



A Franklin Templeton Company



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## Mid Cap Strategy

### Key Takeaways

- ▶ Mid cap equities experienced a challenging environment in the fourth quarter, marked by heightened dispersion and uneven leadership.
- ▶ The Strategy underperformed its benchmark as broad-based market headwinds and uneven earnings reactions weighed on results, with strength in consumer discretionary partially offsetting pressure across several other sectors.
- ▶ We believe improving clarity around policy, business investment and economic conditions is laying the groundwork for a more favorable backdrop for active stock selection.

### Market Overview

Mid cap equities were flat to slightly positive in the fourth quarter, with the Russell Midcap Index returning 0.16%. Market performance was shaped less by macroeconomic shocks and more by an increasingly narrow set of investor preferences, particularly late in the quarter, as momentum faded in several growth-oriented areas that had driven returns earlier in the year. Earnings reactions became more uneven, with stocks often moving sharply irrespective of underlying execution, reinforcing a market dynamic where sentiment and positioning frequently outweighed fundamentals. While certain cyclical and industrial recovery narratives stalled, dispersion beneath the surface of index-level results remained elevated, underscoring both the challenges and opportunities for active, company-specific investing.

Looking at 2025, markets were defined by sharp rotations, episodic volatility and an unusually concentrated focus on a narrow set of growth themes. For much of the year, if performance was not tied to artificial intelligence or its immediate beneficiaries, investor attention was limited, regardless of underlying fundamentals. Early optimism gave way to tariff-related uncertainty and policy concerns in the first quarter, followed by a sharp rebound in the second quarter as trade tensions eased and rate expectations moderated. The third quarter brought renewed confidence as policy uncertainty declined and corporate activity began to normalize, before the fourth quarter saw renewed selectivity and a pause in momentum-driven trades. Against this backdrop, mid cap equities lagged both small and large caps for the year, even as fundamentals across many mid cap businesses quietly improved.

The ClearBridge Mid Cap Strategy underperformed its benchmark for the quarter as broad-based market headwinds and uneven earnings

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Broad-based market headwinds weighed on results, even as fundamentals continued to improve.

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reactions weighed on results, despite solid execution and improving fundamentals across much of the portfolio. While performance pressure was felt across a wide range of sectors, information technology (IT) and real estate were the most notable sources of headwinds, partially offset by strength in consumer discretionary holdings.

IT detracted as investor sentiment toward software businesses weakened amid heightened sensitivity to earnings expectations and concerns around AI-driven disruption. Teledyne Technologies, a diversified industrial technology company, and Bentley Systems, an infrastructure-focused software provider, declined as expectations for near-term acceleration were pushed out. Dynatrace, a provider of application performance monitoring software, also detracted following conservative guidance.

Real estate was another source of pressure, largely driven by the decline in Alexandria Real Estate Equities, a life-science-focused office REIT. The company's stock came under pressure as a slowdown in biopharma research spending and excess laboratory capacity weighed on leasing demand and rental growth expectations. We exited the position as ongoing uncertainty and a dividend cut reinforced our view that a recovery may take longer than previously anticipated.

Consumer discretionary holdings were a bright spot for the portfolio. Light & Wonder, a gaming and entertainment company, rebounded following technical selling pressure related to its relisting to the Australian exchange, creating an attractive entry opportunity. Expedia, a global online travel platform, contributed as improved execution in its consumer business complemented continued strength in its business-to-business segment. New holding Churchill Downs, an owner and operator of gaming and racing assets, advanced as operating trends normalized following earlier weakness tied to the timing of the Kentucky Derby and softer consumer sentiment.

While overall stock selection in industrials and health care weighed on results during the quarter, there were a number of encouraging areas of performance. In industrials, API Group, a provider of safety and specialty services, continued to deliver steady execution, margin improvement and consistent compounding growth. In health care, Argenx, an immunology-focused biotechnology company, advanced on continued commercial execution and pipeline progress.

### Portfolio Positioning

During the quarter, we continued to reallocate capital toward businesses with durable fundamentals, recurring revenue profiles and long-term growth potential that we believe have been underappreciated amid elevated investor concentration. At the same time, we exited positions where evolving industry dynamics or shifting risk-reward profiles warranted a reassessment.

We initiated positions in Casella Waste Systems, a residential waste services provider with a high proportion of recurring revenue, following a transitory selloff tied to minor acquisition integration issues, and Tyler Technologies, a provider of mission-critical software to state and local governments, where a highly recurring revenue model and limited exposure to near-term AI disruption support durable long-term growth.

On the sell side, we exited Corpay, a corporate payments company, as the emergence of stablecoin technologies introduced new uncertainty around portions of its payments business. We also exited DraftKings, a digital sports betting and gaming platform, as the rise of prediction markets introduced additional competitive uncertainty that altered our conviction in the company's medium-term business model.

### **Outlook**

As we look toward 2026, we believe the environment for mid cap equities is becoming incrementally more constructive, though uncertainty remains. The past several years have been characterized by an unusually narrow market, where a small subset of highly visible growth themes attracted the majority of investor attention, while many fundamentally sound businesses across the broader economy were overlooked. In our view, this dynamic contributed to a prolonged period of deferred investment and cautious decision making outside of a limited number of favored areas.

We are increasingly encouraged by signs that this imbalance may begin to ease. Improving clarity around policy, a more accommodative interest rate backdrop and supportive tax dynamics have the potential to reaccelerate business investment and earnings growth across a wider set of industries. Importantly, this does not require a dramatic shift in economic conditions; rather, a normalization of capital allocation and decision making could meaningfully benefit many mid cap companies with durable cash flows, attractive valuations and clear paths to improvement.

From a portfolio perspective, we are deliberately not positioning the portfolio for a single outcome. Instead, we are actively reallocating capital from areas where expectations appear more fully priced toward businesses that we believe have been underappreciated despite solid fundamentals. With dispersion elevated and valuation gaps wide across sectors such as industrials, health care, utilities and financials, we believe patient, bottom-up stock selection and balanced portfolio construction are well suited to the evolving opportunity set.

### **Portfolio Highlights**

The ClearBridge Mid Cap Strategy underperformed its Russell Midcap Index during the fourth quarter. On an absolute basis, the Strategy had contributions from two of the 11 sectors in which it was invested during the quarter. The contributors were the consumer discretionary

and health care sectors, while the IT and real estate sectors were the chief detractors.

On a relative basis, overall stock selection detracted but was slightly offset by a positive contribution from sector allocation results. Stock selection in the IT, real estate, industrials, financials, utilities, consumer staples, health care and communication services sectors weighed on performance. Conversely, stock selection in the consumer discretionary sector and an overweight allocation to the IT sector benefited performance.

On an individual stock basis, the largest detractors from relative returns were Alexandria Real Estate Equities, Resideo Technologies, Chewy, Teledyne Technologies and Performance Food. The largest contributors to relative returns were Light & Wonder, Expedia, Api Group, Churchill Downs and not owning Roblox.

In addition to the transactions listed above, we initiated new positions in XPO in the industrials sector, CompoSecure in the IT sector and Doximity in the health care sector. We exited positions in PTC in the IT sector, Pinterest in the communication services sector, BJ's Wholesale Club in the consumer staples sector and Everest in the financials sector.

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