace of headline-driven developments, including escalating geopolitical tensions in the Middle East, renewed policy uncertainty and a debatably shifting monetary policy framework following the appointment of a new Fed Chair. To that point, market expectations for rate cuts were revised lower over the quarter as inflation remained stubborn and energy prices rose rapidly. At the same time, the debate around the potential for accelerated disruption driven by AI has reached a fever pitch particularly in software and services.

These concerns have contributed to increased dispersion within sectors, as areas perceived to have greater obsolescence risk — such as horizontal/front-office software, information services and contract research organizations (CROs) in health care — faced pressure, while more asset-heavy or capital-intensive businesses with limited disruption risk, including select industrial and energy companies, were viewed more defensively. As a growth-oriented Strategy, this shift has reinforced the importance of selectivity and idiosyncratic fundamentals in navigating the current environment.

More positively, capital markets activity appears to be accelerating, with IPO activity improving after a multiyear lull and M&A volumes rebounding — an environment historically favorable for the Strategy. Recent M&A transactions, like Palo Alto Network's acquisition of portfolio holding Cyber Ark Software, highlight that sophisticated buyers are opportunistically deploying capital at what they view as depressed valuations, reinforcing our confidence in the underlying value of many small and mid cap businesses.

Last quarter we discussed being strong believers that innovation and secular trends endure and usually emerge from soft patches in the economy even stronger; we also believe in picking our spots with companies going "on sale." Today, we remain similarly opportunistic with the Iran conflict emerging as a catalyst leading to attractive entry points in beaten-up areas of the market such as consumer

discretionary and alternative asset managers. We have been increasing exposure to these segments through recent purchases of Starbucks and Formula One, as well as Ares Management.

Amid the spike in geopolitical volatility, the equity market has turned to favoring near-term stories over long-term secular trends. In longer duration plays, multiples have compressed on stocks that have been long-term winners or had high expectations coming into the year. Unlike certain “style-pure” peers, we have the flexibility to own companies over long periods of time and through business cycles as they compound cash flows significantly and grow from emerging disruptors into larger and steadier compounders. We expect the macro backdrop to remain bumpy but have positioned the portfolio to perform well in a variety of market and economic scenarios. With a balanced approach, we own stocks with organic growth drivers and strong management teams that have the proven ability to execute regardless of macro conditions.

### **Portfolio Highlights**

The ClearBridge Select Strategy underperformed its Russell 3000 Index benchmark during the first quarter. On an absolute basis, the Strategy saw contributions across three of the 11 sectors in which it was invested. The main contributors were the industrials and energy sectors while the primary detractor was the IT sector.

Relative to the benchmark, overall stock selection detracted from performance, outweighing positive sector allocation effects. In particular, stock selection in the IT, energy, real estate, communication services and financials sectors and an overweight to IT weighed on results. On the positive side, stock selection in industrials, overweights to industrials, consumer staples and energy as well as underweights to financials and communication services contributed to performance.

On an individual stock basis, the primary relative detractors were AppLovin, ServiceNow, Shopify, Reddit and MercadoLibre. The leading contributors were Casey’s General Stores, Comfort Systems, Vertiv, Baker Hughes and L3Harris Technologies.

In addition to the transactions mentioned above, we added a position in Wintrust Financial in financials, NRG Energy in utilities, Solstice Advanced Materials in materials and Republic Services in industrials. Among our sales were exits from Penumbra and Medpace Holdings in health care and Verisk Analytics in industrials.

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