



Brian Angerame
Managing Director,
Portfolio Manager



Matthew Lilling CFA
Managing Director,
Portfolio Manager

Mid Cap Strategy

Key Takeaways

- ▶ Stock selection in consumer staples stood out amid broader sector weakness, driving Strategy outperformance alongside gains in health care.
- ▶ The Strategy's proactive positioning and willingness to redeploy capital toward new ideas, such as QXO and Bio-Techne, reflect our commitment to staying nimble amid shifting market dynamics.
- ▶ With policy headwinds easing and corporate decision making beginning to normalize, we see a healthier environment for mid cap equities and continue to focus on bottom-up opportunities where fundamentals can shine through macro noise.

Market Overview

Mid caps advanced in the third quarter as the investment landscape was shaped by a combination of monetary policy shifts, stabilizing earnings and improving sentiment. The Federal Reserve's decision to cut rates in September, along with rising hope of further easing and expectations for earnings resilience in third-quarter reports, helped provide relief from headwinds that had weighed on small and mid cap stocks. As a result, the benchmark Russell Midcap Index returned 5.3% for the quarter. Value stocks outpaced their growth peers, with the Russell Midcap Value Index returning 6.2% compared to the Russell Midcap Growth's 2.8% return.

Investor sentiment continued to build as the passage of the One Big Beautiful Bill and incremental progress on trade agreements helped to ease policy uncertainty, allowing companies to begin executing on previously delayed strategic decisions. Earnings estimates, which had been previously revised downward, broadly stabilized with pockets of resilience in technology and AI-related sectors. While parts of the economy continued to "bounce along the bottom," particularly in non-residential and discretionary segments, the anticipated post-Liberation Day downturn has so far failed to materialize. Instead, we are encouraged by early signs of recovery and normalization in corporate decision making, setting the stage for a more constructive environment heading into year end.

The ClearBridge Mid Cap Strategy outperformed its benchmark for the quarter, driven by standout stock selection in consumer staples and health care — two areas where portfolio holdings delivered strong results amid muted sector performance in our benchmark. This strength offset softness in consumer discretionary and materials.

The post-Liberation Day downturn has failed to materialize, and we are seeing companies move forward with previously delayed decisions.

Consumer staples — the only negative sector of the Russell Midcap Index — proved a clear standout for the Strategy, led by Performance Food Group, a top U.S. foodservice distributor that supplies a broad range of fresh, frozen, dry and non-food products. The stock benefited from constructive activist engagement and news that the company entered an agreement with US Foods to explore the merits of a strategic combination. The company's strong execution and steady earnings underscore its leadership in U.S. food distribution. Casey's General Stores also contributed to returns, benefiting from its aggressive reinvestment in its stores over the past decade in which it has built its private label brand and broadened its product offerings. This has not only helped improve same-store sales but has also encouraged repeat traffic, allowing the company to buck broader industry trends toward contraction in gas volumes and margins.

Health care was another key driver of outperformance, anchored by strength in biotechnology and the addition of new opportunities in life sciences tools. Argenx delivered robust second-quarter results, supported by continued adoption of its lead therapy for autoimmune disorders and promising progress across its clinical pipeline. Alnylam Pharmaceuticals also advanced, driven by accelerating uptake of its treatment for transthyretin cardiac amyloidosis (ATTR-CM) and a raise to full-year revenue guidance, reinforcing confidence in its commercial execution and deep RNA-based drug pipeline. ICON, a leading global contract research organization, also delivered a strong performance, reporting solid gross business wins that expanded its backlog — potential signs of improvement in what has been a challenged environment for clinical research services.

Top contributor AppLovin, a mobile technology company specializing in gaming and e-commerce monetization and marketing, rallied on continued investor excitement about the launch of its e-commerce business in the fourth quarter. A longtime holding, AppLovin continues to deliver best-in-class AI demand generation to its customers, and we believe this new e-commerce business has the potential to further drive incremental cash flow growth.

Stock selection in the consumer discretionary sector proved the greatest overall headwind. Chewy, the e-commerce pet products and services retailer, declined despite solid revenue growth as the company's increased growth investments for the second half of the year weighed on investor sentiment. However, we are confident in its strategic direction and believe these initiatives will increase the company's recurring revenue and growth rate. Light & Wonder, a gaming and interactive entertainment company, also lagged due to uneven product sales.

Stock selection within the materials sector also weighed on performance, as global packaging solutions provider Crown Holdings sold off on macro jitters and commodity worries, and paper and forest products company International Paper came under pressure due to soft end-market demand.

Portfolio Positioning

We added a new position in QXO, a newly formed building materials distribution platform in the industrials sector led by Brad Jacobs. We have a long history with Jacobs, an executive with a strong track record of building and scaling businesses such as XPO and United Rentals. The company is pursuing a strategy of consolidating the fragmented building materials industry by acquiring mid-size distributors and applying advanced technology, logistics and pricing systems to improve efficiency and profitability. We see the potential for the company to evolve into a scaled leader with meaningful margin expansion opportunities.

Complementing the success of our health care holdings, we initiated a new position in Bio-Techne, a leading provider of life sciences tools and diagnostics used in biological research, clinical testing and biopharmaceutical manufacturing. We capitalized on recent weakness in the name tied to uncertainty surrounding tariffs and National Institute of Health funding to initiate a position in the company, whose high-margin consumables and instrumentation portfolio provide durable recurring revenue streams. This recurring revenue, along with biopharma and academic exposure and an attractive entry price underscore Bio-Techne's appeal as a high-quality growth-oriented compounder within health care.

We exited our position in ATS Corporation, a provider of automation solutions for a range of industries including life sciences, food and beverage and transportation. While ATS has demonstrated strong capabilities in delivering custom automation systems and has benefited from secular trends in manufacturing automation, the departure of its CEO has caused us to question our expectations for further outperformance.

Outlook

Heading into year end, we remain constructive on mid cap equities — though with a healthy respect for near-term volatility. The Fed's rate cut in September provides a potential inflection in sentiment and relief for rate-sensitive sectors. Combined with moderating macro data and fewer policy surprises, we believe the environment is better suited for selective stock pickers.

We expect dispersion to remain elevated, which plays to our strength: the names we own are generally not index-dependent, but driven by differentiated fundamentals, catalysts and structural advantages. We remain disciplined — seeking businesses with durable competitive moats, resilient free cash flow, balance sheet flexibility and clear paths to growth.

In short, we are optimistic but humble. The environment may not offer broad and easy gains, but it should reward fundamental differentiation. We believe our process is robust and our portfolio is well-positioned to navigate this backdrop and capture upside where it emerges.

Portfolio Highlights

The ClearBridge Mid Cap Strategy outperformed its Russell Midcap Index during the third quarter. On an absolute basis, the Strategy had contributions from 10 of the 11 sectors in which it was invested during the quarter. The largest contributors were the IT and industrials sectors, while the materials sector was the sole detractor.

On a relative basis, overall stock selection positively contributed to performance. Stock selection in the consumer staples, IT and health care sectors benefited performance. Conversely, stock selection in the consumer discretionary and materials sectors weighed on performance.

On an individual stock basis, the biggest contributors to relative returns were AppLovin, Resideo Technologies, Performance Food Group, Argenx and Expedia. The largest detractors from relative returns were Willscot, Light and Wonder, Dynatrace, EQT and Draftkings.

In addition to the transactions listed above, we initiated new positions in Axon Enterprise in the industrials sector, UMB Financial in the financials sector, BJ's Wholesale Club in the consumer staples sector and Jones Lang LaSalle in the real estate sector. We exited positions in Eastman Chemical in the materials sector, Avantor and Ultragenyx Pharmaceutical in the health care sector and U.S. Bancorp in the financials sector.

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