



Mid Cap Growth Strategy



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Key Takeaways

- ▶ Mid growth stocks surged in the fourth quarter, benefiting from both a post-election rally and the market's rotation back to growth leadership in December.
- ▶ The Strategy kept pace with the benchmark in the fourth quarter, as contributors in IT counterbalanced detractors in health care.
- ▶ Our investment approach focuses on companies that can compound high levels of growth without depending on macro tailwinds, provide durable returns and have access to capital to fund high-growth opportunities.

Market Overview

Mid cap growth stocks surged during the fourth quarter, sitting at the intersection of tailwinds from both a post-election rally in small and mid cap stocks and the market's rotation back to growth leadership in December. The Russell Midcap Growth Index returned 8.14% for the quarter, making it the best-performing area of the market, outpacing the large cap Russell 1000 Index by 540 basis points, the Russell Midcap Index by 752 basis points and the Russell Midcap Value Index by nearly 1,000 basis points. This strong performance solidified mid growth as the best-performing mid cap style of the year, returning 22.10% in 2024 compared to the 15.34% and 13.07% returns of the Russell Mid Cap Index and Russell Mid Cap Value Index, respectively.

Inklings of a market broadening in the fourth quarter sparked by Donald Trump's election victory and investor optimism over greater deregulation and business-friendly policies were seen as a boon to equities, particularly mid and small cap stocks. This was further bolstered by additional interest rate cuts from the Federal Reserve. However, rate cuts came amid strong economic data that began to support the case for a slower easing cycle in 2025 than had been expected, contributing to a market rotation back to growth and large cap leadership. This, along with potentially reflationary policy from the Trump administration, such as tariffs, as well as slight upticks in inflation, put upward pressure on interest rates, causing some weakness in economically sensitive and rate-sensitive sectors.

We continue to find an array of attractive investment opportunities across the spectrum of growth characteristics we seek.

Portfolio Performance

Stock selection in information technology (IT) was the greatest contributor to performance, with five of our top six relative contributors coming from the sector. This included AppLovin and Marvell, two of the best-positioned AI beneficiaries in the mid cap market. AppLovin is the world's leading mobile game and app advertising platform, providing software for marketing and monetization, powered by its proprietary AI targeting engine. We see opportunity for AppLovin to continue to expand and grow its share of the market for mobile app marketing at a time when mobile gaming ad spend is recovering from a higher-rate-driven trough. We also see the potential for the company to expand its addressable market to include e-commerce advertising, around which initial forays have been encouraging. With strong incremental margins and management keeping expenses controlled, the company should be able to drive significant free cash flow growth as revenue continues to scale impressively. Likewise, Marvell, a networking and storage semiconductor designer, participated in the late-year rally on the back of investor enthusiasm for generative AI acceleration due to its position as a key supplier of custom silicon solutions for hyperscale data centers and AI infrastructure.

Stock selection in health care was the biggest detractor from returns, as the prospect of higher rates, continued pushout of health care R&D spending and the potentially disruptive nomination of RFK Jr. as Secretary of Health and Human Services weighed heavily on the biotechnology and pharmaceutical industries and related supply chains. This included ICON, a contract research organization that provides outsourced clinical management of drug trials and related development work for biopharmaceutical and life science customers, and Mettler-Toledo, a supplier of precision instruments, solutions and services to the laboratory, industrial and food retailing industries. While recognizing these headwinds, we continue to believe that the health care sector is a fertile hunting ground for opportunities as end markets stabilize and begin to recover.

Portfolio Positioning

We added a new position in Reddit, a unique destination for community and conversation on the internet. The company's latest quarterly results showed strong gains in daily average users while advertising and data licensing revenues also ramped aggressively. Reddit is still early in its engagement, monetization and profitability journey and has continued opportunity to license its data for AI training purposes.

We also added to our position in Palantir, whose AI-powered operating system connects data to existing customer applications. Palantir's platform acts as a hub to improve business outcomes across government and commercial end markets, allowing users to synthesize diverse data sources into actionable insights in real time.

The company is highly profitable and growing rapidly at scale with 80%+ gross margins.

Meanwhile, we exited our position in Lineage, the world's largest temperature-controlled warehouse REIT. After seeing a downward inflection in its key performance indicators that were at odds with our investment thesis, we sold the stock.

Outlook

We continue to find an array of attractive investment opportunities across the spectrum of growth characteristics we seek and have positioned ourselves in what we view as the highest-quality mid cap growth companies, which we believe should outperform if broader AI tailwinds continue, or if investment dollars experience a digestion period and this broader theme dwindles. Going forward, competitive differentiation will be more important to stock performance as spending and investment evolve following the strong revenue accelerations that companies exposed to AI trend experienced at its beginning.

Our investment approach evaluates businesses without any macro tilt, focusing on companies that can compound high levels of growth in large markets without depending on macro tailwinds, provide durable returns and have ample access to capital to fund high-growth investment opportunities.

Portfolio Highlights

The ClearBridge Mid Cap Growth Strategy made strong absolute gains, performing in line with its Russell Midcap Growth Index benchmark during the fourth quarter. On an absolute basis, the Strategy had positive contributions across eight of the 11 sectors in which it was invested. The leading contributor was the IT sector, while the health care and real estate sectors detracted the most.

On a relative basis, overall stock selection contributed to performance but was offset by sector allocation effects. Specifically, stock selection in IT, consumer discretionary and consumer staples, as well as an overweight to the IT sector and underweight to the consumer discretionary sector benefited performance. Conversely, stock selection in health care, industrials and real estate sectors and overweights to the materials and real estate sectors weighed on performance.

On an individual stock basis, the biggest contributors to absolute returns during the quarter were AppLovin, Palantir Technologies, Marvell Technology, HubSpot and Rubrik. The largest detractors from absolute returns were Monolithic Power Systems, ICON, IDEXX Laboratories, Mettler-Toledo International and MercadoLibre.

In addition to the transactions mentioned above, we initiated new positions in Natera in the health care sector, Nu Holdings in the

financials sector and DraftKings in the consumer discretionary sector. We exited positions in Veeva Systems in the health care sector and Aspen Technology in the IT sector.

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