ClearBridge Investments

All Cap Growth Strategy

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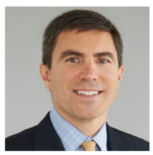

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Key Takeaways

- We were opportunistic in the face of recent market volatility, using pullbacks to initiate eight new positions as well as add to recently established ones.
- As liquidity is removed from the economy, we believe the Strategy is well-positioned for a return to normalized economic growth and equity returns where protecting capital through periods of volatility will be a significant contributor to performance.
- We remain committed to building a portfolio of our best growth ideas for the next three to five years and that is reflected in a dynamic level of trading activity.

Market Overview

Mega cap growth stocks continued to lead in a fourth quarter that saw equities look past the emergence of a new COVID-19 variant, the highest inflation prints in decades and a hawkish shift by the Federal Reserve to deliver solid returns. The S&P 500 Index gained 11.03% and the benchmark Russell 3000 Growth Index advanced 10.89% as robust gains for several of the FAAMG stocks obscured weakness across the majority of stocks in the index. Growth equities maintained the leadership mantle they took back in the spring, with the Russell 3000 Growth Index outperforming its value counterpart by 335 basis points. The benchmark finished the year up 25.85% compared to a 25.37% gain for the Russell 3000 Value Index.

Volatility spiked to its highest levels since January, with the Omicron variant emerging as the latest threat from the COVID-19 pandemic. Meanwhile, the Fed gave its strongest signals since the start of the pandemic that accommodative monetary policy would soon end. At its December meeting, Fed Chair Jerome Powell announced that the central bank would be accelerating its tapering of government bond purchases and its latest dot plot projected three interest rates increases in 2022, a much more aggressive tightening program than expected just three months ago.

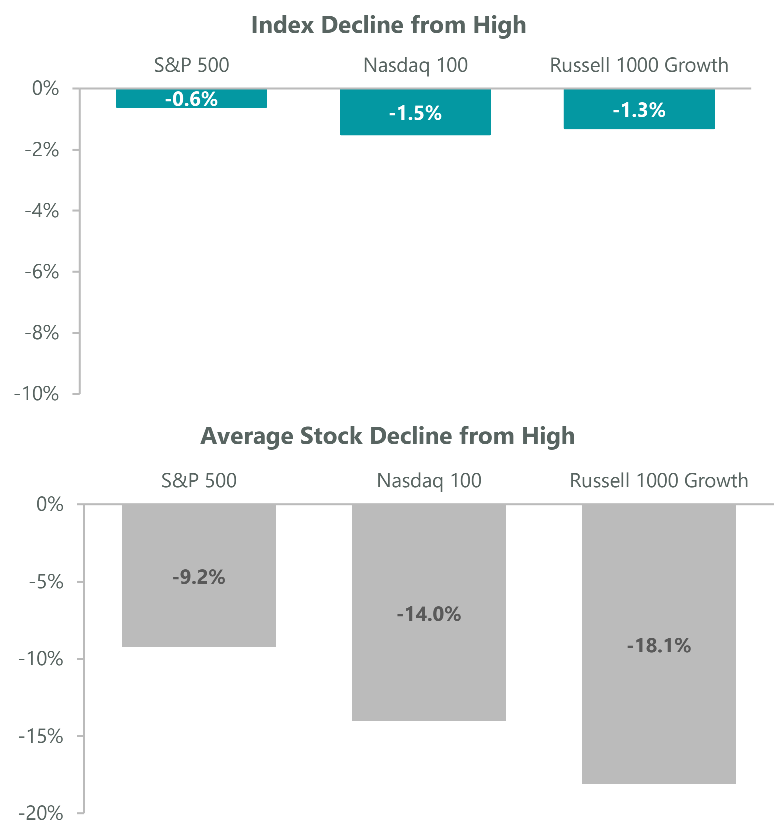
On a sector basis, materials (+15.66%), information technology (IT, +15.43%) were the best performers in the benchmark. Consumer discretionary (+10.48%) mostly kept pace while communication services (+2.17%), health care (+2.86%), energy

(+4.18%), financials (+5.87%) and industrials (+9.74%) lagged the Russell 3000 Growth Index.

Amid these volatility drivers, the mega cap growth stocks that dominate the benchmark continued to uniquely act both offensively and defensively as they have through most of the pandemic. The result is a Russell 3000 Growth Index that becomes more concentrated every quarter the FAAMGs (and now Tesla) outperform. In the fourth quarter, Apple and Microsoft — positions where the Strategy is underweight — were the big winners, with Apple's market capitalization approaching the $3 trillion mark.

This outsize mega cap performance has weighed on Strategy performance and obscures a broader market where most growth stocks, as represented by the Nasdaq 100 Index and the Russell 1000 Growth Index, are well off their 52-week highs (Exhibit 1). Higher-valuation names in the market have been especially susceptible to sharp selloffs on any perceived negative news or when results disappoint, highlighting the importance of actively managing higher risk holdings. During the fourth quarter, most of the Strategy's primary detractors were stocks where we have sized positions on the lower side based on our fundamental assessment of each company's risk/reward profile.

Exhibit 1: Average Growth Stock Has Already Corrected



High for S&P 500 – Dec. 29, 2021; Nasdaq 100 – Nov. 19, 2021; Russell 1000 Growth – Dec. 27, 2021. Stock declines are an average of the individual declines from each stock's all-time high. Data as of Dec. 31, 2021. Source: FactSet.

Weakness among our holdings in the communication services sector was the other detractor to performance. Twitter shares sold off following weaker than expected third quarter results, but under new leadership, we see the potential for improved execution and performance as live events and entertainment return to pre-pandemic levels. Comcast was hurt by tepid subscriber growth in its broadband business but demonstrated strong growth in free cash flow, positioning the company for accelerated capital return going forward. Sea Limited, a leading emerging markets provider of e-commerce, digital payments and gaming services, was a detractor from performance as investors became more focused on the pace of operating losses in its growth segments and on fundamentals of the gaming segment. This despite Sea more than doubling its revenue in the third quarter and raising e-commerce guidance for the third time in 2021.

Portfolio Positioning

We took advantage of market volatility in the fourth quarter, using pullbacks to initiate eight new positions and add to recently established ones while closing another eight positions Seeding the Strategy with disruptive growth companies and broadening out the portfolio's industry weightings have been central to our repositioning efforts in 2021. To this end, we added two new disruptors in the quarter: Etsy and CrowdStrike Holdings.

Etsy operates a number of online marketplaces with its flagship brand, Etsy.com, an e-commerce destination for craft and artisan goods. We see the company's scaled, two-sided network and focus on unique and special goods as competitive advantages. We believe Etsy has a long runway for growth ahead as it captures a greater share of the very large and growing global retail market. We view Etsy as a differentiated, early stage way to participate in the secular growth of e-commerce. We are also attracted to the company's capital light business model and strong and improving profitability profile. Furthermore, our position increases our exposure to the consumer discretionary sector, where we have historically had less exposure.

CrowdStrike is a leading cybersecurity software provider focused on next-generation endpoint protection. The company is a key beneficiary of the rise in security threats for enterprises globally and a needed solution to allow today's hybrid work environment to function securely. We see a long runway for growth ahead as CrowdStrike continues to not only take share from legacy players in the large and growing market for endpoint security, but also to consolidate even larger portions of the security market. The company is profitable today, though we still see room for adjusted operating margins to increase meaningfully over time. Likewise, our position helps to close our significant underweight to the IT sector, in particular adding exposure to software and services.

In health care, we are looking beyond biopharmaceuticals to other promising areas like life sciences, tools and lab services.

PayPal, a platform and provider of digital and mobile payment services through brands including Venmo, enhances our exposure to digital payments, e-commerce and fintech; nascent markets with penetration rates accelerating globally. The pandemic pulled forward growth of digital payments, which was further accelerated by PayPal's entrance into cryptocurrency and buy now, pay later (BNPL). Shares recently declined 40% from their 52-week high due to competitive concerns and disruptions to consumer spending, providing an attractive entry point. PayPal is trading at its pre-pandemic multiple while its long-term growth drivers remain intact and it has increased innovation at both Venmo and core PayPal, adding new experiences around shopping and investing that we expect to positively contribute to growth in users and average revenue per user over the next five years.

Nike is another play on e-commerce as well as the anticipated growth in consumer spending as we learn to live with COVID-19. After selling out of the stock in 2016 due to competitive concerns, we were motivated to repurchase shares because of optimism around a new management team's focus on accelerating Nike's shift toward e-commerce and direct-to-consumer (DTC) distribution. Near-term supply chain issues in Vietnam and retail weakness in China that we see as ephemeral provided a good buying opportunity. We do not believe the market is giving proper credit to Nike's potential to deliver attractive, high-single-digit revenue growth while delivering operating margin expansion as more merchandise is sold direct. Nike is also still under-indexed to the women's category, which we see as a significant ongoing catalyst.

Health care also provides a good example of industry diversification as we look beyond our historical foundation in biotechnology and pharmaceutical companies to other promising areas like life sciences, tools and lab services. We recently added Charles River Laboratories, a leading drug discovery, non-clinical development and manufacturing organization which serves a large and growing market that is being driven by research & development/biologics manufacturing and increased outsourcing. The company is also well-positioned to benefit from rapid growth in cell and gene therapies on the heels of recent M&A activity. The business is a solid free cash flow generator and should continue to see further operating leverage on the back of topline growth.

Intuitive Surgical, a maker of robotic instruments for soft tissue surgery, was another new health care addition. The market for soft tissue procedures is enormous, including those performed with the aid of the company's DaVinci machines, whose three-dimensional imaging capabilities require smaller incisions, resulting in less nerve damage and bleeding and shorter patient stays. DaVinci machines are a $1 million plus investment by hospitals that can be run continuously through the day, allowing for a greater number of procedures with less physician fatigue. Surgeons are trained on the device from medical school and residency on up. Combining the related training and supply chains, these purchases are very sticky. We see the opportunity for Intuitive Surgical to benefit from more indications for the devices, procedure growth and greater sales in hospitals and surgical centers.

We also established a position in 10x Genomics (TXG). TXG is the dominant player in single cell analysis and enjoys a duopoly in spatial profiling, two emerging areas of scientific research. Though the company is not yet profitable, we are attracted to the business's strong gross margin profile and high degree of visibility as consumables account for 85% of revenue. We also continue to see opportunity for investment in other disruptive areas of health care with large addressable markets, like diabetes.

Outlook

While recent and medium-term performance against the benchmark has been disappointing, stock selection remains solid across sectors outside of momentum technology and shadow tech (large tech-focused companies outside the IT sector). We need more of these contributions, and we need to see the distribution of returns in the market broaden beyond the mega caps. We believe this will begin to happen over the next two or three years as we move past a peak everything economy propped up by a never before seen policy response to the COVID-19 pandemic. The majority of performance in the current cycle has resulted from multiple expansion and a pull forward of growth expectations for the largest stocks most favored by investors. We do not see that trend repeating as we move into the next phase of the cycle but instead see earnings growth as the key driver of returns. The market should begin to reward companies capable of generating organic growth amid the headwinds of higher input costs, higher rates and higher taxes.

Several encouraging macro trends are emerging in support of two areas outside tech: consumer spending and industrial production. Unlike in past recessions and recoveries, consumer balance sheets have actually improved dramatically since the onset of the pandemic. This should feed through to increased spending on services like travel, which should benefit companies tied to the reopening and boost spending on discretionary items. We expect the supply chain constraints contributing to inflation and goods shortages will begin to lessen with an ambitious rebuilding of inventories. This should be a multi-year phenomenon beneficial to quality industrials with high levels of organic growth.

The ramp up of Fed tapering and a steepening yield curve likely mean the best earnings growth going forward will not be in technology. We believe the Strategy is well-positioned for a return to an environment of normalized economic growth and equity returns where protecting capital through periods of volatility will be a significant contributor to performance.

Portfolio Highlights

The ClearBridge All Cap Growth Strategy underperformed its Russell 3000 Growth Index benchmark in the fourth quarter. On an absolute basis, the Strategy generated gains across seven of the eight sectors in which it was invested (out of 11 sectors total). The primary contributors to performance were the IT and health care sectors while the sole detractor was the communication services sector.

Relative to the benchmark, overall stock selection and sector allocation detracted from performance. In particular, stock selection in the communication services and IT sectors and overweights to the health care and communication services sectors were the primary drag on results. On the positive side, stock selection in health care and industrials contributed to relative performance.

On an individual stock basis, positions in UnitedHealth Group, Broadcom, Nvidia, Microsoft and Seagate Technology were the leading contributors to absolute returns during the period. The primary detractors were Twitter, DocuSign, Comcast, Biogen and Guardant Health.

In addition to the transactions mentioned above, we initiated a position in UiPath in the IT sector. We also closed positions in Qualcomm, NXP Semiconductors, Mandiant and Akamai Technologies in the IT sector, Ecolab in the materials sector, Lions Gate Entertainment in the communication services sector, Qurate Retail in the consumer discretionary sector and NOW, Inc. in the industrials sector.