



Appreciation ESG Strategy



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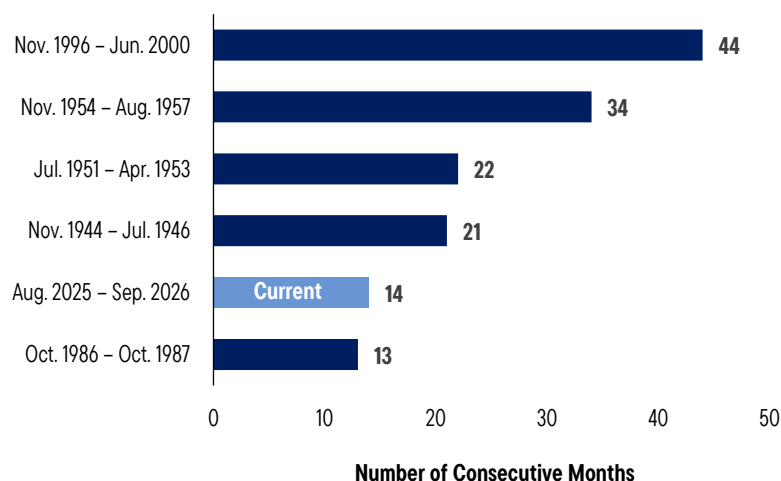
Key Takeaways

- ▶ Strong earnings growth continued to support equities, but sticky inflation, rising interest rates and deteriorating market breadth made the rally increasingly vulnerable.
- ▶ Tightening financial conditions are beginning to weigh on risk appetite and market liquidity, a notable change from recent quarters when capital markets were wide open.
- ▶ The growth of AI and data centers increasingly depends on managing power, water and community impacts, creating opportunities for companies providing more sustainable infrastructure.

Market Overview

Following the second quarter's historic run, the S&P 500 Index ground higher again in the third quarter, returning 2.3%; the index is up 12.7% year to date. September marked the 14th consecutive month in which the S&P 500's trailing three-year annualized total return exceeded 18% — the fifth-longest such streak of the past century, exceeded only by the late-1990s melt-up and three post-war episodes (Exhibit 1). An extraordinary run by any measure.

Exhibit 1: An Historic Run of Returns



As of September 30, 2026. Source: ClearBridge Investments, Atlanta Fed, Bloomberg Finance.

The market's advance has been underpinned by a remarkable surge in corporate earnings. Historically, analysts have entered each year too optimistic, revising EPS forecasts steadily lower as the year progresses.

We view a narrowing market financed by leverage as another cautionary signal.

Through the current AI-fueled upcycle, the opposite has held: since July 2025, consensus 2026 and 2027 EPS estimates for the S&P 500 have climbed 20% and 26%, respectively, driven primarily by rising expectations for information technology (IT) and energy. The rate of growth is equally striking. Consensus now calls for year-over-year EPS growth above 10% in 2027 — a fourth consecutive year of double-digit expansion — compounding off an exceptionally difficult 2026 comparison in which earnings are expected to grow roughly 30%. The last time the S&P 500 delivered double-digit earnings growth in four straight years was the 2002–2006 expansion.

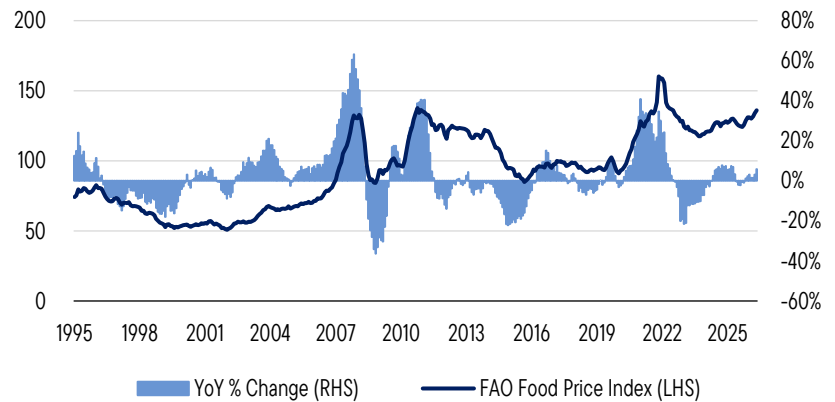
Energy led the benchmark in quarter, completing a round trip from best-performing sector in the first quarter to worst in second and back to best in third. Crude rose sharply over the quarter — Brent up 41% and WTI up 29% as the U.S.-Iran ceasefire announced in April fizzled by July, carrying the oil-levered sector with it. Health care was supported by a surge in life science and tools names as R&D spending appears to be recovering from its post-COVID hangover and as concerns eased over how AI might reshape drug discovery. Finally, IT shares extended their outperformance, though at a less spectacular pace than in the second quarter.

Utilities were the benchmark's weakest sector, pressured both by the sharp rise in long-term interest rates and by an unwind of the AI-power trade that had carried the group through the first half of the year. Industrials were dragged lower by transports and capital goods. Airlines struggled against rapidly rising fuel costs, while capital goods — defense in particular — contended with mounting concern that mid-term election gridlock will delay the budget clarity those businesses need to underwrite future Department of War demand. Consumer discretionary also lagged, with leisure-exposed names such as hotels and restaurants weighed down by the prospect that higher energy expenses will absorb incremental consumer spending.

Our second-quarter commentary described a nuanced backdrop: fundamentals broadly supportive of risk assets, but with several risks percolating beneath the surface. That characterization still holds, though in our view the risks to the rally have become materially more pronounced.

First, inflation remains sticky and shows signs of worsening. After bottoming at 2.3% in April 2025, the Consumer Price Index pushed solidly above 3% in the third quarter. Higher energy costs are plainly a contributor, with gasoline up 40% year over year to well above \$4.00 per gallon. Even if diplomatic efforts produce a renewed U.S.-Iran ceasefire, however, we do not expect crude to retreat to pre-war levels: global reserves need replenishing and we expect a lasting energy risk premium to remain embedded in the price since the weaponization of energy infrastructure appears to be the new normal. We are watching as well for a renewed bout of food inflation, as the Russia/Ukraine war disrupts key grains and elevated energy costs drive fertilizer prices higher (Exhibit 2).

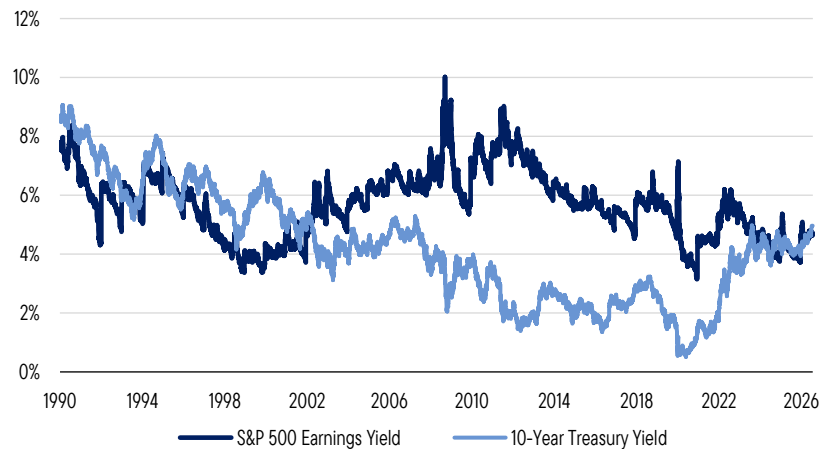
Exhibit 2: Monitoring for Food Inflation



As of September 30, 2026. Source: ClearBridge Investments, United Nations, Bloomberg Finance.

Second, interest rates have become unanchored, with Treasury yields surging to levels last seen nearly two decades ago, before the Global Financial Crisis. We view the absolute level of risk-free rates — the 10-year at roughly 5.25% — together with the velocity of the move as likely to further tighten financial conditions. Moreover, whether rates rising reflects the inflation dynamic described above, a repricing of global risk-free rates against mounting sovereign debt loads, or an expectation of meaningful GDP acceleration, we see little reason for yields to revert to a more “normal” level any time soon. This is a direct headwind to equity multiples, in our view. The 10-year Treasury yield has now converged with the S&P 500’s forward earnings yield of 5.25%, leaving equity investors effectively uncompensated for bearing equity risk — a condition with few precedents outside the late 1990s and the pre-crisis mid-2000s (Exhibit 3).

Exhibit 3: Equity Earnings and Treasury Yields Converge



As of September 30, 2026. Source: ClearBridge Investments.

Tightening financial conditions are beginning to weigh on risk appetite and market liquidity, a notable change from recent quarters when capital markets were wide open. According to Renaissance Capital, seven companies postponed or withdrew proposed IPOs in the third quarter, including the bellwether AI lab Anthropic. High-yield issuance

likewise slowed materially from the torrid pace of the first half, while the all-in yield required to fund a high-yield deal climbed to 8.3%, its highest since April 2025. Part of that increase simply reflects higher risk-free rates, but investors also demanded more for credit risk itself: the high-yield option-adjusted spread widened 39 basis points over the quarter to 309 basis points, its widest level since March when the U.S.-Iran war began. Even so, this spread still sits in only the 18th percentile of its history since 1994 — so although investors require greater compensation for risk today, the absolute incremental yield to investors remains benign.

Finally, we watch market breadth as a barometer of the health of the underlying trend. Breadth — measured as the share of S&P 500 constituents trading above their 50-day moving average — has deteriorated steadily to roughly 21%, back to levels last seen during the war-driven malaise of late March. To us, this signals stalling momentum beneath the index's surface and a warning that the market is less healthy than implied by the index price alone. Notably, that loss of breadth has not been accompanied by any reduction in risk-taking: FINRA margin debt continues to hover near the highs set in June, at the height of AI euphoria (Exhibit 4). We view a narrowing market financed by leverage as another cautionary signal.

Exhibit 4: Margin Debt Balance Near Recent Highs



As of September 30, 2026. Source: ClearBridge Investments, FINRA.

Portfolio Positioning

During the third quarter, the ClearBridge Appreciation ESG Strategy increased its exposure to the energy sector, adding to our position in Diamondback Energy and initiating a position in Cheniere Energy. We believe energy — specifically domestic production of both oil and LNG — grows more valuable in a world where infrastructure is increasingly weaponized for geopolitical ends and where governments are prioritizing security of supply. We view this exposure as an important ballast for downside capture, one that preserves our capacity to invest selectively in more pro-growth, AI-levered opportunities should a market selloff create them.

Outlook

As through-the-cycle investors with an emphasis on downside protection, we believe current conditions argue for a more cautious stance. Although absolute levels are still relatively benign, financial conditions have begun to tighten, underlying momentum is waning and investor leverage to equities remains elevated.

As in the second quarter, the argument for continued robust benchmark returns remains nuanced given ongoing economic momentum and sustained technology-related capital expenditure against the risk factors discussed above. We do not see meaningful recession risk. Rather, we read the second quarter's herd mentality and the third quarter's breadth decay as evidence of a market vulnerable to a speculative washout — a correction that would force investors to retrench around their highest-conviction, long-term ideas rather than continue to chase momentum.

We would view such a correction, even a reasonably sharp one, as healthy for the long-term durability of the bull market.

Portfolio Highlights

The ClearBridge Appreciation ESG Strategy underperformed its S&P 500 benchmark during the third quarter. On an absolute basis, the Strategy had positive contributions from five of the 11 sectors in which it was invested. The leading contributors were the IT and financials sectors, while the materials and utilities sectors detracted the most.

On a relative basis, stock selection in industrials, IT and financials contributed to performance. Conversely, stock selection in communication services, energy and materials detracted from performance. An underweight to IT and an overweight to consumer staples also weighed on results.

On an individual stock basis, the largest contributors to relative returns were Thermo Fisher Scientific and not owning Applied Materials, KLA, Lam Research and Caterpillar. The largest detractors were TJX, ASML, WEC Energy and underweights to Microsoft and Meta Platforms.

During the quarter, we initiated positions in Colgate-Palmolive in consumer staples, ServiceNow in IT, United Rentals, XPO and Fastenal in industrials, Cheniere Energy in energy and Novartis and CVS Health in health care. We exited positions in Cisco Systems in IT, Stryker in health care, SpaceX, Walt Disney and T-Mobile in communication services, Honeywell International and Honeywell Aerospace in industrials and International Paper in materials.

ESG Highlights: Investors Reinvigorated About Climate

Held annually in New York alongside the United Nations General Assembly, Climate Week brings together investors, companies, policymakers, researchers and civil society organizations to discuss climate risks and solutions. ClearBridge attends these events to deepen our understanding of emerging sustainability issues, compare

perspectives with experts across industries and identify developments that could be material to our portfolio companies.

This work complements the company-level research and engagement performed throughout the year by ClearBridge analysts and portfolio managers. We seek to understand how environmental and social factors affect costs, competitive positioning, access to resources, regulatory exposure and long-term value creation.

Our overarching observation from this year's Climate Week was that investors appear reinvigorated about climate. Conversations focused on the mechanisms through which climate and sustainability issues are already affecting businesses: energy affordability, resource efficiency, infrastructure resilience, insurance availability, community acceptance and economic competitiveness.

Not surprisingly, AI was central to almost all of these discussions. Participants debated not only the environmental footprint associated with data-center growth, but also AI's potential "handprint": how the technology might enable scientific advances, optimize power systems, improve industrial processes and accelerate the development of lower-carbon technologies. Energy efficiency was a key pillar of AI's potential positive effects on climate, although we acknowledge projections far out into the future remain highly theoretical. All in all, while stakeholders debate the pros and cons of AI center development — and headlines over the summer have overwhelmingly highlighted the cons — AI infrastructure is on track to be built: the question for investors is how it can be built responsibly.

Food Security and Responsible Mining Remain Material

Although AI and data centers dominated the week, sustainable food and human rights in mining were also important areas of focus for ClearBridge.

For sustainable food, the central question is what happens when geopolitical disruption and climate variability affect agricultural inputs at the same time. Recent disruptions to fertilizer production and trade illustrate the issue. Nitrogen-based fertilizer must be available during relatively inflexible planting windows; a delayed shipment cannot necessarily be recovered later in the growing season. If fertilizer shortages or higher prices coincide with an El Niño-related disruption to rainfall and temperature patterns, the effects could extend from farm input costs to crop yields, commodity prices and food inflation.

This is an example of climate acting as a threat multiplier. It also highlights the importance of supply-chain diversification, soil health, efficient fertilizer use and agricultural technologies that help farmers adapt to more volatile conditions. For investors, historical weather and production patterns may be less and less useful for assessing agricultural risk. At Climate Week we discussed how JPMorgan's food-security analysis emphasizes how fertilizer disruptions, planting windows and climate variability can combine to create longer-lasting

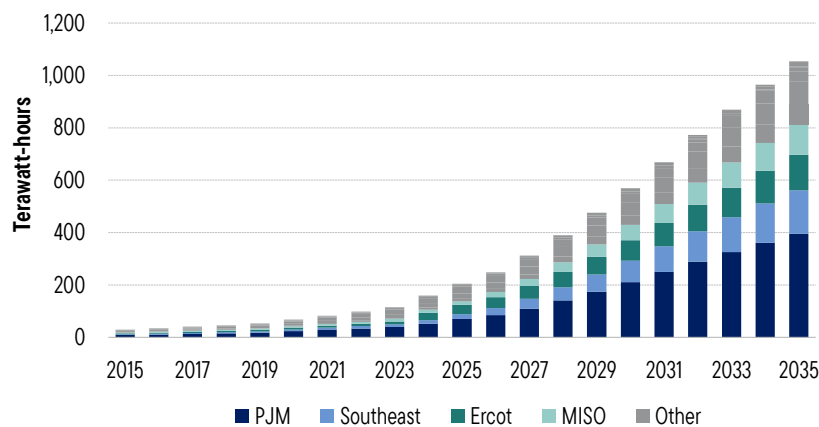
food-system pressures.¹ AI is a potent source of innovation in this regard: ClearBridge holding US Foods, for example, uses AI-driven inventory forecasting to cut food waste.

For mining, the key question is how investors can connect community-level impacts to the companies in their portfolios and turn that information into actionable engagement. This is particularly important in industrial parks and complex mineral supply chains, where responsibility may be distributed among mine owners, operators, tenants, suppliers, customers, lenders and public-sector partners. Investors need information that sometimes embodies a complex balance: comparable across portfolios but sufficiently detailed to identify specific harms, responsible parties and potential remedies. Discussions focused on the Indonesian nickel supply chain in light of the EU Battery Regulation, which requires greater supply chain traceability, carbon footprint disclosure and environmental and human rights due diligence for battery materials sold in the EU and is relevant for EV and battery companies that source nickel such as China's CATL and Tesla.

Sustainability Is a Key Gating Factor for Data Centers and AI

The scale of anticipated AI infrastructure development is intensifying pressure on power systems and local resources. BloombergNEF estimates U.S. data-center power demand could reach 118 gigawatts by 2030 and that data centers could account for roughly one-fifth of U.S. electricity consumption by 2035 (Exhibit 5).

Exhibit 5: Data Centers' Growing Electricity Consumption



Source: BloombergNEF, DC Byte. Note: Pipeline includes capacity under construction, committed and early stage. MISO is Midcontinent Independent System Operator, Ercot is Electric Reliability Council of Texas and PJM is Pennsylvania-New Jersey-Maryland Interconnection.

Meeting that demand will require substantial new generation and grid infrastructure. Yet long interconnection timelines, transmission constraints and equipment shortages are already affecting where and how quickly projects can proceed. Developers are exploring nuclear power, on-site generation and other behind-the-meter solutions, but each option introduces its own cost, emissions and community considerations.

¹ Dr. Sarah Kapnick, "Climate Intuition: Food security under pressure: Iran conflict disruptions and a brewing El Niño." May 21, 2026.

Data center
sustainability
and economics
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closely aligned.

Power is not the only constraint. Communities are asking whether data centers will increase electricity bills, consume scarce water, create persistent noise or require infrastructure whose costs are ultimately borne by residents. They also want to understand the local benefits, including employment, tax revenue and investments in public infrastructure.

These concerns can delay or prevent development. Sustainability is therefore becoming a practical requirement for translating demand for AI into operating data-center capacity.

Microsoft Raises the Standard for Development

Microsoft, a holding in several ClearBridge portfolios, offers a good example of how hyperscalers are responding. Its community-first infrastructure framework addresses several of the issues that can determine whether a project earns local support. The company has committed to paying the electricity and grid-infrastructure costs associated with its facilities rather than passing them through to residential ratepayers. It is working with utilities to forecast demand, contract for new generation and fund necessary transmission and substation improvements. The company is also targeting a 40% improvement in data-center water-use intensity by 2030 and has begun deploying closed-loop cooling designs that do not require potable water for cooling.

The framework extends beyond environmental performance to include social dimensions. Microsoft has committed to paying full local property taxes, supporting workforce training and investing in schools, libraries and community organizations. It also plans to provide greater local transparency about water use and replenishment.

These measures don't eliminate every impact associated with data-center development, but they illustrate the higher standard increasingly required of developers: mitigate costs, provide measurable local benefits and engage communities early. Microsoft's community-first framework reflects the growing recognition that technical capacity alone is insufficient to secure a project's social license to operate.²

Equinix Focuses on Long-Term Community Trust

A recent engagement with Equinix, another ClearBridge portfolio holding, provides the perspective of a data-center owner and operator. In September 2026 we asked whether faster anticipated capacity growth threatened Equinix's goal of covering 100% of its power consumption with renewable energy by 2030. The CEO told us the commitment had not changed, noting both Equinix's own priorities and demand from customers seeking to meet their sustainability commitments.

We also discussed community opposition to new data centers in general. Equinix views itself as a long-term neighbor rather than a temporary developer because it expects to own and operate its facilities for decades. This creates an incentive to establish durable relationships with local stakeholders.

² <https://blogs.microsoft.com/on-the-issues/2026/01/13/community-first-ai-infrastructure/>

Equinix also distinguishes its average approximately 65-megawatt retail colocation facilities from the hundreds-of-megawatts — and sometimes gigawatt-scale — campuses attracting the greatest scrutiny. While that difference does not remove the need for responsible development, it shows why investors should consider a facility's scale, design and operating model when evaluating community risk.

Johnson Controls Improves Cooling Efficiency

ClearBridge's recent engagement with Johnson Controls (JCI) highlighted how equipment suppliers can help address the physical constraints on data centers. JCI's thermal-management offering includes cold plates, coolant distribution units, chillers and air-cooled technologies. Because it owns several major cooling subsystems, the company can optimize the entire cooling architecture rather than focusing only on the efficiency of an individual component. This system-level approach becomes more important as computing density rises and cooling represents a larger share of facility power requirements.

JCI's technologies can also respond directly to local environmental concerns. Its cooling solutions can generally be configured for zero-water operation. Magnetic-bearing technology can reduce mechanical noise as well as energy consumption, while major product lines are available with low- and ultra-low-global-warming-potential refrigerants. In certain applications, absorption chillers can use waste heat in place of electricity as a primary energy source.

The engagement reinforced that data center sustainability and economics are becoming closely aligned. Reducing the power, water and noise associated with cooling can lower operating costs while making projects more acceptable to utilities, regulators and neighboring communities.

Vertiv Helps Make Power-Dense AI Feasible

As AI chips increase rack-level power density, data centers require tightly integrated power and thermal-management systems. Vertiv's closed-loop cooling technologies are well suited to higher-density computing and can reduce dependence on continual water consumption. Its broad offering also allows customers to integrate cooling and power systems more easily — an increasingly important consideration as infrastructure becomes more complex.

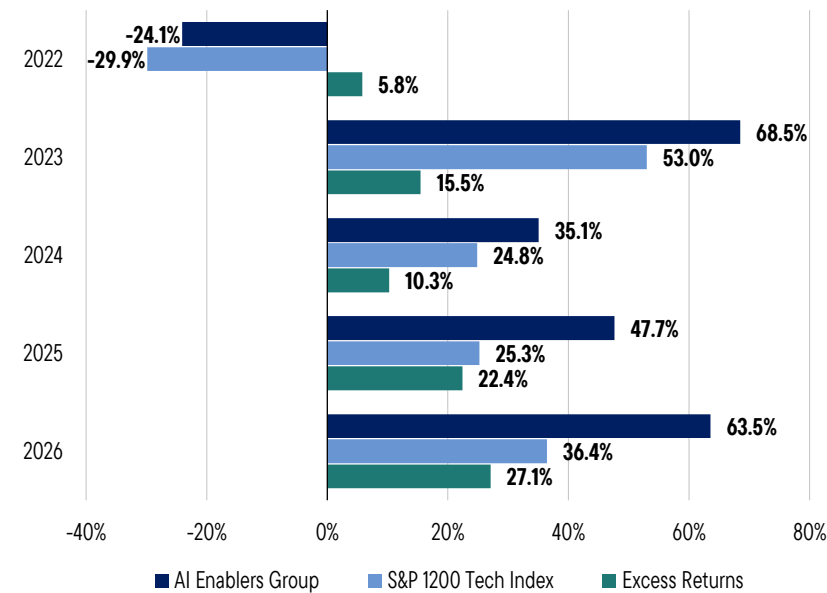
Modular construction is another part of the solution from Vertiv. Its prefabricated OneCore platform brings multiple systems together before they reach the construction site, reducing on-site complexity and helping customers bring computing capacity online faster. Its global service network, real-time monitoring and predictive maintenance capabilities support reliability and efficient operation over the facility's life.

Vertiv's example illustrates that the sustainability of AI infrastructure is not limited to how electricity is generated. It also depends on how efficiently power is delivered, heat is removed, water is managed and complex facilities are constructed and maintained.

Conclusion

AI's rapid expansion is creating investment opportunities across technology, utilities, construction and industrial infrastructure. As it is also exposing physical and social constraints, the need to deploy more efficiency could be a tailwind for AI Enablers (Exhibit 6).

Exhibit 6: AI Efficiency Enabler Group Returns by Year



As of September 22, 2026. Source: Bloomberg Intelligence.

ClearBridge's research seeks to understand these constraints across the data-center value chain. With developers and operators, we ask whether energy and water commitments can keep pace with growth and how local communities will share in the benefits. With equipment suppliers, we examine total system efficiency, water requirements, refrigerants, noise, reliability and speed to deployment.

A common thread: sustainability is increasingly the mechanism connecting AI demand with practical development. Companies able to lower resource requirements, protect ratepayers, address community concerns and deliver reliable capacity may be better positioned to support — and benefit from — the next phase of AI infrastructure growth.

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