

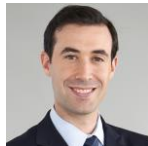
ClearBridge

Investments

Mid Cap Strategy



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Key Takeaways

- ▶ Recent outperformance reflects the work done over the last several quarters to maintain a high-quality, diversified portfolio while paying close attention to risk.
- ▶ We have been disciplined in trimming strong performers among our growth holdings and redeploying the proceeds in more attractive opportunities in value areas with improving fundamentals.
- ▶ We maintained our pace of portfolio activity during the first quarter, adding six new positions while exiting seven names.

Market Overview

A rotation in market leadership that commenced last September continued to gain strength in the first quarter, with efforts to reflate the economy through fiscal and monetary stimulus helping the S&P 500 Index gain 6.2%. The benchmark Russell Midcap Index advanced 8.1% as mid cap companies are likely beneficiaries of an accelerating post-COVID expansion. Value stocks continued to outperform, with the Russell Midcap Value Index gaining 13.1% compared to a loss of 0.6% for the Russell Midcap Growth Index.

From a sector standpoint, energy (+29.7%) was the best performer in the benchmark as crude oil prices rose 21%, followed by financials (+16.5%), a direct beneficiary of a steepening yield curve and improving credit. The cyclical consumer discretionary (+13.6%), materials (+12.9%) and industrials (+10%) sectors also outperformed. Meanwhile, the information technology sector (IT, +0.9%), which thrived in the work-from-home and e-commerce boom during the pandemic, as well as health care (+0.5%) underperformed.

The ClearBridge Mid Cap Strategy has delivered solid results through the rotation, which reflects the work done over the last several quarters to maintain a high-quality, diversified portfolio while paying close attention to risk. Recent outperformance is less a function of transactions in the current quarter and more a cumulative effect of strong fundamental research resulting in new investments stretching back to the second quarter of last year.

Several of our better performers in the first quarter were purchased while their business models were under stress from COVID restrictions.

Portfolio Positioning

On the growth side, we have been trimming back holdings such as Carvana, Chewy, Lam Research and SolarEdge Technologies amidst strong performance. We still see opportunities for these companies but are seeking to size them appropriately in the portfolio. These actions allow us to maintain growth exposure while cycling profits into companies with a better risk/reward.

We have been finding many of these more attractive opportunities in value areas where business fundamentals were improving but had not been acknowledged by the market. Examples include Vertiv, a provider of HVAC systems and other support functions for data centers and other commercial customers, which is poised to improve margins, and Masonite, a maker of doors for residential construction and renovation that is gaining pricing power in a cyclical recovery for housing.

More recent additions Resideo Technologies, a distributor of comfort, safety and energy efficiency products for the home, and Regal Beloit, a manufacturer of electric motors, are benefiting from new management teams better at allocating capital, optimizing manufacturing and improving procurement. These companies have a strong opportunity to improve returns, which should lead to improved earnings and multiples.

Several of our better performers in the first quarter were purchased while their business models were under stress from COVID restrictions or the macro environment the pandemic created. What gave us confidence in purchasing Expedia and Carnival were the actions the companies took to extend out their balance sheets until travel resumed. Both should benefit as a broader vaccination rollout prompts cruise lines to resume operations and consumers to start traveling again and are positioned to deliver better margins and gain pricing power as the economy normalizes due to the cost controls implemented during the downturn.

Regional banks Western Alliance Bancorp and Fifth Third Bancorp, as well as Hartford Financial Services, were all pressured last year by historically low interest rates that restrained interest margins and income. Credit metrics have since improved and all three have been direct beneficiaries as rates have risen and loan growth potentially picks up in anticipation of a robust recovery.

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APi Group, in the industrials sector, was our most significant new addition. APi helps office and industrial buildings ensure their safety and fire alarm systems are operating properly, a largely recurring business where the company has an opportunity to grow market share. We also purchased Marvell Technology Group, in the IT sector, a semiconductor maker with exposure to the fast growing 5G

and data center markets whose shares sold off in the latest rotation out of growth stocks. Marvell just acquired data center supplier Inphi, a name we have held in other ClearBridge portfolios, which should increase the chipmaker's cross-selling opportunities in a strong demand environment for chips.

We closed out of defense contractor L3Harris Technologies and insurer Progressive after recent appreciation moved both out of our mid cap range. Biotechnology firm Alexion Pharmaceuticals was sold ahead of its acquisition by AstraZeneca while we exited BioMarin Pharmaceutical after a number of its clinical catalysts had played out. We also sold World Wrestling Entertainment as we believe the shares reflected full value after finally signing a U.S. content distribution agreement.

Outlook

The bottom-up fundamental work we have completed on target mid cap companies, with the support of our analysts, helps us identify what stocks and sectors are getting expensive, what other areas are unreasonably cheap and where we should be participating. We will continue to seek a balance of compounding, high return growth companies and more value-oriented names with quality fundamentals and clear paths to improvement to construct a portfolio that can work in many different market environments.

Portfolio Highlights

The ClearBridge Mid Cap Strategy outperformed its Russell Midcap Index during the first quarter. On an absolute basis, the Strategy had gains across 10 of the 11 sectors in which it was invested during the quarter. The leading contributors were the industrials and financials sectors while real estate was the lone detractor.

On a relative basis, overall stock selection and sector allocation contributed to performance. Specifically, stock selection in the financials, IT, industrials, health care and consumer staples sectors, an overweight to industrials and an underweight to communication services drove results. Conversely, stock selection in the consumer discretionary, real estate and materials sectors and an underweight to the energy sector detracted from relative returns.

On an individual stock basis, the biggest contributors to absolute returns in the first quarter were Western Alliance Bancorp, Hartford Financial Services, Pioneer Natural Resources, Fifth Third Bancorp and Performance Food Group. The largest detractors from absolute returns were Splunk, Black Knight, Ball Corp., Cloudera and Alexandria Real Estate Equities.

In addition to the transactions listed above, we initiated positions in Lear and Petco in the consumer discretionary sector, Cloudera in the IT sector and Shoals Technologies Group in the industrials sector. We also closed positions in Amdocs in the IT sector and Ardagh Group in the materials sector.

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