



Large Cap Value Strategy



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Key Takeaways

- ▶ U.S. value stocks advanced despite an oil-driven rise in inflation expectations and bond yields, with energy leading a mixed quarter for sector performance.
- ▶ The Strategy posted a positive return but trailed the Russell 1000 Value Index as weak stock selection in IT, health care and materials outweighed favorable sector allocation and strength in industrials and financials.
- ▶ Portfolio activity emphasized higher-quality franchises — including new positions in Nvidia and Coca-Cola — while the Strategy maintained its valuation discipline amid narrow, speculative AI-led market leadership.

Market Overview

U.S. stocks continued to rise in the third quarter, with returns shaped by two major macro forces: the oil supply shock stemming from tensions in the Middle East driving oil prices higher and, partly a result of this, higher inflation expectations and bond yields. The benchmark Russell 1000 Value Index returned 2.6%. The Fed raised interest rates for the first time since 2023 in September and grew more hawkish in its forecasts, implying another hike in 2026; the 10-year Treasury yield finished the quarter up roughly 80 basis points at 5.3%. Sector performance in the index was mixed, with energy leading on higher oil prices, information technology (IT) and communication services lifted by hyperscaler strength, health care continuing its rebound and consumer and rate-sensitive sectors flat to down as a result of inflation and rate pressure.

Performance Overview

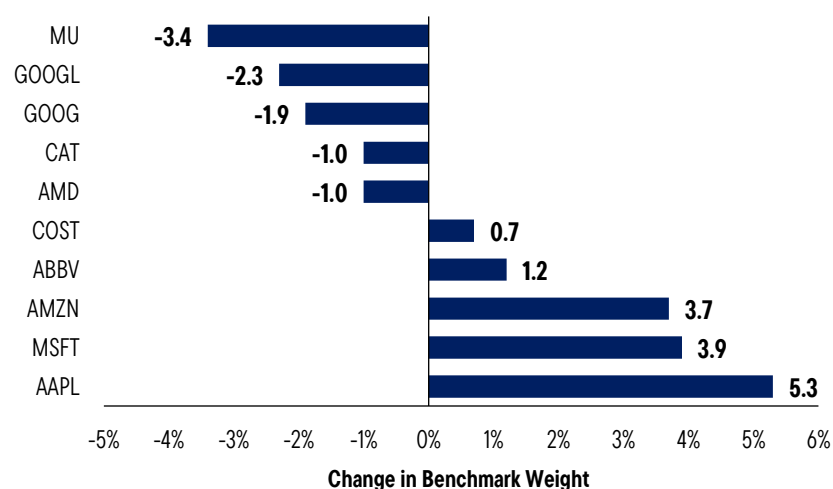
The Strategy delivered positive returns but trailed the index in the quarter. Sector allocation contributed positively via underweights to real estate and consumer staples and a health care overweight, but this was more than offset by weaker stock selection in IT, health care and materials. Selection was strongest in industrials and financials.

The portfolio seeks to outperform over a full market cycle, including both normal and difficult markets. It can lag, however, when gains are unusually narrow and concentrated in higher-beta securities. The last nine months have exhibited many of those characteristics. High-beta and lower-quality stocks have outperformed their lower-beta, higher-quality counterparts, while a narrow group of AI-related memory,

storage and optical-networking companies has generated particularly strong returns.

The Russell's rebalance in June added some relative performance challenges (Exhibit 1), as names like Micron rose sharply inside the value benchmark — costing anyone who didn't own them — then left the index at the June rebalance and subsequently declined. The index captured their full run-up; managers who avoided them on quality grounds took the relative pain on the way up, with no offset on the way down. That is an index-construction issue, not a stock-selection issue, in our view, although it has ramifications on portfolio turnover, which has been elevated as a result.

Exhibit 1: Russell 1000 Value Rotation within AI



Source: Aladdin Russell 1000 Value snapshots at June 1, 2026, and June 26, 2026. Ticker matching; corporate actions can affect apparent additions and deletions.

Along these lines, our underweight to Microsoft was a top relative detractor in the third quarter as strong Azure growth and increasing Copilot adoption reinforced confidence in the company's ability to monetize AI investment. We added to our position following Microsoft's significant increase in the index yet remained underweight following the stock's ~400 basis point jump in index weighting.

In health care, CVS Health shares weakened despite strong second-quarter results and increased 2026 guidance as investors focused on management's warning that pressure in its 340B business would persist into 2027. The federal 340B program allows qualifying hospitals and clinics serving lower-income communities to purchase outpatient drugs at substantial discounts, with CVS participating by administering claims and dispensing prescriptions through Caremark and its pharmacy network. Changing manufacturer restrictions and reimbursement arrangements are pressuring the fees and margins CVS earns from this business, while expected Caremark membership declines and litigation concerning 340B specialty-drug reimbursements added further uncertainty. We maintain our overweight as we see a likely path to margin expansion as CVS recovers profits in its Medicare Advantage business.

Health care holdings were also among top relative contributors. Thermo Fisher Scientific, a high-quality life science tools company with a broad portfolio gaining wallet share among biopharma customers, rose on stronger-than-expected results, improving customer activity across its end markets and an increase in full-year guidance that reinforced expectations for a recovery in life-sciences demand. McKesson gained on similar strong results and a raised outlook, supported by higher prescription volumes and strong growth in its oncology, multispecialty and specialty-pharmaceutical businesses. Waters, to which we added in the quarter, is generating encouraging early synergies from its acquisition of Becton Dickinson's biosciences and diagnostic solutions businesses. Medical devices and supplies maker Becton Dickinson, meanwhile, delivered a second consecutive quarter of core growth, with improving free cash flow, capital allocation, execution and forecasting credibility adding to sentiment.

Industrials and financials holdings also contributed positively. Deere advanced after reporting stronger-than-expected earnings, raising guidance and indicating that 2026 could represent the bottom of the agricultural equipment cycle. Travelers outperformed on a large second-quarter beat driven by favorable reserve development, light catastrophe losses and better underlying margins.

In materials, Martin Marietta Materials declined despite better-than-expected quarterly results as investors focused on weaker aggregates pricing and gross profit per ton, acquisition-related margin pressure and concerns regarding its planned acquisition of Lhoist North America, a major lime producer in the country.

Portfolio Positioning

As a result of Russell 1000 Value rebalancing, the benchmark weight of semiconductors and related areas has declined materially, resulting in our decision to reduce our exposure to Broadcom, Microchip Technology in the second quarter and Taiwan Semiconductor in the third. We partially offset that by moving even further up on the quality curve and initiating a new position in Nvidia, the leading developer of graphics processing units used in generative AI, gaming and enterprise application. Nvidia is a very high-quality, cash-flow-generative franchise with strong competitive positioning that is returning substantial cash to shareholders. The company's valuation has grown more attractive in recent months both on an absolute basis and relative to the rest of the industry, offering an attractive entry point, particularly in the face of robust earnings growth over the coming years.

We trimmed our overweight position in Intel early in the quarter, then later took advantage of the stock's meaningful selloff to add back some exposure. We continue to be impressed with the progress the company is making under its new CEO, both on product and foundry sides of the business. The company should be one of key beneficiaries of agentic AI adoption over the coming years.

In addition, while still maintaining overweight positions, we reduced exposure to Alphabet and Meta in the communication services sector (the latter late in the second quarter). We added to Amazon in

consumer discretionary and Apple in IT. All four companies are strong durable franchises with defensible moats and strong balance sheets. These changes were mostly made as part of risk management to address Russell rebalancing.

In addition to changes affecting our technology and communication services exposures, we made adjustments in energy and consumer staples. We sold out of Chevron and added to ExxonMobil, in whose quality characteristics we have higher conviction, and we exited PepsiCo, initiating a new position in Coca-Cola. Price cuts at PepsiCo have not been able to stimulate volume growth in its Frito Lay North America operations, challenging our investment thesis. We bought the higher-quality Coca-Cola, a global beverage leader with strong brands, a global footprint and robust pricing power.

We also exited Roche, a global diversified biopharmaceutical and diagnostics company, as our initial thesis premised on reasonable valuation and a promising product pipeline of new cancer and MLS antibiotic drugs was largely invalidated by disappointing interim trial data readouts.

Outlook

We continue to adhere to our philosophy of seeking quality businesses with durable franchises, strong balance sheets and proven management teams, purchased with valuation discipline and assembled through risk-aware portfolio construction. We believe this discipline is particularly important given elevated valuations and the market's increasingly narrowing focus on lower-quality AI players, which up until the June Russell rebalancing represented a meaningful and growing part of the benchmark. Over the past year, the outperformance of high-beta, lower-quality, more commoditized stocks over lower-beta, higher-quality stocks has produced what we view as a historic low-quality, or "junk," rally.

While that environment has obscured the portfolio's defensive characteristics, we like the setup going forward. If the economy accelerates, the quality franchises we favor should be positioned to compound earnings, while improved investor confidence could help close their valuation discounts. If the economy weakens, their durable business models, balance-sheet strength and earnings resilience should provide downside mitigation after a period in which those characteristics have received little recognition from the market.

We do not have a strong conviction that either economic scenario must prevail; our positioning reflects our view, rather, that the current combination of narrow market leadership, unusually strong performance of speculative stocks and rapidly expanding valuations among cyclical AI beneficiaries will not persist indefinitely. In a market with broader leadership and greater emphasis on earnings durability, cash generation and balance-sheet strength, we believe the Strategy's diversified quality orientation should become increasingly valuable and apparent.

Portfolio Highlights

The ClearBridge Large Cap Value Strategy underperformed its Russell 1000 Value benchmark during the third quarter. On an absolute basis, the Strategy had positive contributions from six of the 10 sectors in which it was invested (out of 11 sectors total). The leading contributors were the health care and energy sectors, while the materials and utilities sectors detracted the most.

On a relative basis, stock selection in financials and industrials contributed to performance. A lack of exposure to real estate, an overweight to health care and an underweight to consumer staples also contributed to performance. Conversely, stock selection in IT, health care and materials detracted from performance.

On an individual stock basis, the largest contributors to relative returns were Thermo Fisher Scientific, ConocoPhillips, Waters, McKesson and not owning IBM. The largest detractors were CVS Health, XPO, WEC Energy Group, Martin Marietta Materials and an underweight to Microsoft.

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