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## Large Cap Value Strategy

### Key Takeaways

- ▶ Despite initial signs of market broadening following Donald Trump's election victory and further interest rate cuts from the Federal Reserve, the market reverted to the narrow mega cap growth leadership that characterized most of 2024.
- ▶ Against the backdrop of a challenging year of narrow market breadth, the Strategy outperformed in the quarter, demonstrating resilience and potential for recovery as the market began to normalize and our quality bias in materials and utilities stood out.
- ▶ Given already-stretched investor optimism amid a variety of indeterminate risks, volatility is likely to create opportunities for disciplined investors with an eye on long-term value creation.

### Market Overview

Despite initial signs of market broadening following Donald Trump's election victory and further interest rate cuts from the Federal Reserve, the market reverted to the narrow mega cap growth leadership that characterized most of 2024. Outside this group, market action was more subdued, with the benchmark Russell 1000 Value Index returning -1.98%, about 900 basis points behind its growth counterpart. Potentially reflationary policies from the Trump administration, such as tariffs, and slight upticks in inflation put upward pressure on longer-term interest rates, causing weakness in economically sensitive and rate-sensitive sectors.

2024 presented a number of challenges for the ClearBridge Large Cap Value Strategy due to the narrow market breadth, the strong performance of specific thematic growth stocks and the sluggish economy. Our diversified, valuation-sensitive approach struggled in this environment. Stock selection, typically a strong point for our Strategy, detracted from performance, especially due to certain technology and health care stocks like Intel, Microchip Technology and CVS.

Despite these setbacks, we remain confident in our long-term process of investing in high-quality franchises within durable, growing markets at reasonable valuations. We believe this approach will drive sustained outperformance over time. Notably, the Strategy showed improvement in the fourth quarter, demonstrating resilience and potential for recovery as the market began to normalize.

Our quality bias in materials and utilities stood out the most in a quarter that saw a reversal of some of 2024's themes. Materials was the worst performer in the benchmark, though we tend to avoid the highly commoditized businesses that led the selloff. Relative outperformance among utilities came from not owning AI-levered power companies, which sold off, and by our large active weight in Sempra, a well-positioned diversified utility likely to benefit from a Republican energy policy and growing LNG demand, both for export and domestic production.

Our overweight in financials, with a focus on payments and consumer finance companies like Visa, Capital One and American Express, proved beneficial. These firms, along with banks such as JPMorgan Chase and Bank of America, gained from economic resilience, robust consumer spending, yield curve normalization and the anticipated reduction in regulatory pressures from the incoming administration. Adhering to our valuation discipline, we trimmed positions in American Express and JPMorgan Chase, primarily due to their strong performance.

Detractors came mainly from the health care sector. Elevated utilization trends, lower Medicare Advantage (MA) rates, and more generous MA benefits broadly across the industry materially pressured profitability of CVS and, to a lesser extent, UnitedHealth Group. Ongoing Medicaid redeterminations resulted in increased acuity of remaining Medicaid members, leading to increased pressure on Medicaid profitability, with Elevance Health being the most exposed among our holdings. Potential regulatory pressures on pharmacy benefit managers also weighed on CVS Health and UnitedHealth Group, while the latter's managed care business, along with that of Elevance, was pressured by increased medical care ratio increases. We elected to exit our marginal position in Elevance in the quarter, given relatively higher exposure to Medicaid, typically a target for Republican administrations, and redeployed some of the proceeds in CVS and UnitedHealth.

The largest relative detractor was the information technology (IT) sector, particularly Microchip Technology. The company announced a change in CEO, lowered its revenue guidance and revealed manufacturing restructuring plans, which collectively pressured the stock at year-end. The embedded semiconductor industry is experiencing a significant cyclical downturn as customers deplete inventories they had stockpiled during the COVID-era chip shortages. While this has negatively impacted Microchip's near-term financials, we believe that its large and fragmented customer base (~120,000 customers and several thousand SKUs) and sticky products will allow it to maintain pricing and market share once a recovery materializes. We took advantage of the weakness to add to our position, confident that Microchip is a well-positioned, scaled player in the analog/microcontroller market with the potential for higher margins in the long term.

### Portfolio Positioning

In a very skewed market in 2024, we saw a large valuation divergence that provided opportunities for our process as high-quality companies simply weren't attracting capital. In the fourth quarter, we added to out-of-favor defensive holdings such as PepsiCo and Becton Dickinson, appreciating their lower economic sensitivity and reasonable valuations. We also added to Deere, which we had trimmed aggressively in 2023 as the agriculture cycle was in its later stages. We added to it during the period at what we view as very reasonable valuations based on what look like trough earnings. Deere's competitive advantages, such as distribution scale and tech stack, continue to manifest in sustainably higher profitability through the cycle, relative to peers and its own history. At the same time, we maintained our valuation discipline and reduced exposure to Oracle and Broadcom. Both companies benefited from robust AI spending, Oracle on the infrastructure side and Broadcom on the custom silicon side, as well as a well-executed VMware acquisition.

### Outlook

As the U.S. political landscape shifts, we are reminded why we try to own resilient, durable franchises that can withstand various uncertainties and generate attractive risk-adjusted returns over the long term. We anticipate a potentially more business-friendly environment under the new administration in the coming four years, which would support economic growth and a broadening of the market. The ISM Manufacturing PMI has been in contraction territory for some time; should that trend reverse, capital that has been on the sidelines may find more incentive to enter the market. We believe there are pockets that would benefit, perhaps those overlooked in the narrow market of 2023 and 2024, more than others. Given already-stretched investor optimism amid a variety of indeterminate risks, volatility is likely to create opportunities for disciplined investors with an eye on long-term value creation.

### Portfolio Highlights

The ClearBridge Large Cap Value Strategy outperformed its Russell 1000 Value Index benchmark during the fourth quarter. On an absolute basis, the Strategy had positive contributions from four of the 11 sectors in which it was invested for the quarter. The financials sector contributed the most, while the health care, materials, and IT sectors were the main detractors.

On a relative basis, overall stock selection and sector allocation effects contributed to outperformance. In particular, stock selection in the materials, utilities and financials sectors helped relative returns. Conversely, stock selection in the IT sector and a materials overweight detracted.

On an individual stock basis, the largest contributors were JPMorgan Chase, Broadcom, XPO, McKesson, and Capital One. Positions in Microchip Technology, CVS Health, Thermo Fisher Scientific, UnitedHealth Group, and Elevance Health were the main detractors.

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