



Growth Strategy



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Key Takeaways

- ▶ Aided by strong performance from our target mid cap plus segment of the market, combined with stock selection in IT, industrials and financials, the Strategy outperformed for the quarter.
- ▶ The Strategy's AI exposure was a significant contributor, led by a balance of longtime holdings across sectors and disruptor names that we have added to the portfolio over the last several years.
- ▶ The parabolic rise in share prices of several holdings allowed us to take profits and trim back exposures to these names. We deployed the proceeds into five new positions, further diversifying the portfolio by adding to underweight areas such as consumer discretionary and industrials.

Market Overview

U.S. equities rebounded strongly from tariff and geopolitical scares to deliver healthy gains in the second quarter. Stocks fell to begin the quarter after President Trump unveiled wide-ranging reciprocal tariffs on April 2 but recovered as a 90-day delay in their implementation, a handful of bilateral trade deals and a softened tone from the White House on both China and Federal Reserve policy improved the outlook. May then delivered the best monthly performance for the S&P 500 Index since November 2023 as the trade picture continued to brighten, while in June markets looked past Middle East conflicts to maintain their positive momentum.

The S&P 500 returned 10.9% in the quarter, swinging from a near bear market to an all-time high. The benchmark Russell Midcap Growth Index advanced a market-leading 18.2% as risk-on sentiment took hold. Growth stocks led across market caps, with the Russell Midcap Growth Index outperforming its value counterpart by more than 1,200 basis points.

Aided by the combination of strong performance from the "mid cap plus" segment of the market that the Strategy targets and strong stock selection in IT, industrials and financials, the ClearBridge Growth Strategy outperformed its benchmark for the quarter.

The Strategy saw strong relative contributions across information technology (IT), led by some of its AI-levered holdings such as Broadcom, ServiceNow and Snowflake. Our largest holding, Broadcom, added nearly two-thirds to its value as it continued to benefit from strong demand for its custom silicon chips for AI computing. ServiceNow rose after an impressive quarter in spite of a tough macro environment. The company remains a leader among its

software peers in the monetization of generative AI with a target of \$1 billion in annual contract value from AI-related products by 2026. Likewise, Snowflake outperformed on strong results benefiting from improved product momentum and an increased imperative among corporations to get their data layer in order so that they can fully harness the power of AI. CrowdStrike also moved higher with crisp execution against a still-large market opportunity in the priority spending area of information security.

Several of the Strategy's industrials holdings also continue to benefit from the growing focus on AI and the underlying infrastructure investments required to support it. Vertiv delivers power and thermal management systems critical for data center operations, while Johnson Controls has a leading position in commercial HVAC for data centers, with a data center business larger than the next two competitors combined.

In financials, shares of disruptor Robinhood more than doubled over the last three months, lifted by a more favorable environment and increased demand for cryptocurrencies as well as a flurry of new product introductions.

Health care underperformed amid worries over the prospect for tariffs on pharmaceutical imports and the impact of reimbursement rate pressures within the Medicare Advantage market. The latter, in combination with some execution-related challenges, weighed most heavily on UnitedHealth Group, which missed first-quarter earnings forecasts and later withdrew guidance for the full year. However, efforts to trim back our exposure over the past few years and into 2025, at much higher prices than where the stock is trading today, helped to mitigate the impact to overall performance. Longtime biotech holding Vertex Pharmaceuticals also traded lower on softer than expected first-quarter revenue and earnings, primarily due to weakness in parts of Europe and slower uptake of its next-generation cystic fibrosis treatment, Alyftrek. That said, the company's key compounds, including non-opioid acute pain reliever Journavx, should see solid growth in the second half of the year. Within consumer discretionary, Starbucks and TJX were laggards for the quarter.

Portfolio Positioning

While we remain long-term investors, the parabolic rise in share prices of several of our portfolio holdings, such as Robinhood, Palantir Technologies, Broadcom and CrowdStrike, allowed us to take profits and trim back exposures to these names. We remain disciplined in our approach, looking for opportunities to optimize the portfolio while balancing being mindful of turnover with being sensitive to valuation and risk.

The Strategy added five new positions during the quarter, further diversifying the portfolio from a stock and sector perspective, adding

to underweight areas such as consumer discretionary and industrials, while exiting two other names.

Alnylam Pharmaceuticals was among the larger additions. The commercial stage biotechnology company is the world leader in RNA interference, a technology that selectively shuts off the production of any protein at the genetic level. The company's platform of five approved drugs can be used to treat a broad array of rare and common diseases as well as consistently generate new drug candidates. We do not believe the market appreciates the potential value of Alnylam's core Amvuttra franchise to treat a liver condition that can lead to heart failure. It also has several early-stage pipeline assets, including opportunities in high blood pressure and Huntington's Disease.

We also added global hotel and resort operator Hilton Worldwide and paint and coatings producer Sherwin-Williams. Hilton's business is asset-light, with the majority of its revenue and profits derived from franchised and managed properties rather than company-owned and operated hotels. We believe the company has a long runway for growth supported by continued mid- to high-single-digit net unit expansion. It also has strong margins and free cash flow conversion enabling consistent return of capital through share buybacks. While higher inflation and interest rates could impact leisure and business travel demand, we believe Hilton should remain a relative share gainer irrespective of the macro backdrop.

Sherwin-Williams is a high-quality company with share gain opportunities and is well-positioned to benefit from accelerating earnings growth as housing turnover normalizes higher over the coming years. We also like the defensive characteristics of the company's business model with strong through-cycle pricing power and raw material costs, largely downstream derivatives of oil refining, which are macro linked and often act as a natural offset in periods of volume decline. The company also stands to benefit as a division of competitor PPG is taken private and is likely to close stores.

The purchases of Howmet Aerospace and Axon Enterprise complement existing defense holding L3Harris Technologies, adding exposure to original equipment and aftermarket aerospace and public safety end markets. Both are dominant players in their respective industries with significant runway for growth and margin expansion ahead.

The Strategy closed out of MongoDB and Charles River Labs to focus on higher-conviction growth names. While MongoDB remains a category leader in modern database architecture, recent fundamentals have been negatively impacted by the timing of multi-year renewals and a more cautious IT spending backdrop. Decelerating growth has also fueled investor concerns about rising competition, a bear case difficult to dispel without a clear catalyst on the horizon for a re-acceleration of growth.

For Charles River, a challenging biotech funding environment, risks of disruption from U.S. policy shifts and spending reprioritization by

large pharmaceutical clients have reduced its earnings visibility. Additionally, potential changes to FDA guidelines on animal testing represent a material regulatory overhang that could weigh on sentiment and future revenue streams. While the company has recently attracted activist interest, we think the stock already reflects increased optimism related to the potential for a strategic transaction.

Outlook

Our primary goal over the last few years has been to give clients a portfolio with an improved growth profile — one with better upside capture in risk-on markets as well as good downside capture through turbulent periods. We are excited about the number of new ideas we have put to work in the Strategy in pursuit of this goal and are encouraged by our results during the strong market advance this quarter.

While the full impacts of updated tariff policies with U.S. trading partners have yet to be felt globally, we feel confident that our holdings with strong market positions, value-based offerings and pricing power are well-positioned to weather tariff-related cost inflation. We expect the macroeconomic backdrop to remain bumpy but have positioned the portfolio to perform well in a variety of economic scenarios. With a balanced approach to growth, we own stocks with both offensive and defensive characteristics and strong management teams that have the proven ability to execute regardless of macro conditions. Unlike certain “style-pure” peers, we have the flexibility to own companies over long periods of time and through business cycles as they compound cash flows significantly and grow from emerging disruptors into larger and steadier compounders.

Portfolio Highlights

The ClearBridge Growth Strategy outperformed its Russell Midcap Growth Index benchmark in the second quarter. On an absolute basis, the Strategy produced gains across eight 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 health care sector was the main detractor.

Relative to the benchmark, overall sector allocation contributed to performance and more than offset the negative impacts from stock selection. In particular, overweights to communication services and IT, the best-performing sectors in the benchmark, a lack of exposure to the energy sector, which was the worst performer in benchmark, as well as stock selection in the IT, industrials, financials and consumer staples sectors drove performance. Conversely, stock selection in the health care, communication services and consumer discretionary sectors detracted from results.

On an individual stock basis, the leading relative contributors to performance were Broadcom, Robinhood Markets, CrowdStrike,

Vertiv and Snowflake. The primary detractors were Vertex Pharmaceuticals, Palantir Technologies, UnitedHealth Group, HubSpot and TJX.

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