



## SMID Cap Growth Strategy



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### Key Takeaways

- ▶ SMID growth equities looked past a complicated macro backdrop to deliver one of their strongest quarters in recent memory, led by enthusiasm for AI infrastructure beneficiaries and higher-beta momentum stocks.
- ▶ The Strategy underperformed its benchmark as a furious rally, primarily in semiconductors and other AI winners, outpaced the Strategy's AI exposure.
- ▶ While disruption and macro uncertainty remain elevated, a broader cyclical recovery and AI adoption beyond IT and industrials can create opportunities for diversified, bottom-up stock selection.

### Market Overview

Small and mid cap (SMID) growth equities experienced one of the strongest quarters in recent memory in the second quarter. The Russell 2500 Growth Index advanced 24.0% during the period, an exceptionally rare occurrence that has happened only four times over the past two decades. Prior instances largely followed severe market dislocations, including the rebound from the Global Financial Crisis in 2009 and the COVID-related recoveries of 2020. By contrast, this quarter's rally followed only a modest first-quarter decline, underscoring the unusual speed and magnitude of the move.

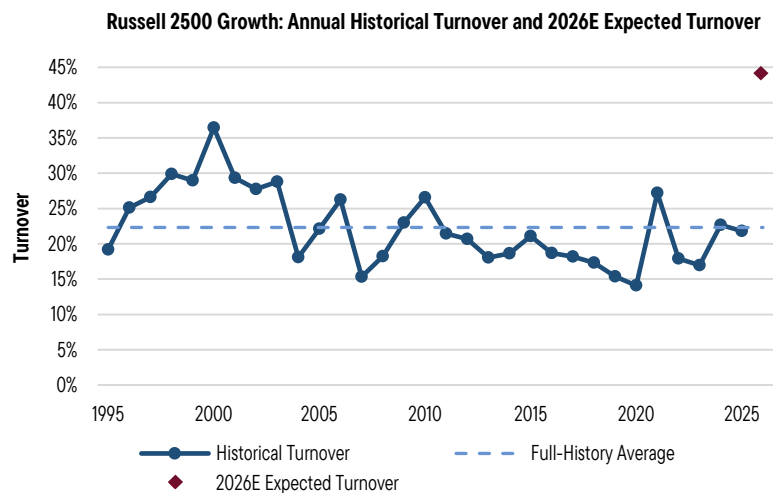
While market leadership broadened beyond mega cap technology from a capitalization perspective, benchmark-level performance narrowed back toward a familiar set of drivers. Artificial intelligence (AI) remained the dominant market narrative, though leadership continues to rapidly chase the next bottlenecks across memory, optical networking, CPUs and high-performance compute capacity. Additionally, some pockets of more cyclical sectors also participated as investors embraced companies with leverage to an improving industrial backdrop.

The rally was striking at the factor level, with performance led by the highest-beta companies: businesses with lower returns on equity, faster expected growth, elevated valuations and, in many cases, limited or no current earnings. This created a challenging backdrop for active management broadly, and for quality-oriented growth strategies in particular, as many of the strongest-performing areas of the benchmark were segments that disciplined bottom-up investors have historically approached with selectivity.

The strength of the AI infrastructure investment cycle overcame a complicated macro backdrop that included geopolitical volatility, a spike and subsequent fade in oil prices, renewed inflation concerns and

a sharp shift in expectations for monetary policy. Entering the year, investors expected Federal Reserve rate cuts; by quarter-end, market debate had shifted toward the potential for rate hikes later in 2026. The quarter also included one of the most significant Russell rebalances in several decades, with elevated turnover nearly twice the historical average, the graduation of several perceived AI winners out of the SMID growth universe, a material increase in biotechnology representation and a larger cohort of lower-quality growth companies entering the benchmark (Exhibit 1).

Exhibit 1: A Russell Rebalance of Historic Proportions



As of June 30, 2026. Source: London Stock Exchange Group, ClearBridge Investments

### Portfolio Performance

The ClearBridge SMID Cap Growth Strategy generated double-digit absolute returns but underperformed the soaring Russell 2500 Growth Index benchmark during the quarter, with underexposure to the highest-beta AI infrastructure winners as well as weakness in health care and consumer discretionary sectors more than offsetting strong contributions from several AI-related and biotechnology holdings.

Information technology (IT) was a meaningful source of relative weakness despite strong performance from several individual holdings. Semiconductor companies including Allegro MicroSystems and Lattice Semiconductor, along with networking and semiconductor capital equipment providers such as Coherent, Credo Technology and Onto Innovation, benefited from demand tied to AI infrastructure, semiconductor cycle improvement, automation and cutting-edge AI applications. However, these gains failed to keep pace with the extraordinary returns within the benchmark, as roughly one-third of semiconductor constituents doubled or more during the quarter.

Despite reducing broad-based software exposure, select holdings weighed on results, including Wix.com, a website creation, e-commerce and business management software platform. Shares remain caught up in concerns around AI-driven disruption, the investment

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required to develop its own AI capabilities and decelerating growth in the core business.

The Strategy saw strength in long-standing investments outside of IT that offered participation in the AI infrastructure investment cycle alongside competitive differentiation. In industrials, Comfort Systems benefited from demand for complex mechanical, electrical and modular construction capabilities tied to data center and manufacturing buildouts. We profitably exited the name during the quarter. Bloom Energy also participated in enthusiasm for alternative power solutions as investors focused on rising electricity requirements for data centers and AI infrastructure.

Within health care, weakness in provider and select medical technology holdings offset otherwise solid contributions from biotechnology and life sciences tools holdings. Ensign Group, a skilled nursing facility operator, was pressured after regulatory and short-seller-related concerns emerged, reducing visibility and causing us to exit the position. Insulet, the maker of insulin patch pumps, also detracted amid broad medtech weakness, minor product recall and quality issues and rising concerns around potential future competition.

Biotechnology, however, was a bright spot, with multiple holdings delivering strong performance. TG Therapeutics, a commercial-stage biopharmaceutical company focused on therapies for multiple sclerosis, contributed following greater than anticipated growth for its key drug, Briumvi, as well as positive clinical data for a subcutaneous version of the therapy that could expand its addressable market.

Consumer discretionary results were primarily driven by weakness in Chewy, a leading online retailer of pet food, pet supplies and related services. Shares were pressured by mixed end-market growth trends and investor concerns that the company could be an AI loser, despite otherwise solid company-specific execution. However, we view those concerns as overstated given Chewy's competitive positioning, customer purchasing dynamics and margin expansion opportunities.

### **Portfolio Positioning**

In IT, we added Fabrinet and MACOM Technology Solutions to increase exposure to AI networking and data connectivity growth. Fabrinet is a leading contract manufacturer for optical communications components used in data center and telecom networks, where AI compute demand is driving a generational upcycle, while MACOM's compound semiconductor expertise offers differentiated exposure to AI, defense and satellite communications.

We added several new positions in the industrials sector indexed to AI power demands and secular growth in defense spending. Argan — a leading engineering, procurement and construction firm — is positioned to benefit from a multi-year buildout in natural gas and solar power generation, limited industry competition and growing demand for new electricity generation. ATI is a vertically integrated specialty materials provider with strong pricing power exposed to the attractive growth dynamics in many subsegments of aerospace and defense.

Health care activity included a new position in Guardant Health. Guardant's liquid biopsy platform should benefit from broader adoption of blood-based cancer testing across key end markets.

On the sell side, we exited specialty insurance distributor Ryan Specialty due to softer insurance conditions, margin pressure and AI-related uncertainty; Silicon Laboratories following its proposed acquisition by Texas Instruments; cosmetics and skin care maker e.l.f. Beauty as execution and innovation concerns weakened the thesis; and medical device company Penumbra following its announced acquisition by Boston Scientific.

### **Outlook**

Looking ahead, the investment landscape remains characterized by an accelerating pace of disruption, a generational technology investment cycle and rapid shifts in perceived winners and losers. However, we see cautiously optimistic signals of broader cyclical recovery in select areas of industrials, health care and consumer-oriented businesses that were largely left behind during the recent period of narrow AI and reshoring enthusiasm.

Debates around AI capital spending and which elements of the supply chain capture the most economic return are likely to persist, and this technological arms race appears likely to dominate the market's attention. Importantly, the next phase of opportunity may extend beyond the companies building AI infrastructure to the companies using AI effectively. Businesses in transportation, biotechnology, financial services and other industries may be able to unlock cost savings, productivity gains or new revenue opportunities that are not yet fully reflected in stock prices. In a market where leadership can change quickly and narratives often move faster than fundamentals, our bottom-up discipline is designed to separate durable growth from temporary momentum.

### **Portfolio Highlights**

The ClearBridge SMID Cap Growth Strategy underperformed its Russell 2500 Growth Index benchmark during the second quarter. On an absolute basis, the Strategy had positive contributions from nine of the 10 sectors in which it was invested (out of 11 total). The largest contributors were the IT and industrials sectors, while the real estate sector was the sole detractor.

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

On an individual stock basis, the biggest detractors from relative returns were Wix.com, BWX Technologies, Chewy, Burlington Stores and not owning Astera Labs. The biggest contributors were

Allegro MicroSystems, Bloom Energy, Coherent, Onto Innovation and Credo Technology.

In addition to the transactions mentioned above, we initiated positions in Arxis, Sterling Infrastructure, and Woodward in the industrials sector, SiTime, Cipher Digital, D-Wave Quantum and DigitalOcean in the IT sector, Liftoff Mobile in the communication services sector and Axsome Therapeutics, Vaxcyte and Kymera Therapeutics in the health care sector. We exited positions in FTAI Aviation and Rocket Lab in the industrials sector, Colliers International in the real estate sector, Chime Financial in the financials sector, Doximity in the health care sector and IonQ in the IT sector.

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