



All Cap Growth Strategy



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Key Takeaways

- ▶ In a market that continues to become more concentrated in a select few growth names seen as AI beneficiaries, the Strategy underperformed due to a combination of our mega cap allocation and stock selection.
- ▶ We added three new positions while exiting five others to increase focus on our highest conviction ideas and manage risk while remaining vigilant for opportunities tied to a global consumer recovery.
- ▶ The economy is showing more palpable signs of slowing, notably in industrial activity and spending among lower-income consumers. We believe our current portfolio construction is well-suited to this environment and believe diversification across sectors and market caps will take on a more important role as the cycle plays out.

Market Overview

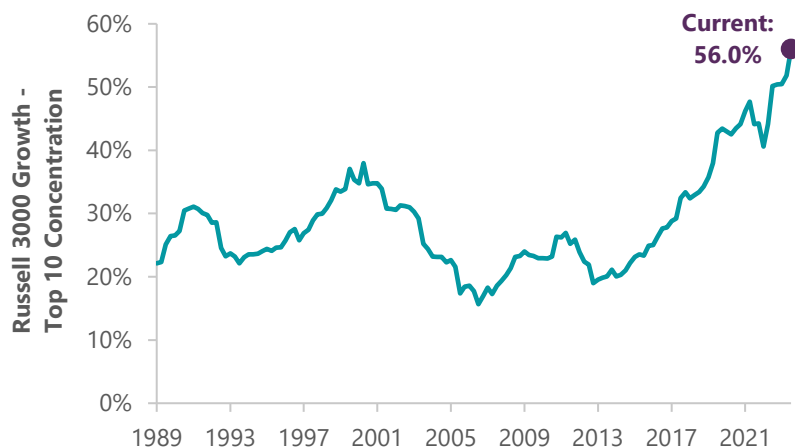
Equity leadership narrowed considerably in the second quarter, with mega cap growth stocks reasserting their influence and obscuring weakness across most of the market. The S&P 500 Index rose 4.28% for the period, while the NASDAQ Composite advanced 8.26%. By comparison, the small cap Russell 2000 Index was down 3.28% for the quarter.

Boosted by Nvidia and a handful of other semiconductor stocks riding the momentum of generative AI demand, the benchmark Russell 3000 Growth Index jumped 7.80%, outperforming the Russell 3000 Value Index by 1,005 basis points. The second quarter marked the fourth time since 2020 that quarterly style dispersion exceeded 1,000 bps in favor of growth. The Magnificent Seven accounted for most of the Russell 1000 Growth's gain, led by Nvidia and Apple. This also increased the weighting of the group to 50% of the benchmark (compared to the ClearBridge All Cap Growth Strategy's 28.5% weighting). Two stocks — Microsoft and Apple — now maintain greater than 10% positions in the benchmark with Nvidia not far behind (Exhibit 1).

The market's focus on AI beneficiaries further accentuated concentration risk and created near-term headwinds for diversified portfolios like ours. The Strategy underperformed the benchmark due to a combination of our mega cap allocation and stock selection. Specifically, we were hurt by underweights to Apple and Alphabet, both of which outperformed the benchmark. We took advantage of

recent price weakness to repurchase Alphabet in April, giving the Strategy exposure to all seven mega cap companies.

Exhibit 1: Market Concentration Only Worsening



As of June 30, 2024. Source: FactSet.

Stock selection in software and consumer staples weighed on relative performance. In software, Salesforce, Workday, MongoDB and Snowflake were among a cohort of enterprise software stocks impacted by weakening software spending, partially resulting from AI-related diversions of IT budgets. Within staples, weakening spending among lower-income consumers weighed on energy drink maker Monster and mass market retailer Target while a pressured recovery in China continued to impact cosmetics and skin care company Estee Lauder.

Portfolio Positioning

We continue to look to diversify the portfolio and added three new positions during the quarter: Alphabet, e.l.f. Beauty (ELF) and IDEXX Laboratories. We also exited five smaller positions to better focus on our highest conviction holdings.

ELF, in the consumer staples sector, is the third-largest mass cosmetics brand in the U.S. We believe the flywheel of ELF's consumer value proposition, its innovation pipeline, its unique ability to bring prestige-like products to mass consumers and high consumer engagement will enable the company to continue to outgrow the global market. We see significant opportunity for ELF to transform itself from an emerging U.S. color cosmetics brand to a global beauty stalwart by doubling its share in the U.S. over the next few years and gaining share in international and skincare markets. ELF is profitable, balancing growth and earnings, and has an attractive balance sheet.

We diversified our health care exposure with the addition of IDEXX Laboratories, a provider of diagnostics products for the companion

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animal and livestock markets. We expect penetration of this large and growing \$45 billion market will continue to increase globally, with only 15% being served today. We are also encouraged by the opportunity for company-specific product cycles and consumables pull through to help sustain growth. Finally, despite solid operating margins today, we see multiple levers to drive continued margin expansion for IDEXX. The new position maintains our animal health exposure following the sale of vaccine and therapeutics provider Zoetis.

Other moves during the quarter included sales of United Parcel Service (UPS) and Nike. We believe our margin expansion thesis for UPS has played out, with growth now more revenue-led with macro and competitive risks increasing. This exit consolidates our positioning in the industrials sector. Nike has become overly reliant on key platforms, like Jordan, for revenue growth while innovation in areas like running has lagged. Nike could face continued revenue and profit pressure as it invests to re-invigorate innovation and re-position the business back toward wholesale outlets. As such, we are seeking out better ways to participate in the global consumer recovery in companies where earnings estimates have already reset.

Outlook

AI-related momentum was a key driver of performance in the second quarter, lifting the enablers in technology as well as holdings supporting the increasing energy needs of data centers. Parts of the market lacking an AI connection, like our medical device holdings, underperformed despite no change to fundamentals. We have managed through several similar momentum periods over our tenure and have delivered long-term results for shareholders by staying true to an approach that emphasizes diversification across three buckets of growth companies (select, stable and cyclical) and seeks to take advantage of attractive entry points into quality growth businesses.

We have also learned to not allow short-term investor sentiment to undermine our long-term theses for the companies we choose to own. As growth investors, we will always have technology stocks as a core part of our portfolio, and we acknowledge that our more than 600 bps underweight to the sector has been a headwind in mega-cap-driven momentum periods. We have been carefully finding ways to close that gap with our recent IT and IT-related purchases.

Overall, we feel comfortable with our portfolio construction as the economy continues to slow. Retail sales, consumer confidence, loan growth and transport volumes are all down and the latest reading from the leading economic indicators shows signs of weakening. While higher-income consumers continue to spend, the lower end is seeing spikes in credit card delinquencies as accumulated savings from COVID have run out and the delayed impacts of Fed tightening are finally being felt. While frequency and timing remain uncertain, we see eventual rate cuts from the Fed acting as a stabilizer for the

economy. We believe our portfolio companies remain well positioned to generate consistent organic growth through economic cycles.

Portfolio Highlights

The ClearBridge All Cap Growth Strategy underperformed its Russell 3000 Growth Index benchmark in the second quarter. On an absolute basis, the Strategy delivered gains across four of the nine sectors in which it was invested (out of 11 sectors total). The primary contributor to performance was the IT sector while the consumer staples sector was the main detractors.

Relative to the benchmark, overall stock selection and sector allocation detracted from performance. In particular, stock selection in the IT, consumer staples and communication services sectors, overweights to industrials and health care and an underweight to IT hurt results. On the positive side, stock selection in the industrials and consumer discretionary sectors and an underweight to consumer discretionary contributed to performance.

On an individual stock basis, the leading absolute contributors to performance were Nvidia, Broadcom, Apple, Amazon.com and CrowdStrike. The primary detractors were Estee Lauder, Charles River Labs, Grainger, Target and Salesforce.

In addition to the transactions mentioned above, we exited positions in Ionis Pharmaceuticals in the health care sector and Dolby Laboratories in the IT sector.

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