



Mid Cap Strategy



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Key Takeaways

- ▶ Mid cap equities rallied sharply in the second quarter, with leadership shaped by AI infrastructure enthusiasm, risk-on sentiment and a late-quarter rotation toward value.
- ▶ The Strategy generated strong absolute returns but underperformed as benchmark strength in AI-related areas and pressure in IT and consumer discretionary outweighed gains from industrials and consumer staples.
- ▶ We remain focused on balancing exposure to durable secular themes with valuation, market-cap and quality discipline, seeking companies with strong competitive positions and clear paths to value creation.

Market Overview

Mid cap equities participated in a sharp second-quarter rally, with the Russell Midcap Index returning 13.8% and bringing year-to-date gains to 15.3%. Growth modestly outpaced value for the full quarter, with the Russell Midcap Growth Index returning 14.5% versus 13.4% for the Russell Midcap Value Index. Leadership flipped later in the period, however, as value outpaced growth in June and remained well ahead year to date. That late-quarter shift did not displace the market's dominant stock-level theme: enthusiasm for artificial intelligence (AI) infrastructure and the companies perceived to be the best positioned in the continued buildout.

Market direction remained constructive, but leadership was uneven. Participation broadened beyond mega cap technology from a capitalization perspective, yet returns at the benchmark and individual-stock levels remained heavily influenced by AI infrastructure, memory, storage, optical connectivity, data center power and cooling, and select cyclical recovery drivers. The annual Russell reconstitution also influenced flows and reinforced the need to distinguish between index-driven momentum and durable economic value.

The strength of the AI investment cycle helped markets look through a complicated macro backdrop that included geopolitical volatility, an oil-price spike and subsequent fade, renewed inflation concerns and changing expectations for monetary policy. Investors entered the year expecting rate cuts, but by quarter-end were increasingly debating the possibility of a more restrictive policy path in the second half. Against this backdrop, we believe the opportunity is not simply to own every perceived AI winner, but to assess where cash flows, returns and competitive advantages can persist across cycles.

Portfolio Performance

The ClearBridge Mid Cap Strategy generated strong absolute returns but underperformed its Russell Midcap Index benchmark during the second quarter. Relative results reflected several of the quarter's broader market themes: a sharp risk-on rally, powerful flows into perceived AI infrastructure winners and strong benchmark gains from memory, storage, optical connectivity and related hardware areas that the portfolio did not fully capture.

IT was the largest source of relative pressure. Rubrik, a data security and cloud data management provider, benefited from recognition that AI adoption can raise data, security and infrastructure complexity. Microchip Technology also contributed as investors grew more comfortable with management changes, efforts to rebuild customer relationships and the potential for a cyclical recovery in analog semiconductor end markets. These gains, however, were not enough to offset underexposure in a sector that rose 54.4% in the quarter.

Consumer discretionary also detracted. Chewy, a leading online retailer of pet products, was pressured by mixed end-market growth trends and concerns that the business could be vulnerable to AI disruption. We view those concerns as more nuanced given the company's customer relationships, purchasing dynamics and margin opportunities, but the stock weighed on results.

Health care was mixed. Bio-Techne contributed after agreeing to be acquired by Merck KGaA, and we exited the position following the announcement. However, this gain was slightly offset by weakness in Insulet, the maker of insulin patch pumps, which continued to be challenged by concerns around potential future competition.

Industrials were a bright spot. WillScot, a provider of modular space and storage solutions, recovered as investors grew more comfortable with improving non-residential construction indicators and company-specific initiatives under newer leadership. United Rentals benefited from renewed enthusiasm for non-residential growth and infrastructure demand, while Regal Rexnord contributed as operational execution and exposure to attractive industrial end markets supported sentiment.

Consumer staples was the strongest sector for stock selection, led by longtime holdings Performance Food Group and Casey's General Stores. Performance Food Group, a foodservice distributor, rebounded from overly punished levels as resilient demand, supportive market share trends and execution on margin initiatives restored confidence. Casey's, a convenience-store operator, also contributed, supported by resilient demand, private-label offerings and consistent execution.

Portfolio Positioning

In IT, we added Coherent and Fabrinet to increase exposure to optical components, data connectivity and related infrastructure areas benefiting from AI-driven demand. Coherent is a vertically integrated manufacturer of optical components and devices, including lasers, where robust demand is exceeding supply, while a new management team pursues manufacturing efficiencies. Fabrinet is a leading

contract manufacturer supplying optical communications components used in data center and telecom networks, where the AI compute cycle remains strong.

In financials, we initiated positions in Travelers and MSCI. Travelers is a leading commercial property and casualty insurer benefiting from disciplined underwriting and competitive advantages built on scale, data and technology. MSCI is a leading provider of investment indexes, analytics and portfolio management tools used by institutional investors globally, with high recurring revenue, a strong competitive position and a history of disciplined capital allocation.

On the sell side, we exited Hartford Insurance as the stock approached our estimate of fair value following a period of strong performance driven by underwriting improvement and higher investment income. We also exited Vertiv and Ross Stores as the stocks traded nearer to fair value, and their market capitalizations moved beyond levels we believe are appropriate for the Strategy.

Outlook

Looking ahead, we remain constructive on mid cap equities, while acknowledging that the range of potential outcomes remains wide. The durability of a cyclical recovery, the path of inflation and interest rates and the ultimate impact of AI across business models are still taking shape. We expect volatility and dispersion to remain elevated as investors distinguish between companies benefiting from durable fundamentals and those more dependent on flows, momentum or rapidly shifting narratives.

We continue to see cautiously optimistic signs of broader recovery across select industrial, health care and consumer-oriented businesses. AI capital spending should remain an important market driver, but we believe the next phase of opportunity may broaden beyond the companies building AI infrastructure to those using technology to improve productivity, efficiency and customer outcomes.

From a portfolio perspective, we are not positioning for a single outcome. We remain focused on businesses with durable competitive positions, healthy balance sheets, capable management teams and clear paths to value creation. In a market where narratives can move faster than fundamentals, we believe diversified, bottom-up stock selection is well suited to separate durable value creation from temporary momentum.

Portfolio Highlights

The ClearBridge Mid Cap Strategy underperformed its Russell Midcap Index benchmark during the second quarter. On an absolute basis, the Strategy had gains in 10 of the 11 sectors in which it was invested. The largest contributors were the industrials and IT sectors, while the energy sector detracted.

On a relative basis, sector allocation and stock selection both detracted from performance. Stock selection and underweight positioning in IT, as well as stock selection in the consumer

discretionary and health care sectors weighed on results. Conversely, stock selection in consumer staples, industrials, materials and communication services proved beneficial.

On an individual stock basis, the largest contributors to relative returns were WillScot, Rubrik, United Rentals, Microchip Technology and Vertiv. The largest detractors from relative performance were EQT and Chewy and not owning SanDisk, Western Digital and Corning.

In addition to the transactions mentioned above, we initiated positions in Insmed, Charles River Laboratories and Mettler-Toledo International in the health care sector, Mirion Technologies, Cloudflare and Everpure in the IT sector, Advanced Drainage Systems, Rocket Lab, Comfort Systems USA and Karman Holdings in the industrials sector and Burlington Stores in the consumer discretionary sector. We exited positions in Mohawk Industries, Light & Wonder and Hilton Worldwide in the consumer discretionary sector, Doximity in the health care sector, Resideo Technologies in the industrials sector and Bentley Systems in the IT sector.

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