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Large Cap Value ESG Strategy

Key Takeaways

- ▶ Value leadership broadened meaningfully, with the Russell 1000 Value Index positive for the quarter, and roughly 1,200 bps ahead of growth, as markets rotated away from mega cap concentration.
- ▶ Strategy results benefited from quality industrial holdings, which got a boost from a return to positive territory for the ISM Manufacturing PMI.
- ▶ Active repositioning sharpened the Strategy for a more fundamentals-driven market, with portfolio activity concentrated in communication services and industrials in the quarter.

Market Overview

Value stocks offered a rare bright spot in the first quarter of 2026 as market leadership rotated away from a narrow set of mega cap growth leaders and toward a broader set of companies, including value-oriented and more cyclical areas of the market. The Russell 1000 Value Index managed a 2.1% gain, almost 1,200 basis points ahead of its growth counterpart.

Energy companies surged as the U.S.-Iran conflict pushed up oil prices, while materials, industrials, utilities and consumer staples benefited from different combinations of geopolitical supply concerns, AI-related infrastructure demand and a rotation into defensive areas after extended underperformance. Financials and consumer discretionary, meanwhile, lagged as persistent inflation and higher fuel costs weighed on expectations for economic activity, including capital markets, credit, travel and housing.

Performance Overview

The ClearBridge Large Cap Value ESG Strategy's anchoring in high-quality companies with durable moats and predictable cash flows helped it achieve positive absolute returns in the quarter amid the shift in market leadership, although it trailed the benchmark Russell 1000 Value Index. Despite strong performance from Williams, an underweight to energy was a large detractor.

Industrials stocks got a boost from a return to positive territory for the ISM Manufacturing PMI; this helped XPO, a less-than-truckload transportation provider, which is also benefiting from ongoing improvements in service quality, mix and pricing. Deere, meanwhile,

delivered a 20% earnings beat, helped by outperformance in both its small agriculture (e.g., compact and utility tractors) and its construction and forestry segments. Investors were encouraged that large agriculture (machines for commercial farming) orders were better than expected, suggesting there could be upside to Deere's 2026 guidance, and this year may be the cyclical trough. External indicators such as the Dodge Momentum Index and megaproject announcements suggest that nonresidential construction is improving — a plus for Deere's construction and forestry segment — and the company's results helped validate that.

In health care, Johnson & Johnson delivered strong quarterly results; investors have become more confident that cancer and inflammation medicine growth and recent deals will allow the company to grow through the loss of Stelara exclusivity.

Negative sentiment for software weighed on our sole software position, Microsoft, which also traded down on worries over higher-than-expected AI capex and delays in monetizing its AI backlog. Despite some timing and perception issues, we maintain strong conviction in Microsoft, given durable Azure demand, accelerating AI workload monetization as capacity comes online and strengthening traction in higher-margin software offerings like M365 Copilot, which deepen customer engagement and reinforce Microsoft's competitive moat. We added to our position on weakness.

In financials, Capital One shares were lower amid broad sector weakness, driven by investor concerns around weakening macro conditions potentially leading to a credit cycle; deal-related overhang tied to the company's Brex acquisition also weighed on near-term sentiment. American Express detracted as regulatory uncertainty around credit card pricing and renewed attention on the Credit Card Competition Act pressured sentiment across the payments and card issuer space, including Capital One, despite stable underlying fundamentals. Our conviction in both remains intact: we view these sector pressures as cyclical and transitory, with no anticipated change to Capital One's long-term earnings power and strategic positioning or American Express's attractiveness as a high-quality compounder supported by its premium customer base, strong credit underwriting and durable earnings growth.

Portfolio Positioning

Portfolio activity was concentrated in communication services and industrials in the quarter. We initiated a position in T-Mobile: our core view is that it has the best network at the lowest cost in the U.S., and that should insulate it from competition from other wireless entrants (such as cable players). We also believe it should be economically insensitive given the nature of the industry (high recurring revenues and mobile wireless being an essential service for consumers). At the same time, we exited Comcast, whose core broadband business looks

increasingly pressured from new entrants including fixed wireless, fiber entrants and potentially SpaceX through its Starlink internet service. While the company spun out the bulk of its linear cable networks, its remaining content assets, particularly its direct-to-consumer streaming platform, Peacock, appears to be predominantly U.S. focused and lacking scale of peers such as Netflix, HBO (soon to be combined with Paramount) and Disney+.

In industrials we bought Honeywell, partially funding it by selling out of a marginal holding in Otis, which has been going through execution issues that made us question management quality. The appeal in Honeywell was better risk-reward and a more attractive mix of quality, defensiveness and upside relative to other industrial names we own. Honeywell is undergoing a transformation as it breaks up the company into an aerospace business, an automation company and a quantum computing company. We believe the stock today undervalues the assets as they separate into three more focused and independently traded entities over the coming months.

Outlook

A core tenet of the Strategy is that we largely avoid making top-down bets or try to time macro events; we focus on high-quality businesses with durable competitive advantages and reasonable valuations that can drive superior returns through the cycle. The broadening of the market during the first quarter, with its rotation from a concentrated AI-driven growth market to a more dispersed, fundamentals-driven environment, was a positive sign for this quality bias, in our view. Tangible earnings, pricing power and lower disruption risk are key components in the quality franchises we seek in the portfolio. In an increasingly complex macro backdrop marked by geopolitical tensions, rising energy prices and ongoing uncertainty around the durability of AI-driven investment cycles, we believe the companies we own will remain resilient.

Portfolio Highlights

The ClearBridge Large Cap Value ESG Strategy underperformed the benchmark Russell 1000 Value Index for the quarter. On an absolute basis, the Strategy had positive contributions from six of 11 sectors. The industrials and energy sectors were the main positive contributors, while financials was the main detractor.

In relative terms, stock selection in industrials proved beneficial, while stock selection in the energy, materials, communication services and financials sectors detracted from relative results. An overweight to materials was beneficial, while energy and consumer staples underweights and a health care overweight detracted.

On an individual stock basis, the biggest relative contributors during the quarter were XPO, Williams, Air Products and Chemicals, Deere and

Intel. The biggest detractors were Microsoft, Capital One, American Express and not owning Exxon Mobil or Chevron.

In addition to portfolio activity discussed above, during the quarter we exited Starbucks in consumer discretionary. We also received shares of Waters, a high-end lab equipment and consumables provider in the health care sector, following its combination with Becton Dickinson's biosciences and diagnostics solutions business via a Reverse Morris Trust transaction. We are currently evaluating the Waters position.

ESG Highlights: Materiality Drives Stewardship Insights

ClearBridge's approach to ESG integration remains rooted in a simple but enduring principle: material environmental, social and governance factors are integral to long-term value creation. As the global sustainability landscape evolves amid shifting regulatory priorities, geopolitical complexity and rapid technological change, our approach continues to emphasize fundamental research, active ownership and a disciplined focus on materiality.

Our 2026 Stewardship Report highlights how this philosophy is translating into tangible outcomes, underscoring both the breadth of our engagement activity and the depth of our ESG integration across portfolios.

A defining feature of ClearBridge's ESG integration is our proprietary ClearBridge Materiality Framework™, which identifies the ESG factors most relevant to each sector and subsector. Engagement priorities are derived from this framework at the company level, ensuring that these efforts focus on issues that are financially material and aligned with our fiduciary duty.

In 2025, several key themes emerged as focal points of engagement:

- Decarbonization and climate adaptation
- Critical minerals and human rights
- Biodiversity and natural resource management
- Responsible AI and data governance
- Governance and shareholder rights

These themes reflect both structural global trends and evolving investor priorities. For example, climate-related engagements increasingly addressed not only emissions reduction but also adaptation and resilience topics, such as grid modernization, water management and disaster preparedness. Companies like DTE Energy, a utility making grid modernization and storm hardening investments, and Eaton, which builds backup power and electrical resilience systems, illustrate how investments in infrastructure resilience can support both sustainability outcomes and long-term earnings durability.

Similarly, the energy transition has elevated the importance of critical minerals, where demand for copper, lithium and rare earths is driven by electrification, AI infrastructure and renewable energy deployment. ClearBridge engagements in this area extend beyond environmental impact to include human rights, supply chain practices and community relations, particularly through collaborative initiatives such as PRI Advance, with which we have engaged with mining companies Antofagasta and Freeport-McMoRan.

The integration of new teams across regions in 2025 further strengthened the ClearBridge Materiality Framework™ by incorporating new insights from emerging markets, the U.K. and Australia. This global perspective enhances our ability to identify best practices, anticipate risks and engage companies more effectively across diverse regulatory and operating environments.

Insights from Global Engagements

ClearBridge's global engagement activity provides a number of practical examples of how ESG considerations translate into investment insights and outcomes. Across regions, the most frequently addressed ESG factors in 2025 included energy transition risks, environmental impacts of operations, community relations, employee health and safety, capital allocation and executive compensation.

Several engagements illustrate our pragmatic approach focused on long-term value creation and positive change:

- **Amazon.com (U.S.):** Engagements focused on labor practices, safety and environmental efficiency. As of the first quarter of 2025, the company reported a 65% reduction in lost-time injuries over the last five years, progress toward net-zero by 2040 and improvements in logistics efficiency and renewable energy use. These developments demonstrate how operational improvements can enhance both social outcomes and cost efficiency at scale.
- **ASML (Netherlands):** Discussions centered on water usage, energy efficiency and supply chain emissions. While direct water usage is limited, engagement highlighted increasing regulatory and regional risks — water is a material topic due to increasing regulatory scrutiny, particularly in the Netherlands, and in Taiwan and the U.S. water stress is now considered a medium-level risk — reinforcing the importance of forward-looking risk management even where current exposure appears modest.
- **Walmart (U.S.):** Engagement emphasized workforce development, wages and human rights in the supply chain. The company's focus on internal upskilling and technology-enabled human rights monitoring illustrates how social considerations can strengthen operational resilience and labor productivity.
- **Toronto-Dominion Bank (Canada):** We engaged the company against the backdrop of U.S. regulatory scrutiny tied to material deficiencies in TD's anti-money laundering (AML) program and

proxy advisor recommendations to withhold votes from board members. ClearBridge's nuanced voting decision in favor of contested directors took into account a meaningful board refresh in 2025 and momentum in remediation; it also reflected insights gained through direct dialogue, highlighting the value of active ownership beyond standardized proxy recommendations.

- **Freeport-McMoRan (U.S.):** Engagement on emissions, water management and human rights demonstrated the complexity of balancing environmental performance with operational realities in resource-intensive industries. Progress on emissions reduction initiatives and disclosure improvements supported continued investment conviction while identifying areas for further engagement.
- **Companhia Paranaense de Energia (Brazil):** Engagements centered on governance transformation following privatization. Improvements in board independence, disclosure practices and strategic focus highlight how governance reform can unlock value and improve investor confidence in emerging markets.
- **MercadoLibre (Latin America):** Engagement on data privacy and cybersecurity led to improved disclosures and attainment of ISO 27001 certification — an independent, third-party audit confirming an organization's information security system manages data security risks effectively. This progression highlights how governance and technology-related ESG factors are increasingly central to maintaining customer trust and supporting growth in digital platforms.

Responsible AI and Emerging ESG Themes

One of the most rapidly evolving areas of ESG analysis in 2025 was responsible AI. As AI adoption accelerates across industries, factors such as data privacy, ethical use of AI, labor implications and environmental impacts such as energy and water consumption from data centers have grown in importance in our analysis.

This reflects the increasing importance of technology-driven risks and opportunities in sustainability analysis. Responsible AI is now viewed as a material factor influencing competitive positioning, regulatory exposure and stakeholder trust. ClearBridge's approach emphasizes balancing innovation with accountability, seeking to ensure that companies adopt AI in ways that are transparent, secure and aligned with long-term societal value.

Conclusion

The 2026 Stewardship Report highlights a year of continued progress for ClearBridge's ESG platform, characterized by global engagement activity and deeper integration of material sustainability factors into investment decision making. As global markets continue to evolve, our approach positions us to navigate complexity while identifying opportunities that align sustainability with shareholder value.

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