



Mid Cap Growth Strategy



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Key Takeaways

- ▶ Access to cheaper financing not only helped lift growth companies, but also acted as a tailwind to the rotation toward rate-sensitive sectors, and small and mid cap stocks.
- ▶ The Strategy outperformed its benchmark in the third quarter, boosted by contributions from our holdings in the IT and health care sector.
- ▶ Although market uncertainty remains high, we remain committed to our longstanding investment process and philosophy.

Market Overview

A rotation away from large caps beginning in July helped spur a third-quarter rebound that propelled the Russell Midcap Index 9.21% higher, outperforming the 6.08% gain of the large cap Russell 1000 Index and keeping pace with the 9.27% return of the small cap Russell 2000 Index. Value stocks outperformed during the period with the Russell Midcap Value Index returning 10.08%, over 350 basis points ahead of the benchmark Russell Midcap Growth Index.

From a sector standpoint, the Fed's decision to cut interest rates proved a boon to interest rate sensitive sectors such as utilities (+34.37%) and real estate (+23.78%), which substantially outperformed the broader Russell Midcap Growth Index's 6.54% return. Additionally, the industrials (+12.50%), materials (+8.75%), consumer discretionary (+7.94%) and financials (+6.70%) outperformed the overall index. The communication services (+4.74%), information technology (IT, +4.39%), energy (+2.27%) and health care sectors (+1.47%) posted positive returns, while the sole detractor was the consumer staples sector, which returned -6.19%.

Despite causing surges in market volatility during the quarter, a series of weaker than anticipated labor reports and subdued inflation readings helped pave the way for the Fed to cut interest rates by 50 basis points in September, its first cut since the beginning of the COVID-19 pandemic. The likelihood of further cuts and access to cheaper and easier to obtain financing also acted as a tailwind to the rotation away from the generative AI beneficiaries that dominated the first half of the year and toward broader market leadership favoring small and mid cap stocks.

However, this enthusiasm has overshadowed the economic deceleration that continues to weigh on pockets of the market such as industrials and materials, with expected recoveries in these sectors pushed out further into 2025. Additionally, market uncertainty over a

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contentious U.S. presidential election and its resulting policy and trade implications appear to only be increasing as we approach November. Finally, concentration in the Russell Midcap Growth Index remains historically elevated and centers on a greater proportion of more volatile, lower-quality stocks, which could cause broad market shifts stemming from fickle investor sentiment.

Stock selection in the IT sector was the greatest contributor to relative performance, driven by AppLovin, which operates a software-based platform for advertisers to enhance the marketing and monetization of their content, particularly in mobile apps. We believe the company is one of the best examples of an AI beneficiary in the mid cap market, as it has already incorporated AI capabilities into its platform, translating into more effective take rates on clients' mobile games and transactions. We believe mobile games represent only the tip of the iceberg of AppLovin's potential for its AI-enabled platform and that it has a strong growth trajectory over the next few years.

Health care was also a positive contributor in the third quarter. Our top-performing holding in the sector was Doximity, which operates a digital platform for medical professionals that supports collaboration, patient care and telehealth. The company has a history of consistent execution and, while it stumbled last year in effectively communicating realistic guidance and outlooks, it appears that management has regained investors' trust through several quarters of solid execution.

Stock selection in the industrials sector, meanwhile, weighed on quarterly performance. The largest detractor in the sector was Copart, which provides online auctions and remarketing services for automotive vehicles globally. The company's stock declined after it announced quarterly earnings that came in below market expectations, driven by some nonrecurring tax issues, storm preparation costs and labor expenses. However, the company has been a strong, multiyear outperformer, and we believe that its position as the dominant player in the automotive auction and remarketing service industry will continue to help drive attractive long-term performance.

Portfolio Positioning

Our largest new addition to the portfolio was Lineage, in the real estate sector, which is the world's largest temperature-controlled warehouse REIT. The company's expanding geographic footprint along major transportation centers, rather than at the beginning or endpoint of delivery routes, has made it a preferred partner for companies producing and shipping frozen foods. Additionally, the company has shown a proven track record of successfully deploying capital to expand its geographic footprint and secure a stronger position within its core market.

AMETEK, in the industrials sector, makes electronic instruments and electromechanical devices. The company's position as a supplier of high-quality instruments to "cannot fail" industries, such as aerospace applications, health care equipment and marine instrumentation, has made it the dominant player in several of these high-value, but niche areas. Additionally, the company has a strong track record of successfully integrating and raising the margin profile of acquired businesses. Subjected to the same destocking malaise weighing on the broader industrials sector, we were able to capitalize on the company trading at cycle lows to establish a position in this best-in-class industrials business.

On the elimination side, we exited our position in West Pharmaceutical Services, which manufactures containment and delivery systems for injectable drugs and health care products. The company has also struggled amid broader customer destocking trends and, with recent research suggesting that customer inventory levels may be higher than previously expected, we have become less confident in the timing of a potential turnaround.

Outlook

Much uncertainty remains and we do not pretend to be able to predict macro outcomes. However, one constant remains: our team's adherence to our longstanding investment approach and philosophy with an eye toward process evolution to improve client outcomes. We believe that focus on a concentrated portfolio of growth businesses, each of which undergoes a stringent derisking of managerial competence, balance sheet stability and sustainability of competitive advantage, will lead to outsize returns over an economic cycle.

Portfolio Highlights

The ClearBridge Mid Cap Growth Strategy outperformed its Russell Midcap Growth Index benchmark during the third quarter. On an absolute basis, the Strategy had gains across nine of the 11 sectors in which it was invested. The leading contributors were the information technology (IT) and financials sectors, while the energy and materials sectors were detractors.

On a relative basis, overall stock selection contributed to performance. Specifically, stock selection in IT, health care, financials and consumer staples and an overweight allocation to the real estate sector benefited performance. Conversely, stock selection in the industrials, real estate, consumer discretionary and energy sectors and an overweight to the consumer staples sector weighed the most on performance.

On an individual stock basis, the biggest contributors to absolute returns during the quarter were AppLovin, Fortinet, KKR, United Rentals and Doximity. The largest detractors from absolute returns

were Pinterest, HubSpot, Five Below, Super Micro Computer and Chipotle Mexican Grill.

In addition to the transactions mentioned above, we initiated new positions in Coinbase Global in the financials sector and Palantir in the IT sector. We exited positions in Charles River Laboratories in the health care sector, Aptiv and Five Below in the consumer discretionary sector and Palo Alto Networks in the IT sector.

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