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International Growth ACWI ex-US Strategy

Key Takeaways

- ▶ The Strategy outperformed in a value-dominated market environment, supported by strength among communication services and bank holdings that offset weakness in health care and industrials.
- ▶ In a sharp reversal, international equities broadly outperformed the U.S. in the quarter, boosted by plans for increased fiscal spending in Europe and greater economic policy latitude.
- ▶ Multiple drivers are coalescing to support an extended period of strength for international markets, with the potential for easing regulation and increased investments around defense and technological competitiveness being two areas that could drive further improvement.

Market Overview

Led by a sharp revival in Europe, international equities delivered strong gains in the first quarter as increasing policy uncertainty in the U.S. spurred investors to look overseas for more predictable returns. The benchmark MSCI All Country World Ex-U.S. Index advanced 5.23%, outperforming its U.S. counterpart, the S&P 500 Index, by over 950 basis points in a reversal of global leadership. The MSCI Emerging Markets Index added 2.93%, boosted by a rebound in China.

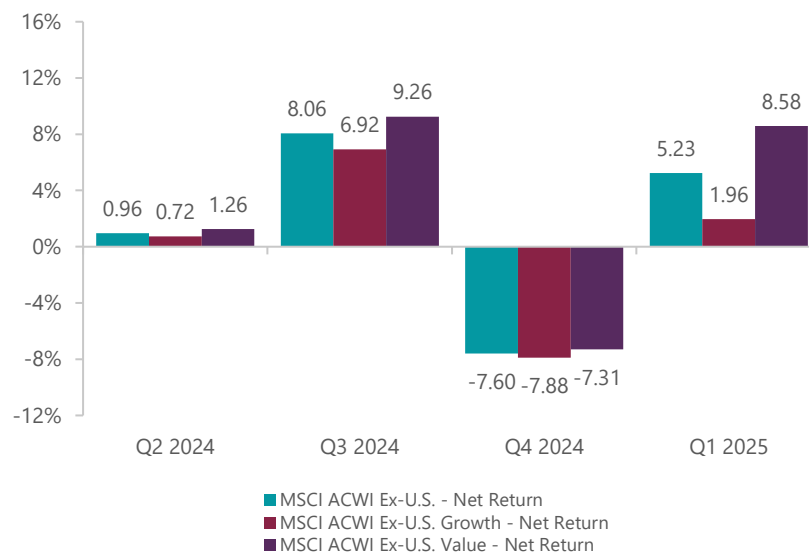
Some might say this was a rally driven by necessity, as U.S. President Donald Trump's aggressive and iconoclastic approach to global trade and foreign policy incited the European Union to action, although key policy leaders in Europe had been in discussion on the topic well beforehand. Global markets, including Europe, sold off sharply to start the second quarter after Trump unveiled a much wider and steeper than expected program of tariffs on all global trading partners, a situation expected to remain in flux in the near term.

As we detail in a [new report on improving conditions for non-U.S. equities](#), Germany is leading a substantial increase in defense, infrastructure and overall fiscal spending as the Continent begins to shoulder greater responsibility for its security and economic growth. Performance has also been supported by easing price pressures, with inflation in the eurozone falling to 2.2% in March. Inflation in the region has now remained below 3% for 18 months, giving the European Central Bank greater latitude than the U.S. Federal Reserve in continuing to cut interest rates. The ECB has cut rates twice to start

2025 and, while growth has been tepid, the expansion is expected to remain intact.

Trump's tariff actions have also sparked increased fiscal spending in China, with government officials billing generative AI as a key driver of the country's economic growth and technology independence. Improving sentiment toward the private sector helped push the MSCI China Index up 15.02% during the quarter.

Exhibit 1: MSCI Growth vs. Value Performance



As of March 31, 2025. Source: FactSet.

While innovation and tech investment are becoming greater priorities in Europe, overseas growth stocks lagged for the quarter with the MSCI ACWI Ex-U.S. EAFE Growth Index up 1.96% while the MSCI ACWI Ex-U.S. Value Index, home to many of the companies expected to lead a resurgence in manufacturing activity, surged 8.58%. Despite these value headwinds, the ClearBridge International Growth ACWI Ex-US Strategy outperformed.

New addition BYD, the world's largest EV maker, drove strength among our consumer discretionary holdings. China is becoming a more investable story due to government support of private industry. The Chinese EV market is being boosted by many local manufacturers with exciting and frequent new model introductions, an extensive network of 2 million charging stations with a universal single plug standard and simple, widely used charging payment platform. Six- to eight-year warranties for EVs should also facilitate consumer adoption.

Another bright spot was banks, with U.K.-based Lloyds, Spain's Banco Bilbao Vizcaya Argentaria (BBVA) and Italy's Intesa Sanpaolo all rerating more than 30%. A sector that was neglected for more than decade, investors are beginning to rediscover European banks for their sustainable earnings growth at some of the lowest valuations with highest capital distributions globally.

In addition, the Strategy received diversified contributions within communication services, led by emerging growth holding Sea Limited, a gaming, e-commerce and fintech provider, and structural growth name Deutsche Telekom. The latter was lifted by a jump in its majority owned T-Mobile US wireless franchise, which upgraded forward guidance and reported accelerating revenue growth and margin improvement in its latest quarterly results. T-Mobile's stable capex, network quality and sustainable market share gains in both rural markets and in the enterprise segment continue to drive the best free cash flow growth among global telecoms.

Stock selection in health care and industrials held back portfolio performance with particular weakness among biopharmaceutical holdings Novo Nordisk, Zealand Pharma and UCB. Novo, a leader in the blockbuster diabetes and obesity market, has been hurt recently by the rise of compounding pharmacies taking advantage of the shortage of Ozempic in the market. The shortage, now over, and the company's more aggressive approach to dealing with them should allow for better performance moving forward. UCB, which specializes in neurology and immune diseases, has been a strong performer over the last year but sold off as the biotech markets have more generally come under pressure. We maintain confidence in the market positioning and outlook for these names.

Portfolio Positioning

We took advantage of the changing investment landscape to add 10 new positions in the quarter while exiting 11 others.

Defense spending is expected to increase dramatically in the EU and Japan, which should boost revenues for new additions Airbus, the largest aerospace contractor in Europe with both a commercial airline and defense business, and Japan's Mitsubishi Heavy Industries (MHI). The latter should benefit from exceptional growth in several of its business units. Gas turbines for electricity generation are seeing significant and prolonged growth due to increased power demand from data centers, electrification and reshoring of manufacturing. MHI is the largest defense contractor in Japan, where military spending could be increasing from 1% to 3% of GDP. Finally, MHI is a leading supplier to the Japanese nuclear power generation complex, where 20 of 33 reactors remain closed, though political consensus might warm up to restarting most of them as Japan's electricity consumption grows.

Trane Technologies, an Ireland-based HVAC supplier, was our largest addition to the portfolio. Trane has a sharp customer value proposition in both replacement and new installations as its products have improved energy efficiency meaningfully in the past five years, bringing significant energy cost savings and quick, top-quality paybacks for replacing old equipment. Avoidance of fines and penalties for non-compliance with pending energy efficiency regulations in both the U.S.

and Europe are a motivation for sales while the company's data center business is also growing at a rapid pace.

We also increased our financials exposure with the addition of banks NatWest and UniCredit. Scotland-based NatWest has gone through a decade-long restructuring that included a government bailout following the Global Financial Crisis and is finally returning to normalcy. NatWest has a quality loan book and, with lending subdued the last several years, it has less bad debt on its balance sheet. It is the most interest rate sensitive of the large U.K. banks with net interest income, expected to increase over the next three years, poised as a major driver of future earnings. UniCredit, meanwhile, should benefit from a consolidating Italian banking market. Earnings should increase over the next two years, driven by rising fee income and effective cost management.

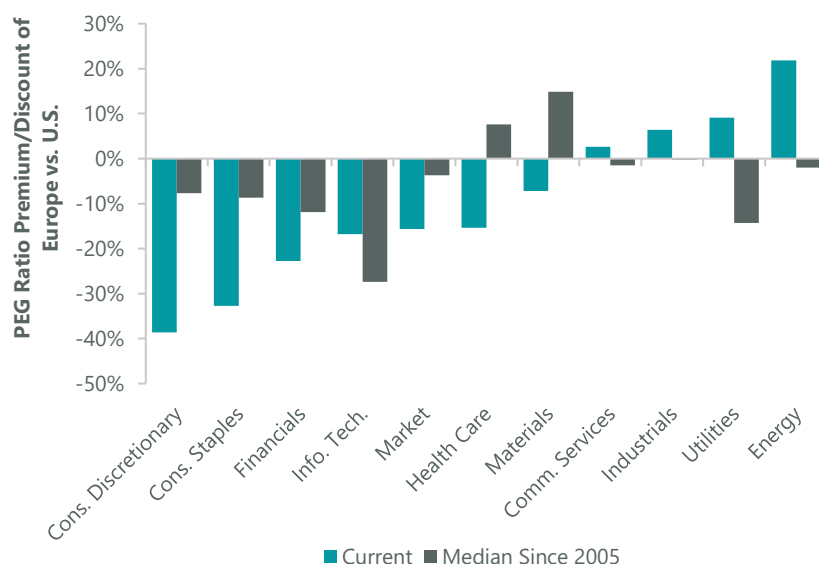
While Japan has become a growing area of interest for investors and we have strategically been reducing our underweight to the region, we want to own companies where we have high conviction. During the quarter, we exited four Japanese holdings to consolidate the portfolio in better opportunities. Running shoe maker Asics was sold as it hit our price target, while we exited medical equipment makers Olympus after a CEO change and Hoya. Although the investment case for industrial gases producer Nippon Sanso is progressing well, with improving margins due to self-help efficiency gains, we sold it to fund higher-upside positions.

As a result of rising tariff headwinds in North America, we exited our position in Canadian Pacific Kansas City, whose freight rail network spans Canada, the U.S. and Mexico.

Outlook

International equities have long traded at a discount to their U.S. counterparts for fundamental reasons. Count among them a higher cost of capital, due to more stringent regulation, and less developed capital markets with which to fund the research and development in information and service industries. As part of Europe's awakening to the reality of a changing global order, we believe these two areas will come into focus as drivers of further improvement and competitiveness. The current price for earnings growth disparity has created attractive growth opportunities for global investors seeking best-in-class substitutes for U.S. industry leaders, with the valuation disconnect most acute in the consumer sectors as well as financials (Exhibit 2).

Exhibit 2: Most Earnings Growth in Europe Comes Cheap



As of March 31, 2025. Source: Datastream, Goldman Sachs Global Investment Research.

Innovation on average has been less prevalent across overseas markets than in the tech-centric U.S. economy. As growth investors with a wide mandate that targets companies at various stages of maturity and profitability, however, we can lean on our fundamental research to identify businesses thriving on their own merits. Our valuation approach to growth targets emerging growth companies harnessing innovation to rapidly develop into regional or global leaders like Sea Limited as well as secular growers expanding their market share in leading technologies like generative AI such as German software maker SAP.

Fund flows are another metric we study closely to gauge investor sentiment. After suffering years of capital drain to the U.S. market, Europe and Japan are seeing positive flows again. This trend is encouraging and could provide the impetus to turn the current reactionary, anti-U.S. trades into a more permanent shift of capital to the overseas regions we target.

Portfolio Highlights

During the first quarter, the ClearBridge International Growth ACWI Ex-US Strategy outperformed its MSCI ACWI Ex-U.S. Index benchmark. On an absolute basis, the Strategy produced positive contributions across five of the eight sectors in which it was invested (out of 11 total), with the financials, consumer discretionary and communication services sectors the top contributors and health care the main detractor.

On a relative basis, positive stock selection offset negative sector allocation effects. In particular, stock selection in the consumer discretionary, IT, financials, communication services and consumer staples sectors contributed to performance. Conversely, stock

selection in the industrials, health care and materials sectors, an overweight to IT and an underweight to financials hurt results.

On a regional basis, stock selection in emerging markets and Asia Ex Japan, an underweight to emerging markets and an overweight to Europe Ex-U.K. proved beneficial while stock selection in Europe Ex-U.K. and an overweight to North America detracted from performance.

On an individual stock basis, the largest contributors to absolute returns in the quarter were BYD in consumer discretionary, Lloyds Banking Group and Deutsche Boerse in financials, as well as Sea Limited and Deutsche Telekom in communication services. The greatest detractors from absolute returns included positions in Novo Nordisk in health care, Taiwan Semiconductor Manufacturing and Tokyo Electron in IT as well as Trane Technologies and Prysmian in industrials.

In addition to the transactions mentioned above, the Strategy repurchased shares of Adyen in financials and also added Siemens Energy in industrials, Galderma Group in health care as well as Antofagasta and Sika in materials. Exits included Haleon in consumer staples, Coupang and LVMH in consumer discretionary, Xero in IT, Spotify in communication services and Deutsche Boerse in financials.

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