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## Small Cap Growth Strategy

### Key Takeaways

- ▶ Small cap growth equities endured a volatile, headline-driven quarter, marked by continued rotation into value and cyclical sectors and early signs that the segment may be entering a period of sustained outperformance.
- ▶ The Strategy outperformed its benchmark driven by strong stock selection, particularly in industrials, while navigating increasing uncertainty around AI disruption and uneven consumer demand trends.
- ▶ We remain focused on identifying companies with durable, idiosyncratic growth drivers and the capacity to invest in new opportunities, while also critically reassessing businesses that could be disrupted by new technologies.

### Market Overview

The first quarter of 2026 underscored the importance of narratives, with rapidly evolving technological and geopolitical dynamics drowning out company fundamentals and disproportionately driving market direction. While the Russell 2000 Growth Index declined 2.8% for the quarter, the reality is that its headline performance masks a far bumpier ride as January strength gave way to February weakness before a sharp drawdown in March.

However, it is encouraging to see small cap outperformance continue through the volatility. After an extended period of narrow performance dominated by a concentrated group of large-cap technology companies and their small and mid cap lookalikes, the first quarter saw returns began to broaden out. Interestingly, despite a rising rate environment to conclude the quarter, smaller cap, value-oriented and cyclical areas of the market outperformed.

The hyperfocus on the artificial intelligence (AI) capex cycle has continued, but intensifying investor concerns have contributed to increased dispersion within sectors. Areas perceived to have greater obsolescence risk — such as horizontal/front-office software, information services and contract research organizations (CROs) in health care — have faced pressure, while more asset-heavy or capital-intensive businesses with limited disruption risk, including select industrial and energy companies, were viewed more defensively and broadly outperformed during the quarter.

Entering the year, investor expectations had begun to build around a potential recovery across several previously depressed end markets such as housing, consumer discretionary and industrials,

supported by anticipated rate cuts, improved policy clarity and incremental fiscal support. However, continued policy volatility and geopolitical risks have reintroduced uncertainty to these areas, reinforcing the importance of selectivity and fundamentals in navigating the current environment.

### Portfolio Performance

The ClearBridge Small Cap Growth Strategy outperformed its Russell 2000 Growth Index benchmark during the first quarter, reflecting strong stock selection across multiple sectors, particularly in industrials and consumer staples amid increasing uncertainty around AI disruption and uneven retail spending trends.

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Even amid the volatility, it is encouraging to see small cap outperformance.

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Contributions in industrials reflected a mix of both long-standing positions and newer investments. Performance was largely balanced between broad-based strength across a variety of industries — particularly the aerospace and defense, data center power and infrastructure and transportation industries— as well as company-specific execution stories and exposure to improving or attractive growth markets. For instance, long-term holding RBC Bearings continues to demonstrate best-in-class execution on profitability improvements while revenue has benefited from exposure to aerospace, defense, and select industrial end markets. XPO, a less-than-truckload transportation provider, is benefiting from implementing an array of strategies to improve service quality, mix and pricing. This is helping profitability while positioning for a possible uptick in freight demand and activity.

Positive stock selection in consumer staples was led by Casey's General Stores and BJ's Wholesale Club, defensive compounders whose value-focused business models continue to see resilient consumer demand, particularly amid an increasingly uncertain macro environment.

While our holdings in the information technology (IT) sector were an overall performance headwind, performance among IT subsectors diverged meaningfully. Several semiconductor and hardware holdings, like Lattice Semiconductor, a provider of low-power programmable analog semiconductors, continued to perform quite well. The company benefited from improving sentiment around cyclical end markets as well as growing recognition of its role in emerging applications within AI servers and robotics. Meanwhile, software and services were notable detractors. Much of the weakness in software was driven by concerns around AI disruption, with indiscriminate selling leading to meaningful valuation compression. While we have reduced our exposure to areas where long-term business model durability is more uncertain, we maintain conviction in companies we believe are better positioned either as beneficiaries of AI adoption or through differentiated, verticalized or consumption-based business models.

Several of our consumer discretionary and financial holdings were pressured due to concerns that they could be exposed to AI disruption. This included Global-e Online, a cross-border e-commerce platform, and Shift4 Payments, a hospitality/restaurant-focused payments provider, which were impacted both by fears they could be replaced by AI agents and debates around the health of the consumer. Meanwhile, several of our consumer discretionary businesses, such as restaurant holdings Wingstop and Dutch Bros, faced additional pressures from a weak demand environment among lower-income consumers.

### **Portfolio Positioning**

We continued to deliver strong new idea generation with eight new portfolio additions in the quarter: Charles River Laboratories, Ensign Group, Glaukos, Madrigal Pharmaceuticals, Rambus, Scholar Rock, Vaxcyte and York Space Systems.

- Charles River Laboratories, in the health care sector, is the leading preclinical CRO providing essential drug research services to biopharmaceutical customers. Its scale and integrated platform position the company to benefit disproportionately as preclinical research activity and biotech funding recover.
- Ensign Group, also in the health care sector, is a skilled nursing facility operator with a long runway for consolidation — despite being the largest player, it still holds less than 5% market share. We believe that with a strong track record of acquiring locations at low valuations and greatly improving acuity mix and operating performance, Ensign can facilitate both superior patient outcomes and profitable growth.
- Rambus designs high-performance memory interface and interconnect solutions for semiconductor systems and also operates a high-margin memory IP licensing business. We believe the rising complexity of server memory will drive content per server growth and, alongside a variety of adjacent product launches, will support robust growth.
- York Space Systems is a focused aerospace and defense satellite manufacturer and service provider. The company is benefiting from increased investment in U.S. space-based defense programs as well as emerging commercial use cases.

During the quarter we sold a variety of holdings, some of which were acquired and others for idiosyncratic fundamentals and portfolio construction considerations. Exited investments included Clearwater Analytics, Hims & Hers, ICON, Onestream and PagerDuty.

### **Outlook**

We believe the investment landscape remains characterized by a high degree of uncertainty across macroeconomic, geopolitical and technological dimensions. The path of inflation and interest rates, the durability of a recovery in cyclical end markets and the ultimate

impact of AI on a wide range of business models all remain difficult to predict while the potential range of outcomes has widened.

In this environment, we believe it is critical to continue to emphasize our consistently rigorous, bottom-up approach to identifying companies with durable competitive advantages in large and growing markets, strong balance sheets and clear idiosyncratic paths to revenue and profitability growth that can help insulate them from broader macro volatility.

We continue to critically reassess long-standing assumptions around business model durability, particularly in areas where AI and technological innovation may result in industry disruption. While some of the market selloff may prove overdone, we believe it highlights the importance of incorporating a wider range of potential outcomes into our analysis. We believe that the combination of the Strategy's strong historical focus on constructing a portfolio across a wide spectrum of growth profiles, along with our intensive derisking process, can allow us to navigate the dynamic straits of the current market.

### Portfolio Highlights

The ClearBridge Small Cap Growth Strategy outperformed its benchmark in the first quarter. On an absolute basis, the Strategy posted gains in four of the eight sectors in which it was invested (out of 11 sectors total). The largest contributor to performance was the industrials sector, while the IT sector was the chief detractor.

Relative to the benchmark, overall stock selection and sector allocation effects contributed to performance. Stock selection in industrials, consumer staples and materials sectors, as well as an overweight to the industrials sector, proved beneficial. Stock selection in the financials, consumer discretionary and IT sectors weighed on performance.

On an individual stock basis, the leading contributors to relative returns were XPO, Bloom Energy, Lattice Semiconductor, RBC Bearings and Casey's General Stores. The primary detractors were Klaviyo, Wingstop, ICON, Varonis Systems and Hamilton Lane.

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