ClearBridge
A Franklin Templeton Company

Erica Furfaro
Director,
Portfolio Manager

Margaret Vitrano
Managing Director,
Portfolio Manager

Large Cap Growth Strategy

Market Overview

U.S. equity markets rose in July, helped by solid corporate earnings, easing trade tensions and economic resilience despite higher tariffs. The S&P 500 Index and Nasdaq Composite continued to reach new record highs, reflecting investor confidence in growth and technology sectors, in particular industries tied to AI, with the S&P 500 returning 2.2% and the Nasdaq advancing 3.7%. Large growth stocks led the market, with the benchmark Russell 1000 Growth Index gaining 3.8%, over 300 basis points ahead of its value counterpart.

Passage of the One Big Beautiful Bill Act, softer than expected inflation and positive earnings reports from the Magnificent Seven and other major companies helped temper concerns about tariffs and Federal Reserve independence. The U.S. economy grew 3% in the second quarter after contracting 0.5% in the first quarter, although much of the expansion was due to declining imports after businesses front-loaded purchases in the first quarter to get ahead of tariffs. Consumer spending grew moderately, while business spending slowed significantly in an uncertain tariff environment.

July's addition of a lower than expected 73k jobs in the nonfarm payrolls report, meanwhile, came with a downward revision of May and June jobs. The ISM Manufacturing PMI dropped to 48 in July from 49 in June, lower than the expected 49.5. Consumer sentiment ticked up to 61.7 in July, although the current level reflects a subdued mood. U.S. Treasury yields rose modestly, with the 10-year yield rising from 4.23% to 4.38% as higher inflation due to tariffs seemed to lower the possibility of rate cuts.

Portfolio Highlights

The ClearBridge Large Cap Growth Strategy underperformed its Russell 1000 Growth Index benchmark in July. On an absolute basis, the Strategy delivered positive contributions across three of the nine sectors in which it was invested (out of 11 sectors total). The primary contributor to performance was the information technology (IT) sector while health care and financials were the chief detractors.

Relative to the benchmark, overall stock selection and sector allocation detracted from performance. In particular, stock selection in the IT, communication services, health care, financials and industrials sectors and an underweight to IT detracted from performance. On the positive side, stock selection in the consumer discretionary sector and an underweight to the consumer staples sector contributed to performance.

On an individual stock basis, the leading contributors to relative performance for the month included Synopsys, Eli Lilly, Apple, Amazon.com and Thermo Fisher Scientific. The primary detractors from relative returns included Netflix, Palo Alto Networks, ASML, Novo Nordisk and UnitedHealth Group.

Portfolio Positioning

The health care sector remains under a cloud of uncertainty around academic and government spending levels, policy concerns around tariffs and the threat of most-favored-nation pricing proposals for pharmaceuticals. We are re-examining each of our holdings amid this backdrop to position the portfolio in our higher-conviction holdings within the sector.

These factors motivated our sale of global pharmaceutical maker Eli Lilly in July. We had originally purchased Lilly in early 2023 because of our positive views around the large market potential for GLP-1 drugs and the overall diabesity market. While the secular GLP-1 trend remains in place, we believe a lot of this is already reflected in the company's stock price. We still believe GLP-1s have a long runway for growth; however, the key players, which include portfolio holding Novo Nordisk, must navigate a lot of complexity in the market, namely broadening patient education about the drugs, competition from companies offering lower-priced compounded versions of branded GLP-1 treatments and figuring out reimbursement as the costs of the drugs are significant.

Also in health care, we exited Zoetis, a leader in the animal health market with strong innovation in parasiticides and dermatology. In recent years, the company's execution on product innovation has slipped with a disappointing ramp of its pain product portfolio. We also believe that Zoetis has a relative dearth of new product launches planned in coming years, while competition is coming to market in dermatology that could make the landscape even more challenging. With not enough innovation at Zoetis to keep revenue growing at the same pace, we decided to exit the stock as valuation remains at premium levels.

Innovation remains accelerated in the secular growth area of generative AI. To further diversify our AI exposure, we added a new position in Oracle, a leading provider of database software for large enterprises globally that has expanded into cloud infrastructure as a platform to run generative AI workloads. Oracle is gaining share in outsourced and cloud data centers and has proven it can help customers optimize for certain workloads at a reasonable profit. We believe Oracle's share of the AI workload market will grow meaningfully over the next few years from business contracts won, including its relationship with OpenAI.

Outlook

We are preparing for a potentially volatile second half of 2025 but feel better about an improving fundamental setup next year. Consumer spending has been resilient and consumer confidence has bounced back off the early 2025 lows. Several positive catalysts for the economy should be apparent in the medium term and we will continue to position the portfolio to participate. The One Big Beautiful Bill Act could add 50 bps to 2026 GDP growth thanks to immediate expensing of R&D and domestic capital spending. Companies are also becoming more confident about getting on with decisions despite lingering uncertainty as evidenced by an uptick in recent M&A activity involving portfolio holdings Palo Alto Networks and Union Pacific. At the same time, the July jobs report and downward revisions for the prior two months show a weakening labor market. We are also cognizant that tariff impacts could be more pronounced through the rest of the year.

We have kept our research focused on secular themes, including determining the trajectory of generative AI and how best to participate in the multi-sector buildout of workloads and emerging use cases. We continue to see rapid growth of AI infrastructure investments benefiting companies participating in data center buildouts (like Eaton) and those producing accelerated networking and chip components. We are also starting to see enterprise adoption of AI rise, although we are still in the early stages of this ramp. While we have been hopeful that infrastructure investments could start to benefit software-as-a-service and application providers, the AI application layer is highly competitive between incumbents, do-it-yourself builds and start-up new entrants. These dynamics motivated our sale of Adobe earlier in the year and we continue to assess elements of our IT portfolio to account for these trends.