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Large Cap Value ESG Strategy

Key Takeaways

- ▶ We believe the current market offers significant value opportunities as overall market breadth improves and capital flows shift away from high-flying growth stocks toward overlooked, high-quality businesses.
- ▶ We have made concerted efforts this year to address performance challenges, neutralizing momentum exposure, reducing outsize bets in higher-volatility stocks and implementing tighter underwriting across the portfolio, with positive results so far.
- ▶ Recent engagements with ClearBridge portfolio companies have touched on ways they are developing carbon capture and sequestration capabilities across several industries and how in most cases advanced CCS capabilities are driving share gains and improving cash flows.

Market Overview

U.S. stocks kept their momentum going in the third quarter, with the S&P 500 Index and tech-heavy Nasdaq Composite setting fresh records. Confidence improved as tariffs landed better than feared, Congress passed the One Big Beautiful Bill Act in July, and the Federal Reserve delivered a 25 bps cut in September while signaling more to come. Strong earnings from mega caps in communication services, information technology (IT) and consumer discretionary sectors added fuel to the rally.

The Strategy kept pace during the period, although results modestly trailed the benchmark. IT led the way, especially semiconductor holdings Broadcom, Intel and Taiwan Semiconductor. The massive surge in spending on artificial intelligence (AI) continues to bolster chip providers like Broadcom, whose custom-designed chips are gaining broader adoption with hyperscalers as a complement to Nvidia's dominant graphics processing units in AI buildouts. We also initiated a position in the quarter in Taiwan Semiconductor, a leader in advanced semiconductor manufacturing, with dominant market share in leading-edge nodes such as 3nm and 2nm, which are being adopted by nearly all major AI companies. While Intel is not as directly exposed to this AI spending wave, it benefited from a slew of investments and partnerships that were announced in the quarter, which shored up the company's balance sheet and provided confidence that Intel will be able to capitalize on the growing need for domestically manufactured leading edge semiconductors.

Health care stocks have been under pressure from heightened regulatory concerns as the U.S. government is pursuing tariffs on foreign-manufactured pharmaceuticals, benefit reductions to health care service providers and potential reductions in drug prices. Despite these headwinds, the Strategy saw bright spots in the quarter with managed care provider UnitedHealth stabilizing and life sciences tools company Thermo Fisher Scientific seeing strong momentum from pharma and biotech customers. A better outlook from Johnson & Johnson, where Tremfya could be a next-gen immunology leader, and for CVS Health, on track toward recovery in its Medicare Advantage insurance book, more than offset weakness in GLP-1 maker Novo Nordisk, which we exited.

Utilities also helped. Sempra, one of our larger positions and a significant active weight versus the benchmark, saw double-digit gains in the quarter as it continued to regain investors' confidence after resetting its 2025 earnings guidance earlier in the year. In addition, its recently announced sale of a 45% stake in Sempra Infrastructure Partners at an attractive valuation eliminates a need for equity raises to fund the company's ambitious capital program in Texas. This announcement further advances Sempra's strategy to focus on its regulated U.S. utilities and strengthens its overall financial position. WEC Energy also rose, supported by AI-related energy demand driving investments for load growth combined with consistent operational execution.

Communication services was a headwind to performance, meanwhile, as a positive resolution to Alphabet's ongoing antitrust trial combined with enthusiasm for its AI offerings led to strong performance. While Alphabet has been a portfolio holding for some time, its weighting in the Russell 1000 Value benchmark increased significantly in July, leading us to become relatively underweight. Comcast was also a detractor to Strategy performance in the quarter, as it continues to lose share of the broadband market to fiber and fixed wireless companies. We continue to hold the name, as it generates substantial free cash flow, and trades at a very attractive 16% free cash flow yield.

While financials were a small drag to performance in the quarter, we stuck to our practice of upgrading quality where we see opportunity by exiting U.S. Bancorp and initiating a new position in PNC. The two regional banks trade at comparable levels but we have greater confidence in PNC's ability to execute on both revenues and expenses, given net interest income tailwinds as its lower-yielding swaps mature and fixed-price assets continue to reinvest at higher yields. U.S. Bancorp will need to grow its expenses to support its targeted organic growth in fee revenues and market share gains.

In materials, Air Products and Chemicals was lower on demand softness in China and Europe and some continued overhang on the timing of its large hydrogen projects in Saudi Arabia and Louisiana. Cell tower REIT American Tower, meanwhile, traded down following a lighter than expected second-quarter print indicated slower leasing

growth. Industrials holding Deere performed well in the first half of the year, but tariff headwinds began to take their toll in the farm and construction equipment maker's second-quarter earnings. In addition, persistently high rates and low grain prices continued to weigh on farmer profitability.

Portfolio Positioning

Performance of the Strategy over the past 18 months has been below our expectations, and we have made concerted efforts this year to address the challenges. First has been our neutralization of the powerful "AI trade," which has driven violent but narrow outperformance for a select number of momentum stocks since the beginning of 2024. We initiated positions in Taiwan Semiconductor and Amazon.com this quarter, while increasing our position in Alphabet, which both reduced our overall portfolio tracking error back to historical ranges and neutralized our unintentional underweight to "AI" stocks. Secondly, we've reduced outsize bets in high-volatility stocks such as Intel and Microchip, which should reduce performance volatility.

Finally, we've implemented tighter underwriting across the portfolio with specific key performance indicators (KPI) that we are monitoring and acting on in a timelier fashion. For example, in the case of Novo Nordisk, we focused on three KPIs — Wegovy weekly scripts, the script recapture rate for GLP-1 compounds, and development milestones for CagriSema — and saw flat/declining weekly scripts for six weeks, which prompted our exit. We believe a tighter risk framework should help us return to our historically low volatility while staying focused on careful, company-by-company stock selection through all cycles.

Outlook

We remain cautiously optimistic about the market, focusing on high-quality companies with resilient durable business models that can compound returns over time, regardless of short-term macro or geopolitical noise. We also see the investment landscape shifting: inflation and interest rates are structurally higher and market dynamism is increasing, especially with the rise of AI. Rather than trying to predict macro events, however, we build portfolios that can withstand volatility. We believe the current market regime offers significant value opportunities, especially as overall market breadth improves and capital flows shift away from high-flying growth stocks toward overlooked, high-quality businesses.

Portfolio Highlights

The ClearBridge Large Cap Value ESG Strategy underperformed its Russell 1000 Value Index benchmark during the third quarter. On an absolute basis, the Strategy saw positive contributions from 10 of 11

sectors. The IT, health care and utilities sectors were the main contributors, while the real estate sector detracted.

On a relative basis, stock selection detracted, while sector allocation was positive. Stock selection in the IT and utilities care sectors along with a consumer staples underweight were beneficial, while stock selection in the communication services, industrials, financials and real estate sectors detracted.

On an individual stock basis, the top relative contributors were Sempra, Broadcom, O'Reilly Automotive, Intel and Taiwan Semiconductor Manufacturing. Top relative detractors were Alphabet, Haleon, Deere, Microchip Technology and Novo Nordisk.

ESG Highlights: Innovating Carbon Capture Across Industries

While deployment of renewable energy sources such as solar, wind and hydro will likely play the largest role in the energy transition, carbon capture and sequestration (CCS) remains an important technology for heavy industries that produce unavoidable CO₂ emissions.

There are many types of CCS, and ClearBridge holdings with which we engage regularly represent a diverse portfolio of CCS technologies. Recent engagements with portfolio companies have touched on ways they are developing CCS across several industries and how in most cases CCS capabilities are driving share gains and improving cash flows.

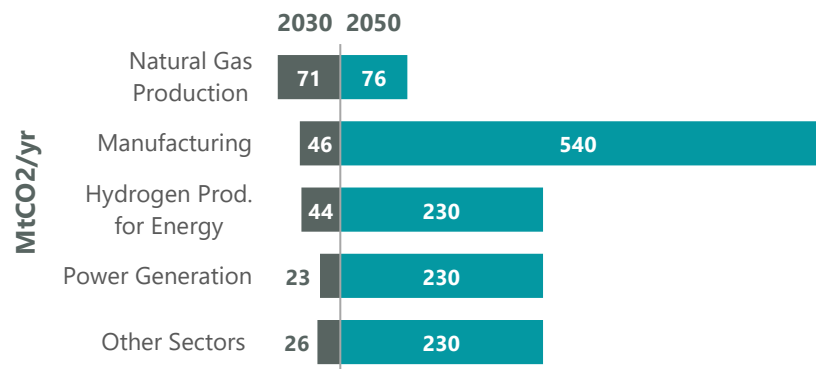
Cleaner Hydrogen Technologies Advancing in Manufacturing

CCS is critical in addressing emissions from manufacturing and will be all the more so as capacity additions ramp up globally in the coming years (Exhibits 1 and 2). In North America, the main applications are hydrogen and ammonia. These were focal points of recent ClearBridge discussions with industrial gas company Linde, which we find is well-positioned to continue taking share in clean hydrogen, specifically blue hydrogen. (Blue hydrogen is produced using fossil fuels but with carbon capture technology preventing emission of CO₂, and is used for various industrial, energy and transport applications.)

ClearBridge recently toured Linde's autothermal reformer (ATR) site at its Clear Lake facility in Texas, where Linde provides blue hydrogen and CO₂ to support industrial chemicals supplier and manufacturer Celanese with its methanol and acetyl production.

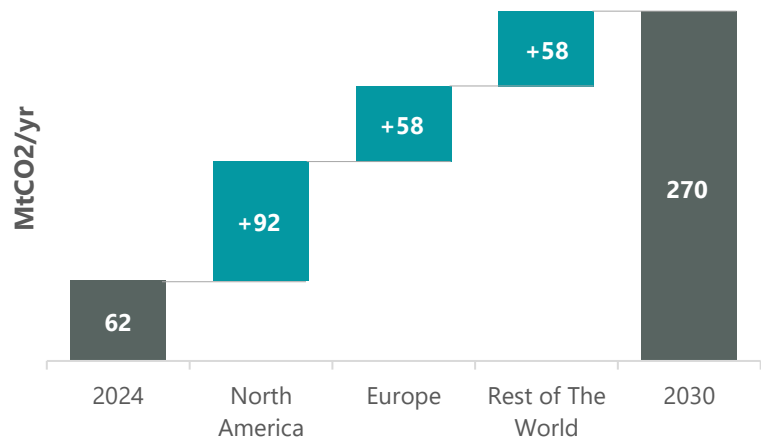
An ATR is essentially a large chemical reactor that combines natural gas, oxygen and water/steam to produce synthesis gas or syngas (hydrogen plus carbon monoxide/dioxide), a critical input for applications like chemicals production (such as methanol, which is used for paint solvents, antifreeze, fuels, pharmaceutical laboratories and adhesives, among other things). Syngas is also used in power generation, ammonia and fertilizer production for growing crops, and refining (desulfurizing oil, which reduces sulfur dioxide emissions).

Exhibit 1: CCS by Sector 2030 and 2050



As of 2025. DNV, "Energy Transition Outlook CCS to 2050."

Exhibit 2: CCS Capacity Additions to 2030



As of 2025. DNV, "Energy Transition Outlook CCS to 2050."

Linde's ATR technology is especially attractive as it is more efficient than other methods of producing these inputs given its better energy efficiency, higher CO₂ concentration for better carbon capture, higher product yield and lower maintenance.

Linde has been able to leverage the success of this technology as a proof point to win other projects that support clean hydrogen and ammonia production in the U.S. Other blue hydrogen deals, such as in Nederland, Texas (where Woodside/OCI creates blue ammonia for agriculture, power and marine sectors), in Alberta, Canada (where Dow produces blue hydrogen for ethylene production with two ATRs), and the latest in Modeste, Louisiana (where CF Industries runs a large-scale air separation unit to support blue ammonia).

Linde represents an excellent example of a company where technological expertise in a sustainability practice is driving both emissions savings and growth for the business. In 2024, Linde helped its customers to avoid more than 96 million metric tons of carbon dioxide equivalent, more than twice the emissions that Linde generated from its own operations.

What is Biogenic CO₂?

Green Plains, a U.S.-based agricultural technology and biorefining company based in Nebraska, is one of North America's largest producers of ethanol and bio-based products. It serves several main industries, such as ethanol for fuel, agricultural services (grain management), high-protein feed for livestock and aquaculture and renewable corn oil.

ClearBridge recently met with Green Plains's CFO and Director of Sustainability to discuss the company's carbon capture initiatives and other developments that impact its carbon intensity (CI) and ability to meet its target of net-zero emissions by 2050. The company recently suspended its clean sugar technology (CST) and ultra-high protein (UHP) initiatives to focus on carbon capture, which is more cost-effective under current tax credit structures.

Green Plains considers carbon capture a key tactic in decarbonizing biorefineries by capturing the pure stream of biogenic CO₂ from fermentation (CO₂ is released from the fermentation process of biological materials such as plants used for biofuels). Initiatives include partnering with Tallgrass Energy on the Trailblazer carbon pipeline, which will initially serve three Green Plains facilities in Nebraska, and is expected to sequester 800k tons of CO₂ annually beginning this year. These facilities are also expected to generate \$150 million in 45Z tax credits (for clean fuel production).

In addition, running other plants in a similar fashion without carbon capture can net another \$50 million under 45Z. Green Plains is raising capital for another deal with startup Carbon Solutions to perform carbon capture on other Midwestern plants. If the 45Z program isn't extended after 2029, Green Plains would drop down to 45Q credits, which are worth one-third of 45Z, until that program ends in 2038.

Overall, however, these credits are valuable programs that get Green Plains past recent liquidity issues after years of capex on plant modernization. With roughly \$50 million left in carbon capture capex, Green Plains has already cut its operating expenses by more than 50%, setting it up to generate ample free cash flow going forward.

Rocks Can Sequester Carbon

In a recent engagement with Vulcan Materials, the largest producer of construction aggregates such as crushed stone, sand and gravel in the U.S. and a name widely owned across ClearBridge, we checked in on Vulcan's goal of 10% absolute reduction in Scope 1 and 2 emissions by 2030. Vulcan shared that its Scope 1 and 2 emissions profile declined by 3% in 2024 versus its 2022 baseline, an improvement on 2023's flat performance. While 3% may seem low, aggregates production already carries a low GHG intensity, so the incremental progress is notable.

Key drivers were increasing renewable adoption (now 14% of total electricity versus a 5% stated goal), upgrades to engines with 20%–

50% lower emissions and increased renewable diesel usage in California. Renewable diesel — produced from vegetable oils, waste oils and animal fats and, unlike biodiesel, a “drop-in” fuel that can be used directly in engines without blending or modifications — now accounts for 9% of Vulcan’s total diesel usage.

We also touched on Vulcan’s operational use of water to wash residue off rocks and to suppress dust. We were encouraged to hear water recycling takes place at roughly 75% of Vulcan’s sites and that the company is striving for further improvement.

Increasing water recycling is a win-win from both a sustainability and economic perspective. At the 25% of sites where there is no recycling, Vulcan purchases water and absorbs the cost of trucking it. This seems like an easy target for the company to address over time.

Another interesting facet of Vulcan’s environmental profile is that some of its basalt fines (i.e., dust byproduct of rock production) actually help sequester CO₂. We learned the agricultural market can spread this byproduct on soil to support “enhanced rock weathering” whereby rainwater spurs a chemical reaction that traps atmospheric CO₂ in newly formed, solid material. While sequestering CO₂ with basalt fines is certainly not a core part of Vulcan’s business, it is nonetheless a positive attribute in its environmental profile.

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