



## All Cap Growth Strategy



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### Key Takeaways

- ▶ Growth stocks led a furious market rebound from tariff uncertainty with the higher-beta technology and communication services sectors leading in the return to a risk-on environment.
- ▶ The Strategy's more diversified exposure compared to our concentrated benchmark reversed from a tailwind in a turbulent first quarter to a headwind in the second.
- ▶ We took advantage of elevated volatility to initiate four new positions, with a focus on upgrading our biopharmaceutical and high-growth IT exposure.

### Market Overview

U.S. equities persevered through tariff, growth and geopolitical scares to deliver solid gains in the second quarter. The broad market S&P 500 Index returned 10.9% while the technology-heavy NASDAQ Composite soared 17.7%, with both swinging from bear or near-bear markets to all-time highs. The benchmark Russell 3000 Growth Index did even better as risk-on sentiment took hold, rising 17.6%, and outperforming the Russell 3000 Value Index by over 1,300 basis points.

Stocks fell to begin the quarter after President Trump unveiled wide-ranging reciprocal tariffs on April 2 but recovered as a 90-day delay in their implementation, a handful of bilateral trade deals and a softened tone from the White House on both China and Federal Reserve policy improved the outlook. May then delivered the best monthly performance for the S&P 500 since November 2023 as the trade picture continued to brighten, while in June markets looked past Middle East conflicts to maintain their positive momentum.

The rebound following April's tariff scare was marked by a return to mega cap AI market leadership, with hyperscalers showing their commitment to high levels of AI-driven capex. Microsoft and Meta Platforms handily outperformed the benchmark as both they and semiconductor companies, including Nvidia and Broadcom, were boosted by solid earnings and renewed expectations of widespread adoption of AI.

The ClearBridge All Cap Growth Strategy's mega cap positioning was mostly neutral for the quarter as an overweight to Meta and underweight to underperforming Apple offset relative headwinds from underweights to Microsoft and Nvidia. Overall, however, the

Strategy trailed the benchmark due to weakness among our health care holdings.

On a broad sector basis, the information technology (IT, +25.4%), communication services (+24.2%) and consumer discretionary sectors (+14.0%) led benchmark performance. Broadcom and Netflix, two of the Strategy's largest active weights, were major contributors. Netflix saw its shares rise due to continued robust execution with double-digit revenue growth driven by a balance of subscriber growth and price, as well as continued margin expansion. We took some profits in the position but remain confident in the company's long-term strategy, strong market position and the attractiveness of the global streaming market. Likewise, Broadcom maintained strong execution in development of custom silicon chips for AI computing. The company is well-positioned for continued healthy investment in AI, working with several large technology companies to develop custom silicon that we expect to grow alongside robust demand for Nvidia's all-purpose GPUs. Broadcom's cloud infrastructure software business should also continue to grow over the next several years given its entrenched position within enterprises.

Industrials (+14.2%) also did well, buoyed by stocks tied to power and electrification, like out-of-benchmark portfolio holding Eaton, and Johnson Controls, which has a leading position in commercial HVAC for data centers, and whose data center business exceeds the next two largest competitors combined.

The health care sector (-1.3%) underperformed amid worries over the prospect of tariffs on pharmaceutical imports and the impact of reimbursement rate pressures within the Medicare Advantage market. The latter, in combination with some execution-related challenges, weighed heavily on UnitedHealth Group, which missed first-quarter earnings forecasts and later withdrew guidance for the full year. Longtime biotech holding Vertex Pharmaceuticals also traded lower on softer than expected first-quarter revenue and earnings, primarily due to weakness in parts of Europe and slower uptake of its next-generation cystic fibrosis treatment, Alyftrek. That said, the company's key products, including non-opioid acute pain reliever Journavx, should see solid growth in the second half of the year. Thermo Fisher Scientific also lagged, largely due to concerns around spending cuts in the academic/government and biopharma segments due to regulatory fears from tariffs and most favored nation drug pricing.

### Portfolio Positioning

We took advantage of recent volatility to add four positions in the second quarter while exiting four others.

In health care, we replaced Eli Lilly, a leading developer of GLP-1 treatments for diabetes and obesity, with its primary competitor Novo Nordisk. Novo's Wegovy drug was first to market among the

new generation of obesity drugs; however, the company has lost market share to Lilly due to delays in scaling up production. While the initial market reaction to Novo's enhanced CagriSema weight loss treatment was negative, we believe this is a more potent formulation that can better compete with Eli Lilly. With Novo poised to have a better product portfolio and improved supply position, we find the company's valuation very attractive given the large secular growth trends behind the diabetes market. We also added Alnylam Pharmaceuticals, a commercial stage biotechnology company and world leader in RNA interference, a technology that selectively shuts off the production of any protein at the genetic level. The company's platform of five approved drugs can be used to treat a broad array of rare and common diseases as well as consistently generate new drug candidates. We do not believe the market appreciates the potential value of Alnylam's core Amvuttra franchise to treat a liver condition that can lead to heart failure. It also has several early-stage pipeline assets, including opportunities in high blood pressure and Huntington's Disease.

In IT, we added Synopsys and Palantir Technologies. Synopsys is a leader in electronic design automation (EDA) software and custom chip designs, operating in a duopoly market with multiple avenues of growth driven by the increased complexity of semiconductor chips. The company's EDA software and tools are mission critical and difficult to replicate, providing defense to its high-margin business model. Palantir is a software-as-a-service provider with an AI-powered operating system that connects data to existing customer applications. Palantir's platform acts as a hub to improve business outcomes across government and commercial end markets, allowing users to synthesize diverse data sources into actionable insights in real time. The company is highly profitable and growing rapidly at scale with 80%+ gross margins. Given the stock's more elevated valuation we are being mindful of position size.

After making progress on margin expansion through the first half of 2024, mass market retailer Target has recently faced challenges from continued shifts in consumer spending away from discretionary categories, like home and electronics, which make up the majority of the company's sales and carry higher margins. Tariffs on imports from China are likely to further pressure Target's business. Despite the company's efforts to protect margins in a difficult operating environment, we see risks weighted to the downside, leading us to exit the position.

Biotech funding challenges and government funding pressure have negatively impacted companies supporting biopharmaceutical development like contract research organization (CRO) ICON. This has pushed out the timing of a CRO growth recovery, even after multiple quarters of spending rationalization among its customers. We exited ICON due to our declining confidence in the timing of CRO business normalization.

We also closed out of MongoDB, a category leader in modern database architecture whose recent fundamentals have been negatively impacted by the timing of multi-year renewals and a more cautious IT spending backdrop. Decelerating growth has also fueled investor concerns about rising competition, a bear case difficult to dispel without a clear catalyst on the horizon for a re-acceleration of growth.

### Outlook

A primary goal over the last few years has been to give clients a portfolio with an improved growth profile — one with better upside capture in risk-on markets as well as good downside capture through turbulent periods. We are excited about the number of new ideas we have put to work in the Strategy in pursuit of this goal and are encouraged by recent results through significant market leadership shifts.

While the full impacts of updated tariff policies with U.S. trading partners have yet to be felt globally, we feel confident that our holdings with strong market positions, value-based offerings and pricing power are well-positioned to weather tariff-related cost inflation. We expect the macroeconomic backdrop to remain bumpy but have positioned the portfolio to perform well in a variety of economic scenarios. With a balanced approach to growth, we own stocks with both offensive and defensive characteristics and strong management teams that have the proven ability to execute regardless of macro conditions.

### Portfolio Highlights

The ClearBridge All Cap Growth Strategy underperformed its Russell 3000 Growth Index benchmark in the second quarter. On an absolute basis, the Strategy delivered positive contributions across seven of the nine sectors in which it was invested (out of 11 sectors total). The primary contributor to performance was the IT sector while the main detractor was the health care sector.

Relative to the benchmark, stock selection contributed to performance but was offset by negative sector allocation effects. From a stock selection perspective, strength in IT, communication services and consumer staples overcame weakness in health care and consumer discretionary staples and real estate. From a sector allocation perspective, an overweight to health care, an underweight to IT and the Strategy's cash position detracted from results.

On an individual stock basis, the leading relative contributors to performance were Apple, Broadcom, CrowdStrike, Eli Lilly and Netflix. The primary relative detractors were UnitedHealth Group, Microsoft, Nvidia, Vertex Pharmaceuticals and Thermo Fisher Scientific.

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