ClearBridge
A Franklin Templeton Company

Sustainability Leaders Strategy

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Key Takeaways

- The market rewarded lower-quality, more volatile names in 2025 where the Strategy is underexposed. We view this dislocation as temporary and continue to believe that through-the-cycle performance favors quality-focused investing.
- We are remaining valuation disciplined as we see pockets of excess in the valuations for stocks in the AI ecosystem and are paying close attention to business model quality, pricing power and balance sheet quality.
- The continued — and apparent increase in — relevance for governance topics reflects our view that good governance is a catalyst for value creation.

Market Overview

U.S. equites finished a strong 2025 with more subdued gains in the fourth quarter, with the benchmark Russell 3000 Index rising 2.4% from October through December to end the year up 17.1%. Only two sectors outperformed the market in the quarter: health care and communications services. Health care stocks led the market due to lower policy uncertainty, improved earnings, and attractive valuations. Despite a 25 bps cut in the federal-funds rate in December, elevated long-term yields and slow growth weighed on the three sectors in the red: real estate, consumer staples and utilities — with the latter also suffering as the AI trade ebbed.

Against this backdrop the Strategy made positive gains but trailed the Russell 3000 in the quarter. While our preference for quality investing remains unchanged, the style fell out of favor in the second half of 2025 and weighed on relative performance. The Strategy kept pace with the market from the start of the year into May, but as the market rally accelerated later in the year, the quality factor sustained one of the worst periods of underperformance in decades (Exhibit 1). Lower-quality, more volatile names, areas where the Strategy is underexposed, were increasingly rewarded. We view this dislocation as temporary and continue to believe that through-the-cycle performance favors quality-focused investing.

This environment was particularly evident within our material holdings where our high-quality businesses, such as industrial gas company Linde and aggregates producer Vulcan Materials, lagged despite sound fundamentals.

Exhibit 1: Quality Stocks Underperforming in 2025

As of Dec. 31, 2025. Source: ClearBridge Investments, Bloomberg Finance. Shows long-short return for quality factor.

Within the Strategy's information technology (IT) exposure, software and services names were weaker. ServiceNow continued to deliver solid results, but the market's caution on software and focus on AI-driven growth weighed on the shares. Palo Alto Networks fell primarily due to investor concerns over its two recently announced acquisitions, the strategic fit and the integration risk of assimilating two deals in a short span of time. AI-exposed names ebbed as the market grew concerned about major capital spenders such as Microsoft.

Meanwhile, positives for the portfolio came from real estate, where industrial REIT Prologis delivered solid earnings and raised its full-year guidance, citing a strong leasing environment. In financials, Morgan Stanley continued its strong share price performance: growth in its wealth management business remains robust, while the market is anticipating further upside in its investment banking business as capital markets activity picks up.

Health care names dominated top relative contributors as well: Danaher benefited from a cyclical turnaround in its bioprocessing segment, investors are increasingly convinced that cancer and inflammation medicine growth and recent deals will allow Johnson & Johnson to grow through the loss of Stelara exclusivity.

Portfolio Positioning

We added two new positions in the quarter: Ferguson and Brookfield Renewable Partners LP.

Ferguson, in the industrials sector, is the largest U.S. plumbing and mechanical distributor for professional contractors and homeowners. Its end market split is roughly half residential and half non-residential. Ferguson's scale enables it to provide a broader product assortment and better availability than its competitors. The company's unmatched service network helps contractors' productivity, which has proven especially valuable given tightening labor market conditions. We believe Ferguson has a long runway of opportunity to continue gaining share organically and through rolling up competitors in a highly fragmented industry. Strong free cash flow generation allows Ferguson to continue investing in existing branches and state-of-the-art distribution centers, further enhancing its value proposition versus competitors.

Furthermore, Ferguson is very well-positioned to continue winning in data centers and other large commercial and infrastructure construction projects. Data centers are increasingly liquid cooled, which is more energy efficient and generally results in a lower carbon intensity. Ferguson is an enabler and beneficiary of this shift and is positioned to be a leading provider of the water-related equipment necessary for liquid-cooled data centers. On the waterworks side, Ferguson is central to infrastructure upgrades. We believe the market underappreciates the size of the opportunity for Ferguson in data centers and other megaprojects over the coming years. In order to establish the new position, we rotated out of existing holding Trex, as we believe Ferguson to be a more optimal choice for exposure to the housing market within industrials.

Brookfield Renewable Partners LP (BEP), in the utilities sector, is one of the largest owners and developers of renewable energy assets. It is a beneficiary of rising power demand resulting from global data center buildouts, rising power prices and growth in renewable energy. The company has shown itself able to sustain funds from operations and distribution growth across energy and renewable cycles, and we expect it will continue to do so as it pursues M&A and its own asset development pipeline. Cash flows should further benefit from higher power prices as its contracts renew. Finally, the company's association with parent Brookfield and its expertise in energy gives BEP access to unique opportunities that few renewable energy companies in the world can take advantage of.

We also exited our position in Colgate-Palmolive due to its facing challenging demand dynamics in several key regions and elected to redeploy the capital into more compelling opportunities.

Outlook

As we turn the page to 2026 — a midterm election year in the U.S. — we see a balance of risks and opportunities for the markets. AI is likely to remain a focus for investors and a continued area of strength in the economy in 2026. At the same time, given their solid performance and elevated expectations, a rising bar for AI-related stocks could result in higher volatility. We continue to adhere to our valuation discipline, especially as we see pockets of the AI ecosystem reaching excessive valuations. Consistent with our long-term investment process, we are paying close attention to business model and balance sheet quality as well as companies' pricing power — characteristics we consider even more crucial during the emergence of new technologies like AI. We continue to see opportunities for alpha generation within AI, and we own a compelling mix of attractively valued AI leaders as well as underappreciated beneficiaries of the AI infrastructure buildout.

While non-AI industrial activity was muted in 2025 and affordability continues to weigh on consumer sentiment, the tax benefits front-loaded into the One Big Beautiful Bill Act (OBBBA) should be stimulative to the economy in 2026, with the OBBA expected to deliver fiscal stimulus equivalent to ~1% GDP over the next year. At the same time, geopolitical risks have risen and deglobalization continues.

A key tenet of the Strategy's approach is that we aim to source most of our risk from stock-specific factors rather than macro factors. As such, while economic uncertainty continues to impact business confidence, consumer sentiment and the profitability and longevity of AI investments, we believe the portfolio is appropriately positioned with a predicted beta close to 1.0.

We were very active in 2025 — particularly amid the volatility stemming from tariff announcements early in the year — and the portfolio saw higher than normal turnover, driven by rapid changes in the technology landscape, U.S. government policies and indeed in the global order as the world retreats from globalization.

Against the backdrop of a rapidly changing world, we remain consistent in our approach while actively positioning the portfolio for success. We build the portfolio from the bottom up, focusing on high-quality compounders with strong fundamentals, attractive valuations, good balance sheets and management teams; these companies should outperform over the cycle as they reinvest capital at attractive rates of return. We remain focused on quality despite the historic underperformance of the quality factor in recent months.

We are overweight in industrials and materials due to secular tailwinds we see from the long-term buildout of data centers and electricity infrastructure, as well as broader U.S. reshoring trends. We also own several high-quality industrials with exposure to the broader industrial economy that are trading at very attractive valuations after a year of muted growth, but where we see potential for improvement heading into 2026.

Given the challenging growth outlooks for many consumer staples businesses, we are underweight the sector and have found other opportunities for more defensive exposure in areas such as industrial services and utilities. We are also underweight communication services because we do not own Meta Platforms, and we continue to not own stocks in the traditional energy sector.

Portfolio Highlights

The ClearBridge Sustainability Leaders Strategy underperformed its Russell 3000 Index benchmark in the fourth quarter. On an absolute basis, the Strategy saw positive contributions from four of 10 sectors in which it was invested (out of 11 total). The health care sector led contributors, while the IT sector detracted the most.

Relative to its benchmark, stock selection and sector allocation detracted. In particular, stock selection in the IT, materials and industrials sectors detracted, while stock selection in real estate and financials proved beneficial.

On an individual basis, the strongest relative contributors were Meta Platforms (not owned), Flowserve, Danaher, Johnson & Johnson and Cooper. Top relative detractors were Netflix, Eli Lilly (not owned), United Rentals, ServiceNow and Chewy.

ESG Highlights: The Evolving Proxy Landscape

Of the tools public equity investors can use to advocate for sustainable business practices, proxy voting is one of the more visible and powerful. It was vigorously debated in 2025. Throughout the year the SEC tightened parameters for shareholder proposals, strengthening the grounds on which they can be excluded from annual meetings.[1] It announced it would no longer "respond to no-action requests for, and express no views on, companies' intended reliance on any basis for exclusion of shareholder proposals under Rule 14a-8," with minimal exceptions.[2] The likely result will be to enable companies to exclude proposals without having to seek SEC approval, leading to fewer shareholder proposals making it to a vote.

Against this backdrop, the broad trends of the 2025 proxy season were a decline in environmental and social proposals and heightened scrutiny on governance issues. Major topics of environmental proposals filed included emissions disclosures and climate risk and plastic pollution. Social proposals, which were reduced in number, showed continued concern with workforce-related risks like pay equity, workplace safety, and diversity and inclusion. Like environmental proposals, social proposals received less support in 2025 than in previous years, although many of these proposals filed were perhaps "overly prescriptive, duplicative of existing disclosures, or insufficiently tailored to company-specific issues,"[3] a reminder that such proposals need to be judged on a case-by-case basis.

Declines in environmental and social proposals and an increase in governance proposals (which received steady support, all told) were also reflected in ClearBridge's voting activity in 2025 (Exhibit 2).

The continued — and apparent increase in — relevance for governance topics reflects our view that good governance is a catalyst for value creation: board and chair independence reduces insular oversight; separating CEO and board chair roles reduces the potential for conflicts

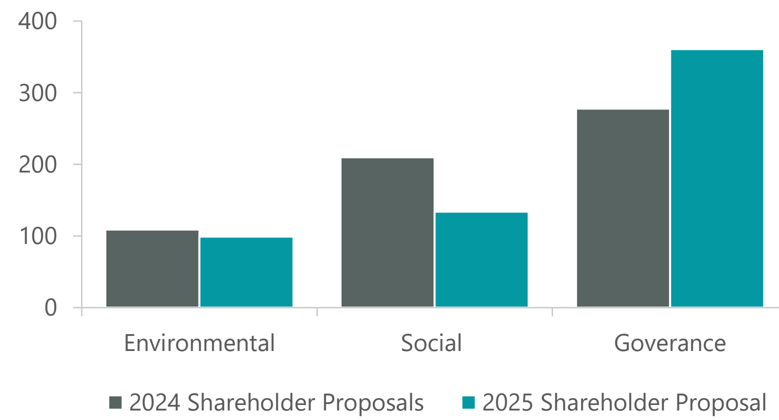
1 Staff Legal Bulletin No. 14M.

2 Statement Regarding the Division of Corporation Finance's Role in the Exchange Act Rule 14a-8 Process for the Current Proxy Season, Nov. 17, 2025. U.S. Securities and Exchange Commission.

3 "2025 Proxy Season Review: From Escalation to Recalibration," Harvard Law School Forum on Corporate Governance. Sept. 15, 2025.

of interest; diversity on the board leads to more varied views and strengthens governance; board tenure should balance experience with innovation; linking compensation with sustainability factors could improve environmental stewardship and ensure the social license to operate. We have seen incremental improvements across many of these goals in recent years, and they remain worthy of supportive company dialogue.

Exhibit 2: Shareholder Proposals Voted on by ClearBridge



As of December 2025. Source: ClearBridge Investments.

The continued — and apparent increase in — relevance for governance topics reflects our view that good governance is a catalyst for value creation: board and chair independence reduces insular oversight; separating CEO and board chair roles reduces the potential for conflicts of interest; diversity on the board leads to more varied views and strengthens governance; board tenure should balance experience with innovation; linking compensation with sustainability factors could improve environmental stewardship and ensure the social license to operate. We have seen incremental improvements across many of these goals in recent years, and they remain worthy of supportive company dialogue.

Voting on a Case-by-Case Basis

Per ClearBridge's Proxy Voting Policy, we evaluate certain environmental and social proposals on a case-by-case basis. While we would generally be supportive of ESG proposals, we also consider whether the ask from the shareholder proposal has merit and whether the wording in the proposal diminishes or enhances shareholder value.

We also take note if a proposal does not seem to recognize substantial improvements by the issuer on the requests being addressed. This is an important element of ClearBridge's approach to proxy voting and our partnership approach to active ownership: we engage with CEOs, CFOs and other company leaders regularly about all factors that could materially affect value creation. This provides a valuable information component for assessing the merits of shareholder proposals.

Here we offer highlights of some recent ClearBridge votes and our thinking behind them.

Companies Are Making Sustainability Improvements

Amazon.com is a good example of a company that has made substantial improvements in areas where it nevertheless continues to see proposals: in 2025, for example, we examined a shareholder proposal asking the company to report on efforts to reduce plastic packaging. The company has received similar proposals for the past five years but has been making significant progress, addressing the resolutions of the proposals with improvements each year.

We chose not to support this proposal this year on the grounds that the company has already been reporting its plastic packaging reduction efforts and has quantified and published the improvements to the public each year. Such improvements include transitioning away from plastic in its outbound packaging and working with its vendors to let them ship in their own brand packaging via their Ships in Product Packaging (SIPP) program — reducing the use of an Amazon box on top of the product packaging. In addition, as of October 2024, Amazon has removed all plastic air pillows from delivery packaging used in its global fulfillment centers, which to date is the biggest decrease in plastic packaging in North America.

Moreover, through innovation and investment in technologies, processes and materials since 2015, Amazon has been able to reduce the weight of the packaging per shipment by 43% on average and avoided more than three million metric tons of packaging material. There are other achievements in packaging (both plastic and other materials) that the company has reported publicly.

Amazon is advancing partnerships and research to improve recycling infrastructure, engaging with organizations such as the Ellen MacArthur Foundation and The Recycling Partnership and demonstrating its efforts to align with industry peers, even if Amazon is not formally a signatory to the New Plastics Economy Global Commitment. We would still like to see Amazon publish an overall baseline of plastic used across its entire supply chain, to add to its robust reporting levels for outbound packaging practices.

Voting Requires Deep Knowledge of the Company

Our portfolio managers chose not to support a shareholder proposal asking Microsoft to report on the risks of its European Security Program (ESP) being used for censorship of free speech. We thought this proposal appeared to conflate a cybersecurity initiative with speech regulation and could mislead investors on the nature of the ESP. The company launched the ESP in response to the sharp rise in ransomware and cyberattacks involving espionage, data theft and disruption of democratic institutions.

Microsoft’s ESP provides structured, limited-scope support to governments by sharing insights into these threats and aligns with

Microsoft's Information Integrity Principles, which emphasize trusted information and freedom of expression rather than content moderation, surveillance or speech regulation. The company also participates in the Global Network Initiative (GNI), which independently evaluates its adherence to principles protecting privacy and free expression.

Executive Compensation Should Be Reasonable

We actively engaged UnitedHealth Group's Board of Directors over the course of 2025 about the appropriateness of the compensation for their executive team.

The company serially missed earnings expectations, resulting in underperformance relative to the S&P 500 Index by 20% in both 2023 and 2024. Further, UnitedHealth had a major cybersecurity incident that jeopardized payments throughout the U.S. health care system, and public sentiment toward the company was at historic lows. Despite poor results, United asked investors to support pay increases for the CEO and CFO, while withholding any bonus payment to the family of murdered executive Brian Thompson. We opposed the proposed pay scheme, as did 40% of voting investors, and we accordingly expressed our views to the board.

Following the proxy vote, UnitedHealth announced it would replace both the CEO and the CFO. UnitedHealth's board failed to hold either outgoing executive accountable for poor performance, and it allowed both of them to keep very significant unvested compensation. We again expressed our dissatisfaction to the board about its compensation decision.

Seeking to Enhance Shareholder Value

In voting proxies, we are guided by general fiduciary principles. Our goal is to act prudently, solely in the best interest of the beneficial owners of the accounts we manage. We attempt to provide for the consideration of all factors that could affect the value of the investment and will vote proxies in the manner that we believe are consistent with efforts to maximize shareholder values.

Among these factors would also be issuance of preferred shares. For example, the ClearBridge Emerging Markets Strategy portfolio managers considered a proposal at Localiza, a Brazilian car rental company, which held an out-of-cycle extraordinary general meeting to approve the creation of preferred stock.

Although the issuance of preferred stock adds complexity to common shareholders, the background here was telling: Brazil was to initiate a new dividend tax in January 2026 and companies were advancing dividends and bonus share issues to use up distributable reserves before the year end.

We judged that shareholder voting rights were being maintained and the company was attempting to issue bonus shares before the year-end tax increase. Ultimately, we agreed with management that the share issue was in the interest of shareholders and voted in favor of the proposal.

Performance source: Internal. Benchmark source: Standard & Poor’s.