

## Aggressive Growth Strategy



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### Key Takeaways

- ▶ Easing financial conditions sparked an equity rally and led to improving market breadth, with mid cap stocks outperforming their large cap counterparts.
- ▶ We were encouraged by contributions from several different areas of the portfolio, evidence of the balance we have sought to build over the last several years.
- ▶ The recent market upswing enabled us to lock in profits across some of our larger cap positions and put the proceeds to work across four newer positions.

### Market Overview

Stocks rose strongly in the fourth quarter, boosted by plunging bond yields and growing optimism that the U.S. economy will pull off a soft landing. Signs of cooling inflation and a slowing labor market not only reversed a two-year climb in yields but also increased the likelihood that the Federal Reserve had completed its tightening cycle, sending the S&P 500 Index 11.69% higher.

With the 10-year Treasury yield declining 70 basis points (bps) during the quarter, growth remained in favor among larger cap stocks with the Russell 3000 Growth Index rising 14.09% and outperforming the Russell 3000 Value Index by 426 bps. Easing financial conditions also led to improving market breadth, with the Russell Midcap Growth Index rising 14.55%.

The ClearBridge Aggressive Growth Strategy outperformed its Russell 3000 Growth Index benchmark for the quarter. While market cap size was a positive contributor to relative performance, the Strategy also had strong stock selection, evidenced by outperformance as compared to the Russell Midcap Growth Index as well. We are encouraged that a number of different areas of the portfolio positively contributed during the quarter, an indication that the balance we have been seeking to build over the last several years is working.

Several newer and existing enterprise software holdings showed particular strength in the quarter, as growth stocks surged in December on the likelihood that interest rates had peaked. CrowdStrike, HubSpot and ServiceNow were among the top performers, supported by the efficacy of innovative product offerings and business models in an uneven economic environment. The performance of these faster growing positions in IT was complemented by contributions from longtime larger cap holdings Broadcom and Vertex Pharmaceuticals. Meanwhile, a handful of

companies that had struggled earlier in the year due to supply chain issues or business model transitions, many of which we consider cyclical or improving growth stories, began to deliver better results. This included high-end electrical component maker TE Connectivity, design software developer Autodesk and defense contractor L3Harris Technologies.

Health care disruptors Insulet and Doximity, which derated earlier in the year due to negative implications of positive GLP-1 trials on medical device utilization and lower advertisement spending by biopharmaceutical companies, respectively, saw solid rebounds. Insulet, a maker of insulin pumps for diabetes patients, was caught up in the debate over the long-reaching consequences of GLP-1 therapeutics significantly curbing appetites and driving a more fit populace, with speculation around growth rates for a variety of businesses ranging from medical devices to restaurants to food distributors & manufacturers. The November release of further data from the SELECT study painted a more balanced picture on the impact to the rest of the health care sector, removing some pressure on the most impacted areas. Additionally, the stock was propelled by strong near-term fundamentals, with better than expected results in its most recent quarter due to continued momentum from its Omnipod 5 product cycle.

### **Portfolio Positioning**

The recent market upswing enabled us to harvest profits from some of our larger cap holdings and put the proceeds to work across four newer positions. We added significantly to Cintas, a position initiated late in the third quarter. Cintas maintains a leading position in a fragmented, \$40 billion market for uniform rental and facilities services. The company's scale gives it better purchasing power, route density and technology, which have historically led to better price and service levels. Its position also enables industry-leading retention rates and sustainably higher returns on invested capital. Finally, Cintas has demonstrated a strong track record of improving margins. This addition not only supports our efforts to increase the aggregate quality and growth of the portfolio, but also acts to further diversify our industry exposures.

We purchased W.W. Grainger, the largest industrial MRO ("maintenance, repair, and operations") distributor in North America. Like Cintas, Grainger is a share gainer in a large and fragmented market, with less than 10% share of the addressable market for their direct, "high touch solutions" business estimated at more than \$165 billion. The company has also barely scratched the surface with its online "endless assortment" platform, Zoro.com, which targets an even larger market. In addition to its growth and profit potential, we are attracted to Grainger's strong balance sheet and improved capital allocation under its current management.

We also took advantage of weakness in payroll providers due to fears of slowing growth to initiate a position in Paylocity. The company delivers payroll, HR, learning, benefits and recruiting solutions through an integrated cloud platform that caters to mid-sized companies and is gaining share from both legacy and regional providers in an addressable market of over 1.3 million businesses. Paylocity has more than doubled its average revenue per user since its IPO, demonstrating expansion potential within its customer base. Already profitable, we expect Paylocity to deliver healthy margin expansion in the years ahead.

New addition MongoDB, in the IT sector, offers a leading modern database platform that handles all data types and is geared toward modern Internet applications, which constitute the bulk of new workloads. Database is one of the largest and fastest growing software segments, and we believe it is early innings in the company's ability to penetrate this market. MongoDB is actively expanding its potential market by adding ancillary capabilities like vector search for AI applications, streaming and real-time data analytics. The company reached non-GAAP profitability in 2022, and we see significant room for improved margins as revenue scales.

### Outlook

Market leadership could see significant shifts in the year ahead depending on the direction of the economy and liquidity conditions. Signs of moderating inflation and the likelihood of a Fed pause have already started to invigorate smaller capitalization companies and we believe a more conducive environment for M&A activity could also act as a catalyst for broader market participation.

We believe the Strategy is well-positioned to benefit from both sides of pickup in deal activity. Larger cap holdings like Broadcom and AbbVie, for example, have demonstrated strong track records as strategic acquirers. Small and mid cap growth companies that remain undervalued compared to larger stocks, meanwhile, could be attractive targets for those large caps seeking new sources of growth.

Given our commitment to balance and active approach to portfolio construction, we remain opportunistic in seeking out good growth businesses that can improve the quality and growth profile of the portfolio. High on our watchlist heading into the new year are companies in the consumer discretionary sector as well as financials which are less interest-rate sensitive.

### Portfolio Highlights

The ClearBridge Aggressive Growth Strategy outperformed its benchmark in the fourth quarter. On an absolute basis, the Strategy delivered gains across seven of the eight sectors in which it was

invested (out of 11 total). The primary contributor was the IT sector while the consumer staples sector was the sole detractor.

Relative to the benchmark, overall stock selection contributed to performance while overall sector allocation had a negative impact. In particular, stock selection in the IT sector was the main driver of performance while selection in the health care, financials and industrials sectors and an underweight to consumer discretionary were also beneficial. Conversely, stock selection in the communication services, consumer discretionary and consumer staples sectors and an overweight to health care detracted from performance.

On an individual stock basis, the leading absolute contributors were positions in Broadcom, CrowdStrike, Vertex Pharmaceuticals, Autodesk and TE Connectivity. The primary detractors were Comcast, TKO Group, Biogen, Diageo and Paylocity.

In addition to the transactions mentioned above, we closed a position in Liberty Broadband in the communication services sector.

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