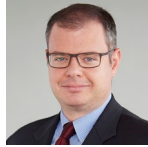


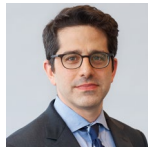
ClearBridge

Investments

Dividend Strategy



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Key Takeaways

- ▶ Over the last year, our confidence in economic expansion has been married with an awareness that a recovering economy must ultimately lead to tighter monetary policy and higher interest rates.
- ▶ We are overweight financial companies that should benefit from rising rates and generally underweight extremely high-multiple stocks that could be at risk should rates rise.
- ▶ We focus on industry structure, market position and intellectual property to select companies that should be able to raise prices to offset rising costs.

Market Overview and Outlook

For the last 11 months, we have believed that both the U.S. economy and corporate earnings would see terrific growth. It did not require a PhD in economics to devise this forecast. In November 2020 the world learned that COVID-19 vaccines were highly effective and that the Democratic Party would control the presidency, the House and the Senate (by the slimmest of margins). The vaccines ensured the pandemic would end. The Democratic sweep suggested the fiscal spigots would remain open. These two forces, combined with the easy comparisons against a historically weak 2020 economy, all but ensured that 2021 would be a barn burner.

The first half of the year unfolded as expected. Nominal GDP expanded 5.88% and corporate earnings rose 15.11% in the first half of 2021. In the third quarter, however, our thesis was tested. The advent of the Delta variant raised questions about the world's ability to put COVID-19 in the rearview mirror. The emergence of breakthrough cases marked a significant shift. Vaccinated people were again at risk of contracting and spreading the virus. For investors, the question became: was Delta a gamechanger that would upend the economic recovery or an obstacle that would be overcome?

We concluded quickly, though not hastily, that Delta likely represented a speed bump rather than a course change. Delta may mean the disease is never eradicated, but given the effectiveness of the vaccines at preventing hospitalization and death, it should be controllable. As vaccination penetration increases further, cases should wane. An optimistic reading of the

Strong GDP should provide a constructive backdrop to corporate earnings and dividend growth, though the withdrawal of Fed stimulus could prove volatile.

numbers would seem to suggest the Delta wave of cases may already have peaked.

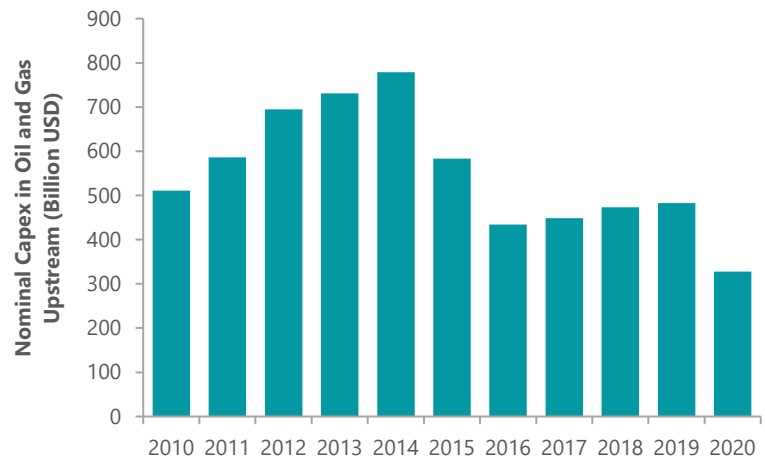
Over the last year, our confidence in economic expansion has been married with an awareness that a recovering economy must ultimately lead to tighter monetary policy and higher interest rates. Indeed, during the first quarter of 2021 Treasury rates rose 70 basis points as the market began to discount this dynamic.

The emergence of Delta in July, however, drove a decline in interest rates. Investors lowered their growth expectations and pushed out their timelines for Fed rate hikes. This decline in rates and increased economic uncertainty sparked an intra-quarter trend reversal within the market. Technology stocks, which earlier lagged as rates rose and the economy ripped, came back into favor. Information technology (IT) benefits from work-from-home and lower interest rates flatter the multiples investors will pay for their higher growth rates. This trend then reversed itself in September as the cresting of the Delta wave, rising commodity prices and hawkish commentary out of the Fed sparked a selloff in bonds that sent interest rates higher and tech stocks lower.

As the world emerges from COVID-19, markets will have to be weaned off the emergency medicine central banks pumped into the system. While we expect strong GDP to provide a constructive backdrop to corporate earnings and dividend growth, we also worry that the withdrawal process from Fed stimulus could prove volatile. We are overweight financial companies that should benefit from rising rates and generally underweight extremely high-multiple stocks that could be at risk should rates rise. This served the Strategy well in the third quarter, with strong performance from Blackstone, which continues to execute well on asset gathering and is benefiting from broadening ownership as it starts to be incorporated in major global indexes, as well as insurer American International Group, whose underwriting overhaul (boosted by the commercial pricing cycle) is beginning to take hold.

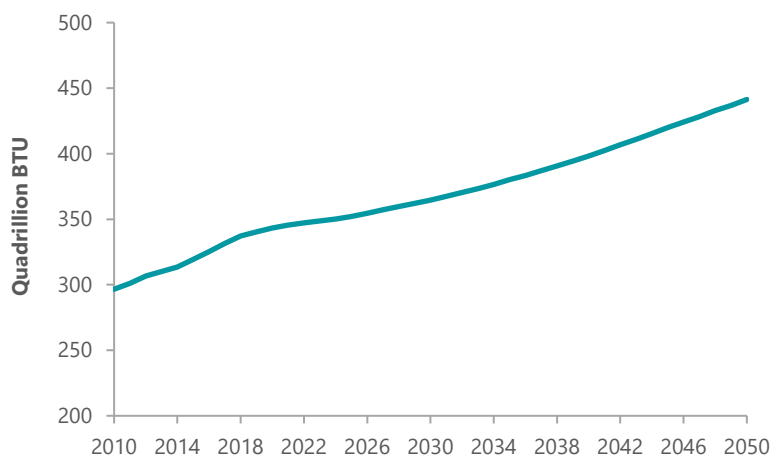
Rising commodity prices and supply chain disruptions have presented additional challenges to companies and investors over the last year. During the depths of lockdowns companies cut capacity sharply. As the economy recovered, demand quickly overwhelmed the remaining supply. Prices rose sharply and shortages, previously rare phenomena, became the norm. Soaring energy and metals prices reflect short-term imbalances, but also longer-term underinvestment in supply. Years of weak and volatile energy prices, combined with increasing ESG pressures, have led to dramatic reductions in global energy investment (Exhibit 1). While we are enthusiastic believers in both the need and eventuality of decarbonization, a clear-eyed assessment of the situation reveals oil and gas will be here for decades. Indeed, demand for both is still growing (Exhibit 2).

Exhibit 1: Falling Oil and Gas Investment



As of May 26, 2020. Source: IEA.

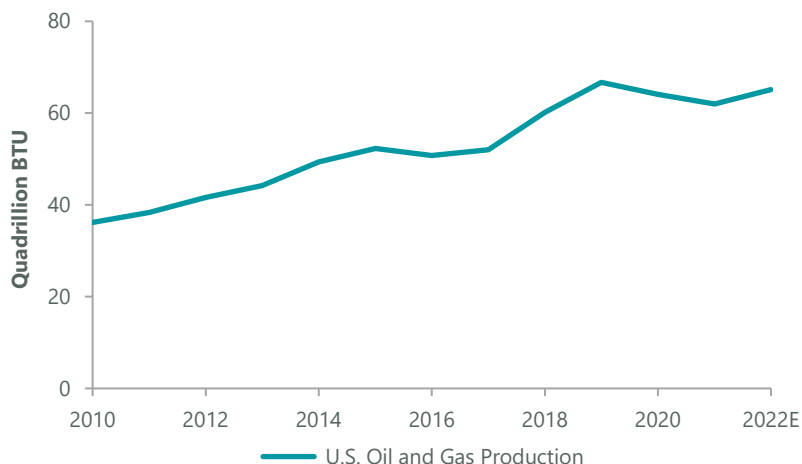
Exhibit 2: Petroleum, Liquids and Natural Gas Demand Expected to Grow



As of Sept. 30, 2021. Source: U.S. Energy Information Administration.

We are meaningfully overweight energy, particularly within North American energy infrastructure. Enbridge and Williams, our two infrastructure holdings, possess crown jewel infrastructure assets. They each deliver meaningful proportions of the overall energy produced and consumed in North America. Their revenues are backed by long-term contracts with high-quality counterparties and have little direct commodity price exposure. Their growth has been driven by the increasing production of North American energy. The advent of unconventional oil and gas production (oil sand and shale) has made North America a low-cost competitor on a global basis. We expect strong North American production to be an enduring feature of global energy supply for decades to come (Exhibit 3).

Exhibit 3: Total U.S. Energy Production Expected to Rebound in 2022



As of Aug. 31, 2021. Source: Department of Energy, ClearBridge estimates.

Over the last year we have also added a position in Pioneer Natural Resources, a best-in-class producer in the Permian Basin. We added Pioneer as we anticipated rising commodity prices and sought more direct leverage to that trend. Our overweight to energy has benefited our performance this year, in particular through the first half of the year, and we believe the sector, still less than 3% of the S&P 500, remains underinvested and attractive going forward.

While the energy portion of our portfolio has benefited from rising commodity prices, other portions of our portfolio (and the economy) have been challenged by rising input prices. We see this in materials companies like PPG and Ecolab and in our consumer staples holdings Procter & Gamble and Nestle. In other sectors (indeed in all sectors), we also see rising labor costs. These cost pressures present margin headwinds to companies as they struggle to raise prices to offset these pressures.

Our companies are not immune to cost pressures, but we believe for most of them these impacts are largely temporary. Our underwriting process emphasizes companies with pricing power. We focus on industry structure, market position and intellectual property to select companies that should be able to raise prices to offset rising costs. To be sure, raising prices is not easy and does not happen in lockstep with rising input costs. But over time we expect most of our companies should be able to offset most of these cost pressures.

Whether this rising cost phenomenon will prove temporary and short lived or something more structural and onerous is a topic of much debate among economists and investors. Only time will tell. We have purposefully constructed a portfolio of companies that, by and large, should be able to raise prices if the world enters an inflationary phase.

During the quarter we continued to trim Blackstone as the stock made new highs. We remain enthusiastic about the company's prospects and continue to be large shareholders, but the risk-reward at current levels is balanced and we sought to manage the overall position size within the portfolio. In utilities we completed the exit of WEC Energy Group to fund our newer position in Sempra Energy. WEC is a solid, well-run utility but trades at a meaningful premium to the group despite similar long-term growth expectations. Sempra embodies a similarly, well-positioned utility but trades at a meaningfully lower valuation.

We are bottom-up investors focused on assembling a diverse portfolio of high-quality companies that can compound dividends at attractive rates over the long term. The portfolio is designed to navigate any environment. The Strategy has generally participated nicely in up markets and protected capital in down markets such as we experienced in the third quarter. As the world navigates its emergence from COVID-19, we believe we are well-positioned.

Portfolio Highlights

The ClearBridge Dividend Strategy outperformed its S&P 500 Index benchmark during the third quarter. On an absolute basis, the Strategy had gains in six of 11 sectors in which it was invested for the quarter. The main contributors to Strategy performance were the financials and IT sectors. The materials and industrials sectors, meanwhile, were the main laggards.

On a relative basis, stock selection contributed positively to performance for the quarter, while sector allocation detracted. In particular, stock selection in the financials and industrials sectors aided relative returns. Conversely, stock selection in the communication services sector as well as an overweight to the materials sector detracted.

On an individual stock basis, the main positive contributors were Blackstone, American International Group, Microsoft, Oracle and Apple. Positions in PPG Industries, United Parcel Service, Union Pacific, Mondelez International and Visa were the main detractors from absolute returns in the quarter.

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