



Mid Cap Growth Strategy



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Key Takeaways

- ▶ Mid cap growth stocks rebounded after a sluggish start to the year, as continued demand for AI and a low-quality rally helped growth stocks overcome tariff-induced market volatility.
- ▶ The Strategy trailed its benchmark as several underweights to higher-performing stocks and headwinds to financials overcame stock-specific contributions across a variety of sectors.
- ▶ While significant geopolitical, macro and trade uncertainty remains, we believe the mid cap growth universe continues to offer an array of attractive long-term compounders.

Market Overview

Mid cap growth stocks rebounded after a sluggish start to the year to become the best-performing sector of the market in the second quarter, as continued demand for AI and a growth-led rally in May and June helped overcome earlier tariff-induced market declines. Growth was the sweet spot of not only the mid cap market but U.S. equities overall as the Russell Mid Cap Growth Index returned 18.2%, outpacing the Russell Midcap Index by over 950 basis points, the Russell 1000 Growth Index by 36 bps and the Russell 2000 Growth by over 600 bps. The powerful growth rally also helped the benchmark eclipse the Russell Midcap Value Index (+5.3%) for the quarter and turn a 500 bps deficit as of March 31 into an over 650 bps lead year to date.

When we look back on the first half of 2025, it may have been full of sound and fury, but recent market action suggests that it signified nothing. Trade wars, regulatory uncertainty and monetary policy headlines shaped the market's direction throughout the quarter. The April rollout of "Liberation Day" tariffs on imports from China and other important U.S. trading partners sparked concerns about rising input costs and a re-acceleration of inflation. However, markets roared back over the following weeks as the Trump administration paused tariff implementation and unveiled a series of bilateral trade discussions. Meanwhile, the Federal Reserve held rates steady but signaled a dovish tilt in June, citing cooling inflation and slowing job growth. While investors are now expecting fewer rate cuts than previously forecast, the prospect of monetary easing boosted sentiment for lower-quality, cyclical and rate-sensitive mid cap growth names, particularly in the consumer discretionary, industrials and financials sectors.

We leveraged the market drawdown to capitalize on compelling entry points for high-quality growth companies.

Portfolio Performance

Despite strong absolute returns, the ClearBridge Mid Cap Growth Strategy failed to keep pace with its benchmark in the second quarter due to limited exposure to several of the rally's leading participants — Palantir Technologies and Cloudflare in information technology (IT), Axon in industrials and Roblox in communication services. Palantir, which has been a highly controversial stock due to excessive valuation and strong retail participation, rose 55% during the quarter, driven by the AI and growth-led rally and heightened attention to security. This proved a significant headwind for relative Strategy performance, but it could have been several times that amount had the team not initiated a modest position as a risk management strategy. We exited Palantir as it left the benchmark at the end of the quarter. We also initiated a new position in Axon — a leading provider of public safety software solutions and hardware including TASER devices and body cameras. Axon saw strong performance as it continued to innovate and broaden its safety and productivity offerings, actions which are driving greater adoption and strong growth in a large total addressable market. With an installed base of over one million software subscribers, Axon is increasingly positioned as the premier operating system for public safety. Meanwhile, Roblox, which we do not own stemming from our concerns about children's safety on the platform and the company only just now starting to compound cash flow, rose 80% in the quarter and also acted as a relative performance headwind in communication services.

Stock selection in the financials sector also weighed on performance, largely stemming from declines from marketplace operator Tradeweb Markets. Tradeweb, one of our top performers in the first quarter, took a breather as investor enthusiasm and growth expectations outpaced fundamentals. Despite reporting strong first-quarter earnings, the company's performance did not meet the growth and profitability improvements that many investors had priced into the stock, resulting in a share price pullback even as the business remains solid.

Our top contributors were broadly dispersed across IT, consumer discretionary and utilities. In IT, data protection and security services company Rubrik continues to benefit from customers' increasing prioritization and spending on IT security, while AI-enabled advertising platform operator AppLovin delivered strong quarterly earnings and solidified its leadership within AI-driven performance marketing. MercadoLibre, which operates online e-commerce platforms targeted to Latin American consumers, rose on strong financial performance and operating margins. Additionally, strong returns driven by its digital advertising division — Mercado Ads — highlights the company's transition from mere e-commerce and fintech platform into a broader digital ecosystem. Finally, merchant power producer and utility company Vistra made gains following a

string of better-than-anticipated results by leading AI developers and IT stocks, easing investors' concerns about a potential slowdown in AI demand and data center buildouts and pointing to continued increases in power demand as they come online. Ultimately the AI ecosystem remains short power and Vistra is among the best positioned to deliver it at a meaningful premium to prevailing prices.

Portfolio Positioning

We were particularly active this quarter in the consumer discretionary sector, where we are seeing weak investor sentiment and some industry leaders with attractive opportunities to improve fundamentals despite an uncertain economy. We re-established a position in Carvana, the leading online used vehicle retailer. Carvana has emerged from a challenging restructuring period with a return to strong growth, record profitability that leads the legacy auto retail sector, and a clear long-term vision to disrupt the large and highly fragmented auto market. The company is targeting a dramatic scale-up from approximately 500,000 annual car sales today to three million over the next five to 10 years, leveraging its existing infrastructure and the Adesa acquisition to support this expansion.

Also in the consumer discretionary sector, we established a position in Hilton Worldwide, one of the largest and fastest-growing lodging companies with over 1.25 million rooms today. The company has a robust pipeline of 500,000 rooms in development and supporting its 6%–7% annual growth target. With high-margin fees from its asset-light franchising and management contracts, strong operating margins and a history of returning capital to shareholders through share buybacks, Hilton's scale, brand strength and resilient business model position it for solid long-term growth.

Outlook

The first half of 2025 was a memorable one, to say the least. We grappled with the continued war in Ukraine, another war in the Middle East, a trade war, DOGE, an unclear inflation picture, a rising deficit, a falling dollar, Trump versus Powell, oil price volatility, the One Big Beautiful Bill, tax policy changes and volatile interest rates, all of which factored into the S&P 500's fall from over 6,100 to below 5,000, only to rebound to a new high in June.

Despite all this, we remain steadfast in our focus on high-quality companies with strong balance sheets, attractive cash flows and compelling growth prospects. One of the major areas of current focus is within IT, where we are hard at work determining who will be the relative winners of the AI investment cycle. We believe the quickly evolving nature of AI means that it is even more important to adhere to our investment philosophy and process to ensure that we capitalize on attractive opportunities while avoiding the losers.

Portfolio Highlights

The ClearBridge Mid Cap Growth Strategy underperformed its benchmark during the second quarter. On an absolute basis, the Strategy had positive contributions across 10 of the 11 sectors in which it was invested. The leading contributors were the IT and industrials sectors, while the energy sector was the sole detractor.

On a relative basis, overall stock selection detracted from performance. Specifically, stock selection in industrials, IT, financials, health care and communication services sectors as well as an overweight to the consumer staples sector weighed on performance. Conversely, stock selection in the consumer staples, energy and materials sectors and underweights to the IT and consumer discretionary sectors proved beneficial.

On an individual stock basis, the biggest contributors to relative returns during the quarter were Rubrik, MercadoLibre, AppLovin, Vistra and Vertiv. The largest detractors from relative returns were Palantir, Copart, Cloudflare, Axon and Baker Hughes.

In addition to the transactions mentioned above, we initiated new positions in Pure Storage and Cloudflare in the IT sector, Shift4 Payments in the financials sector, Howmet Aerospace and Comfort Systems in the industrials sector, Cencora in the health care sector as well as Light & Wonder, Wingstop and Royal Caribbean in the consumer discretionary sector. We exited positions in Nu Holdings in the financials sector as well as Workday, Globant and Marvell Technology in the IT sector.

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