



Value Strategy



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Key Takeaways

- ▶ Equities rebounded sharply in the second quarter, led by growth stocks and AI infrastructure, though value retained a substantial year-to-date lead as investors continued to reward cash flow durability, balance sheet strength and exposure to tangible demand drivers.
- ▶ The Strategy generated solid absolute returns but underperformed its Russell 1000 Value Index benchmark, as positive stock selection across multiple sectors was offset by an underweight to IT and an overweight to energy.
- ▶ We used volatility to add exposure to select AI enablers, low-cost energy and materials companies and dislocated financials, shifting capital toward businesses with visible free cash flow, hard assets and improving earnings power.

Market Overview

The second quarter of 2026 saw a sharp equity recovery, with AI-related capital spending and improved risk appetite driving a growth-led rebound. The Russell 1000 Growth Index returned 16.7%, compared with gains of 15.1% for the Russell 1000 Index and 13.9% for the Russell 1000 Value Index. Value remained substantially ahead year to date, however, with the Russell 1000 Value Index returning 16.3% compared with 10.3% for the Russell 1000 Index and 5.3% for the Russell 1000 Growth Index. Leadership began to broaden late in the quarter as investors reassessed geopolitical risk, inflation pressures and semiconductor valuations.

Energy markets were a central source of volatility and an important channel through which geopolitical risk affected inflation expectations. The conflict with Iran and disruptions to tanker traffic through the Strait of Hormuz pushed WTI crude above \$110 per barrel before prices fell below \$70 as tensions eased. The retracement reduced immediate inflation pressure, but the episode underscored how depleted inventory buffers and fragile supply chains can turn an energy shock into both an inflation impulse and a tax on growth.

AI remained the dominant market theme, but leadership continued to evolve. Compute investment supported demand for semiconductors, high-bandwidth memory, power, cooling and grid infrastructure, while software, services and information-based businesses faced greater scrutiny.

AI remained the dominant market theme, but the strongest opportunities are increasingly tied to the physical inputs required to support it: power, memory, infrastructure and energy.

Portfolio Performance

The ClearBridge Value Strategy generated solid absolute returns but underperformed its Russell 1000 Value Index benchmark during the second quarter, as the same forces that powered the broader market recovery created mixed implications for relative performance. The AI-led rebound benefited several holdings tied to infrastructure demand, but our valuation discipline limited exposure to some of the benchmark's most extended areas, while the late-quarter pullback in oil prices turned our energy positioning into a relative headwind.

Communication services was the largest contributor to relative results, led by Alphabet. Strong first-quarter earnings helped reframe AI from a pure capital spending concern to a monetization story, with Google Cloud benefiting from enterprise AI solutions and infrastructure, margins expanding and search remaining resilient. This reinforced the durability of Alphabet's core franchise even as AI reshapes the competitive landscape.

Health care also contributed, with CVS Health and UnitedHealth Group benefiting from improved sentiment toward managed care. CVS rose as stronger first-quarter earnings, raised full-year guidance and better performance in its health benefits business supported confidence in the company's turnaround, while reduced policy uncertainty around exchange subsidies also helped. UnitedHealth advanced as better cost trends and a more favorable outlook helped rebuild confidence after prior pressure on margins. These gains were partially offset by Boston Scientific, which declined on continued weakness in WATCHMAN, its device used to reduce stroke risk in patients with irregular heart rhythms, and concerns over share loss in electrophysiology.

Within IT, stock selection was beneficial, led by Micron Technology, the Strategy's best-performing holding for the quarter. The stock was supported by growing confidence in the AI-driven memory cycle, with strong demand for high-bandwidth memory used in AI servers reinforcing expectations for pricing strength and earnings growth. Taiwan Semiconductor also contributed as leading-edge semiconductor demand and AI-related capacity investment remained strong. These gains helped performance but did not fully offset the benchmark impact of being underweight one of the market's strongest sectors.

Energy was the other main detractor, with both ConocoPhillips and Chevron declining as easing Middle East tensions and negotiations between the U.S. and Iran resulted in a pullback in crude prices. Despite this pressure, we continue to have high conviction in the sector: the Iran episode reinforced the importance of energy security, supply-chain resilience and capital discipline, while depleted inventories should support durable cash flow opportunities for well-capitalized, low-cost producers.

Portfolio Positioning

During the quarter we initiated a position in Diamondback Energy, an independent oil and natural gas company with high-quality acreage and a low-cost operating profile. Given the potential for tighter oil markets as crude and refined product inventories are rebuilt, we added

exposure to a best-in-class U.S. shale producer with deep inventory, balance sheet strength and corporate action optionality. We believe Diamondback's disciplined capital allocation and continued capital returns create multiple avenues for shareholder value creation through the commodity cycle.

We also initiated a position in Blackstone, returning to alternative asset managers after weakness driven by private credit concerns and retail redemption requests created a more attractive entry point. Blackstone's balance-sheet-light, fee-driven model, real estate franchise and long-term compounding potential remain compelling, and we believe the market was overly discounting manageable risks.

In IT, we added Broadcom and Advanced Micro Devices to increase exposure to AI hardware without chasing the most extended areas of the trend. Broadcom is positioned at the center of the custom AI compute buildout, with multi-year hyperscale relationships providing unusual visibility, while AMD offers exposure to compute demand with what we view as a more balanced risk-reward profile.

Meanwhile, we sold Eastman Chemical, which funded a new position in CF Industries. Eastman's investment case was pressured by its inability to move down the global chemical cost curve, the loss of a federal grant tied to its planned molecular recycling facility and a chemical cycle that remained more challenged than we expected. By reallocating into CF, we shifted from a higher-cost commodity producer to one of the lowest-cost producers in global fertilizer, supported by low-cost U.S. natural gas feedstocks and a more favorable structural demand backdrop.

We also exited Charles Schwab and PG&E. In Schwab, we became more concerned that competition for client cash balances, including potential AI-driven cash sorting, could pressure the company's profitable float monetization business. We exited PG&E after becoming less optimistic about meaningful utility reform in California.

Outlook

As we move into the second half of the year, investors will need to navigate a market that is less one-dimensional than the rally in headline indexes suggests. AI-related demand remains a powerful support, but elevated valuations, shifting equity supply and large infrastructure capital needs could make markets more sensitive to changes in flows and risk appetite. Energy also remains an important swing factor, with depleted inventories keeping attention on energy security, infrastructure resilience and capital discipline.

The fact that value continues to lead growth on a year-to-date basis suggests investors are still rewarding tangible earnings power and balance sheet durability beneath the AI-led rebound. In this environment, we believe selectivity is essential, with a focus on resilient balance sheets, visible cash generation and companies capable of compounding value across a range of macro outcomes.

Portfolio Highlights

The ClearBridge Value Strategy underperformed its Russell 1000 Value Index benchmark during the second quarter. On an absolute basis, the Strategy had positive contributions from nine of the 11 sectors in which it was invested. The leading contributors were the IT, health care and financials sectors, while the energy sector detracted the most.

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

On an individual stock basis, the biggest contributors to relative returns were Micron Technology, CVS Health and Taiwan Semiconductor Manufacturing, as well as not owning Exxon Mobil and Walmart. The largest detractors from relative returns were ConocoPhillips, Chevron and Boston Scientific, as well as not owning Intel and SanDisk.

In addition to the transactions discussed above, we initiated new positions in Vulcan Materials in the materials sector, TGS in the energy sector, FedEx Freight in the industrials sector, Brookfield Infrastructure in the utilities sector and Thermo Fisher Scientific in the health care sector. We exited positions in Becton Dickinson and UCB in the health care sector, Webster Financial, MGIC Investment and Ryan Specialty Holdings in the financials sector, American Homes 4 Rent in the real estate sector and TFI International in the industrials sector.

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