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Mid Cap Strategy

Key Takeaways

- ▶ Trade and geopolitical developments shaped the market's direction throughout the quarter, creating a rollercoaster ride for mid cap stocks that tested the mettle of even the most resilient investors.
- ▶ The Strategy outperformed its benchmark as a rebound in industrials and several high-performing IT stocks offset headwinds to our financials companies.
- ▶ While significant geopolitical, macro and trade uncertainty remains, we believe that mid cap valuations remain supportive.

Market Overview

The second quarter was a rollercoaster ride for mid cap stocks, as double-digit declines in April driven by tariff and regulatory changes were more than made up for in May and June. Mid cap stocks broadly advanced, with the Russell Midcap Index returning 8.5%, in line with the small cap Russell 2000 Index but trailing the large cap Russell 1000 Index's return of 11.1%. Easing macroeconomic fears allowed the Russell Midcap Growth Index to return 18.2%, more than 1,200 basis points higher than the Russell Midcap Value Index.

When we look back on the first half of 2025, it may have been full of sound and fury, but recent market action suggests that it signified nothing. Trade wars, regulatory uncertainty and monetary policy headlines shaped the market's direction throughout the quarter. The April rollout of "Liberation Day" tariffs on imports from China and other important trading partners sparked concerns about rising input costs and a re-acceleration of inflation. However, markets roared back over the following weeks as the Trump administration paused tariff implementation and unveiled a series of bilateral trade deals. Meanwhile, the Federal Reserve held rates steady but signaled a dovish tilt in June, citing cooling inflation and slowing job growth. While investors are now expecting fewer rate cuts than previously forecast, the prospect of monetary easing boosted sentiment for lower-quality, cyclical and rate-sensitive mid cap names, particularly in the consumer discretionary, industrials and financials sectors.

From a sector standpoint, information technology (IT, +22.0%) was the top performer as investment in data centers, AI applications and infrastructure continued to drive demand. This was followed by communication services (+15.9%), industrials (+13.2%) and consumer discretionary (+10.3%). Financials (+9.8%), health care (+4.0%), utilities (+2.3%) and materials (+1.9%) also generated positive

Thankfully, we have been able to shift our focus from macro triage back to strong balance sheets, attractive cash flows and compelling growth prospects.

performance. Conversely, energy (-5.2%) proved the biggest detractor as oil prices came under pressure due to concerns over lower demand and the prospect of increased production from OPEC+ members. The consumer staples (-1.2%) and real estate (-0.4%) sectors also declined.

Against this background, the ClearBridge Mid Cap Strategy outperformed its benchmark for the second quarter, lifted by solid stock selection in the industrials sector and several strong performers within our IT holdings. Our industrials holdings rebounded nicely in the second quarter, led by APi Group, which specializes in fire protection and infrastructure maintenance. Strong quarterly earnings bolstered performance. The company's strategy of using inspections to help cross-sell products and maintenance is a proven and successful business model that has allowed APi Group to take market share while growing pricing power and margins.

Several of our IT holdings also had a strong second quarter, including Rubrik, and a relatively new holding, Microchip Technology. Rubrik, which provides data protection and security services, continued to benefit from customers' increasing prioritization and spending on IT security. Meanwhile, Microchip Technology, which supplies analog and mixed-signal microprocessors for use in the automotive, industrial, computing and other industries, gained on the gradual recovery of several of its end markets, as well as the recouping of some lost market share. Microchip is a good example of the type of attractive cyclical self-improvement story that we look for.

In financials, several companies experienced headwinds during the quarter. Private credit manager Blue Owl sold off alongside its peers over increasing uncertainty about the credit cycle as delinquencies ticked upward. Meanwhile, shares in payments company Corpay declined following the April tariff announcements as a substantial portion of the company's earnings come from corporate cross-border payments. Investors also responded negatively to the introduction of stablecoin legislation, which has cast a shadow on Corpay's long-term prospects.

Health care also proved an obstacle, as companies including ICON and Avantor continued to battle concerns about regulatory policy and an anemic funding environment for biotech companies. However, both holdings are industry leaders within the life sciences industry and we believe their underlying fundamentals remain attractive.

Portfolio Positioning

We were particularly active in repositioning our health care exposure during the quarter, taking advantage of some of the policy uncertainty-induced declines to add several high-quality names in medical devices. For example, Penumbra's products use an aspirator to remove clots from the brain, heart, lungs and peripheral circulation. With this new innovation quickly becoming a best-in-class

approach among physicians, Penumbra is continuing to develop new products to serve this large and growing market. We also established a position in Insulet, a developer of insulin pumps for the treatment of diabetes, which is seeing incredible growth at impressively high margins. With increasing opportunities overseas and the recent approval of its pumps for use in type 2 diabetes cases, we believe that the company has an attractive, long-term growth runway.

We exited several companies during the period including Entegris and Keysight Technologies in IT. Although semiconductor materials and solutions company Entegris remains a solid business, we believe other semiconductor stocks like Microchip Technology and Qorvo offer better risk/reward tradeoffs. Design and test solutions provider Keysight, meanwhile, reached our fair valuation target during the period.

Outlook

The first half of 2025 was a memorable one, to say the least. We grappled with the continued war in Ukraine, another war in the Middle East, a trade war, DOGE, an unclear inflation picture, a rising deficit, a falling dollar, Trump vs. Powell, oil price volatility, the One Big Beautiful Bill, tax policy changes and volatile interest rates, all of which factored into the S&P 500's fall from over 6,100 to below 5,000, only to rebound to a new high in June.

Despite all this, we remain steadfast in our focus on high-quality companies with strong balance sheets, attractive cash flows and compelling growth prospects. One of the major areas of focus is within IT, where we are hard at work determining who will be the relative winners of the AI investment cycle. With the Russell Mid Cap Index rebalance lowering the weight of the IT sector in our benchmark, it becomes even more important to adhere to our investment philosophy and process to ensure that we capitalize on attractive opportunities while avoiding the losers.

Portfolio Highlights

The ClearBridge Mid Cap Strategy outperformed its Russell Midcap Index during the second quarter. On an absolute basis, the Strategy had contributions from seven of the 11 sectors in which it was invested during the quarter. The largest contributors were the industrials and IT sectors, while the real estate and health care sectors were the greatest detractors.

On a relative basis, overall stock selection positively contributed to performance while overall sector allocation detracted. Stock selection in the industrials, consumer staples, utilities and energy sectors benefited performance. Conversely, stock selection in the financials, health care, materials and real estate sectors weighed on performance.

On an individual stock basis, the biggest contributors to relative returns in the quarter were APi Group, Rubrik, Chewy, Vistra and

Regal Rexnord. The largest detractors from relative returns were Alexandria Real Estate Equities, Avantor, ICON, International Paper and PPL.

In addition to the transactions listed above, we started a new position in Alnylam Pharmaceuticals in the health care sector. We exited positions in Bio-Techne and IDEXX Laboratories in health care and Marvell Technology in IT.

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