



Select Strategy



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Key Takeaways

- ▶ Growth equities rallied sharply, led by continued enthusiasm for AI infrastructure, but the Strategy underperformed due mainly to stock selection in IT and consumer discretionary.
- ▶ Market leadership favored AI-linked semiconductors and infrastructure, while energy and defense-related cyclicals lagged.
- ▶ Portfolio activity emphasized higher-conviction exposure to AI infrastructure and other structural growth opportunities while reducing AI disruption risk.

Market Overview

Growth equities experienced one of the strongest quarters in recent memory in the second quarter. The Russell 2500 Growth Index of small and mid cap companies advanced 24.0% during the period, a rare occurrence that has happened only four times over the past two decades. Meanwhile, the benchmark Russell 3000 Index advanced 15.4% and the Russell Midcap Growth Index rose 14.5%, the best quarterly performances for each index since 2020.

While market leadership broadened beyond mega cap technology, artificial intelligence (AI) remained the dominant market narrative, though leadership continued to rapidly chase the next bottlenecks across memory, optical networking, CPUs and high-performance compute capacity. Additionally, some pockets of more cyclical sectors also participated as investors embraced companies with leverage to an improving industrial backdrop.

The strength of the AI infrastructure investment cycle overcame a complicated macro backdrop that included geopolitical volatility, a spike and subsequent fade in oil prices, renewed inflation concerns and a sharp shift in expectations for monetary policy. Entering the year, investors expected Federal Reserve rate cuts; by quarter-end, market debate had shifted toward the potential for rate hikes later in 2026.

Against this backdrop, the ClearBridge Select Strategy underperformed its broad market Russell 3000 Index benchmark, primarily due to stock selection in the information technology (IT) and consumer discretionary sectors.

The primary performance headwinds resulted from not holding several higher-beta AI favorites in the semiconductor industry, which soared in the quarter. These included Micron Technology, Advanced Micro Devices (AMD) and Intel as investors aggressively favored semiconductor companies benefiting from surging AI-related chip demand.

Baker Hughes was also a relative detractor as oil prices fell around \$32 per barrel during the quarter as geopolitical tensions eased and tanker traffic through the Strait of Hormuz tentatively resumed; L3Harris Technologies declined on profit taking and disappointment that the defense contractor did not raise full-year guidance in a period of increased global defense spending.

While IT was an overall detractor, the Strategy saw positive contributions from a handful of AI-indexed names. Lam Research continued to benefit from the AI-driven semiconductor investment cycle, with strong demand for chip manufacturing equipment supporting gains. Coherent advanced on robust demand for its optical networking equipment used in AI data centers and high-speed data transmission. Fortinet also contributed meaningfully as software stocks rebounded, supported by improving investor sentiment toward AI-enabled enterprise software and cybersecurity providers.

Meanwhile, Comfort Systems remained a recipient of accelerating investment in data center construction that boosted demand for its commercial HVAC solutions.

The Strategy's private investment in Anthropic surged following the release of metrics showing robust enterprise adoption of its Claude model, which stoked enthusiasm for the LLM developer ahead of its expected second half IPO.

Portfolio Positioning

The Portfolio remained active over the quarter, initiating 11 new positions and exiting 10 holdings as we continued to recycle capital into higher-conviction opportunities while reducing exposure to businesses where either the risk/reward had become less favorable or we saw increasing competitive pressures from AI.

Among the new investments, the largest was Alphabet, which we see exceeding cloud growth expectations while benefiting from its expanding AI ecosystem, including Tensor Processing Unit (TPU) chips and the potential monetization of AI coding agents.

We also participated in the IPO of SpaceX, which competes in several large addressable markets with a significant technology lead versus peers. Its core competitive advantage is its proven ability to reuse rockets, which materially lowers the cost of delivering payloads into orbit. By combining SpaceX's operations with Starlink, the dominant satellite Internet provider, the company plans to extend this playbook into AI infrastructure scaling orbital data center compute.

Other moves included the repurchase of CrowdStrike and the additions of Medpace, a contract research organization serving biopharma customers, and Solaris Energy Infrastructure, whose oil and gas logistics platform is expanding into power markets supporting data center development.

In financials, we exited alternative asset manager Ares and redeployed capital into Arch Capital, a specialty insurance and reinsurance provider, while increasing our investment in regional bank Wintrust Financial.

The Strategy continued to add businesses positioned to benefit from long-term AI infrastructure spending and structural growth trends. We initiated a position in Arista Networks, whose high-speed networking equipment is critical to cloud platforms and AI data centers and where we believe the company is well-positioned to gain additional enterprise market share. We also added Everpure, a provider of enterprise data storage and management solutions benefiting from growing AI-related demand, and Freeport-McMoRan, the world's largest copper producer, which we believe is well-positioned to capitalize on favorable long-term copper supply and demand dynamics driven by electrification and AI infrastructure investment.

On the sell side, we further streamlined the portfolio by exiting Doximity, Wix.com and Sprout Social, reflecting our view that these businesses face an elevated risk of disruption as AI adoption accelerates.

Outlook

The determination of AI winners and losers will take quarters if not years to determine. We view the May rebound in the recently pressured software industry as a sign of stabilization following a selloff based on fears that generative AI would disintermediate software business models. The reversal was supported by improving sentiment among software makers viewed as enablers of AI adoption and solid earnings results. Software has always been a core exposure in the Strategy and we maintain confidence in the innovators we own across the industry.

The macroeconomic and geopolitical backdrop remains highly fluid, but the U.S. outlook is becoming increasingly constructive. While inflation has spiked to levels last seen in 2023 due to commodity prices increases related to the ongoing closure of the Strait of Hormuz, oil prices have since moderated, employment is on the mend and consumer spending has held up amid a sharp drop in sentiment. Fed policy is unlikely to be supportive in the near term; however, the companies we own and target have exhibited resilience as demonstrated by healthy earnings results.

Capital markets activity is also improving, with strong debuts by AI-related companies and SpaceX as well as the eagerly anticipated IPOs of Anthropic and OpenAI on the horizon, both of which we currently own as private investments. This trend supports our idea generation process and should offer more growth opportunities to choose from going forward. We will continue to support the addition of such higher growth businesses through a balanced approach that also includes steady franchises with organic growth drivers and strong management teams as well as evolving opportunities that we believe are being mispriced by the market. We will also continue to harness our private market research and relationships to be early participants in innovation and the creation of new markets.

Portfolio Highlights

During the second quarter, the ClearBridge Select Strategy underperformed its Russell 3000 Index benchmark. The Strategy delivered positive contributions across eight of the 11 sectors in which it

was invested, led by the IT, industrials and consumer staples sectors, while energy and financials were the main detractors.

Relative to the benchmark, overall stock selection detracted from performance while sector allocation was positive. In particular, stock selection in the IT, financials, consumer discretionary, industrials and real estate sectors, and overweights to consumer staples and energy weighed on results. Conversely, stock selection in the consumer staples and communication services sectors, underweights to financials and utilities and an overweight to IT contributed to performance.

On an individual stock basis, the primary contributors to relative performance for the quarter included Lam Research, a private placement in Anthropic, Fortinet and Coherent in the IT sector, as well as Comfort Systems in the industrials sector. The main detractors from relative returns were L3Harris Technologies in industrials, Baker Hughes in energy and not holding Micron Technology, Advanced Micro Devices and Intel in IT.

In addition to the transactions mentioned above, we initiated a position in Bloom Energy and made a private placement in Majestic Labs in IT. The Strategy exited Waste Connections in industrials, Vistra in utilities, Roblox in communication services, Wingstop in consumer discretionary, SentinelOne in IT and Shift4 Payments in financials.

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