ClearBridge
A Franklin Templeton Company

Global Growth Strategy

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Key Takeaways

- The Strategy outperformed, led by U.S. mega cap exposure as well as holdings in cyclical sectors and the more defensive health care sector.
- We initiated 11 new positions while eliminating 13 others. These new purchases represent a mix of secular, structural and emerging growth companies reflecting a more balanced market environment.
- We believe global growth equities will remain in favour this year as rate cuts appear likely across the U.S. and Europe, credit flows in the eurozone are rising and corporate reform in Japan continues to make progress.

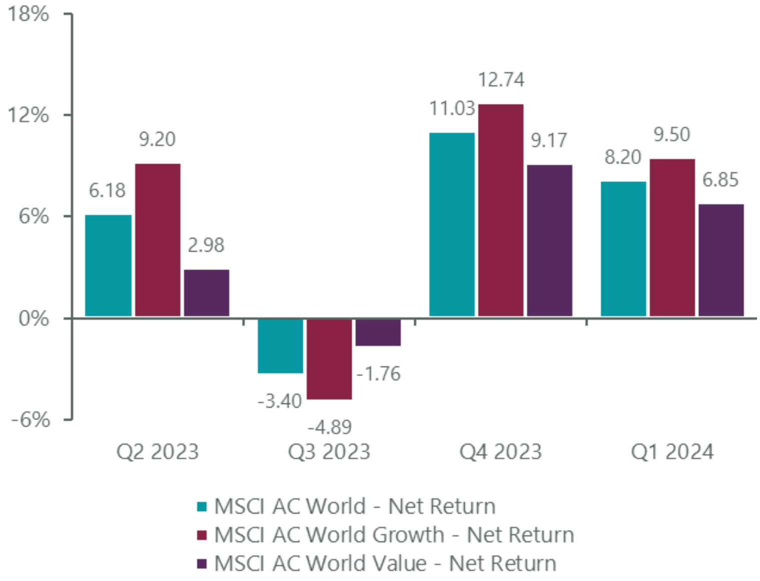
Market Overview

Global equities continued to climb in the first quarter, supported by improving investor sentiment, better economic data in the U.S., rate cuts beginning in Europe and confidence in a Japanese economy that is seeing improved corporate governance. The benchmark MSCI All Country World Index advanced 8.20%, led by strength in the U.S. with the S&P 500 Index advancing 10.56% while the MSCI EAFE Index added 5.79%.

Growth stocks surged to start the year, buoyed by optimism that bond yields would continue to ease off their 2023 peak. Switzerland became the first major developed market to reduce rates in March, the U.S. Federal Reserve communicated its plan for the start of rate cuts this year and the market is pricing in 90 bps of easing from the European Central Bank. Against this backdrop, the MSCI ACWI Growth Index rose 9.50% for the quarter, outperforming the MSCI ACWI Value Index by 265 bps (Exhibit 1).

The ClearBridge Global Growth Strategy outperformed its benchmark for the quarter, led by active management of our U.S. mega cap growth holdings across the communication services, IT and consumer discretionary sectors. We maintain exposure to six of the stocks in the group known of the Magnificent Seven, with overweights in Alphabet, Amazon.com, Meta Platforms and Microsoft, the latter three outperforming in the first quarter. We maintain a market weight in Nvidia, the best individual performer in the portfolio in the quarter by a wide margin, and an underweight in Apple, which underperformed to start the year.

Exhibit 1: MSCI Growth vs. Value Performance



As of 31 March 2024. Source: FactSet.

Performance was also supported by holdings in cyclical sectors as well as the more defensive health care sector. We were encouraged that stock selection in these areas worked, as did active positioning that expresses our growth style, with an overweight to IT proving particularly beneficial to performance.

We believe global growth equities will remain in favour this year as rate cuts in Europe appear to be ahead of the Fed, European economic data has been weak and credit flows in the eurozone are rising, both on the corporate and consumer side, which is often a leading indicator of GDP growth.

Positions tied to generative AI and diabesity, two relatively recent but key growth themes that have dominated global markets over the last 15 months, were meaningful contributors for the second straight quarter. The continued positive momentum of GPU maker Nvidia was supported by two stocks essential to high-end chip production: Dutch semiconductor equipment maker ASML and contract manufacturer Taiwan Semiconductor. Enterprise resource planning software maker SAP was also a standout. We recently wrote about the large and growing opportunity in diabetes and obesity treatment where Eli Lilly and Novo Nordisk, leading developers of GLP-1 pharmaceutical treatments for these conditions, continue to execute well. Emerging biotechnology company Zealand Pharma, a new purchase during the quarter, is making progress in clinical trials for a new therapeutic for fatty liver disease and obesity with very promising results.

These positive drivers offset weakness in financials, where our meaningful underweight to banks and emerging markets exposure weighed on results. Chinese equities remained pressured by economic uncertainty. Japan, meanwhile, was the best performer regionally in the benchmark. Japanese equities rose following the Bank of Japan's (BOJ) decision to end its negative interest rate and yield control policies. This move reflects Japan's confidence that it has achieved price stability by removing deflation as a major risk to its economy. The BOJ will, however, maintain accommodative policies. Combined with ongoing corporate reforms and a weakening yen, we believe the outlook for Japanese stocks should continue to improve.

Portfolio Positioning

We were active during the quarter, initiating 11 new positions while eliminating 13 others. While Strategy positioning was slanted toward more defensible and self-help business models through the monetary tightening regime, our new purchases represent a mix of secular, structural and emerging growth companies reflecting a more balanced market environment.

U.S. aircraft parts manufacturer TransDigm was our largest addition. TransDigm is a steady compounder with strong pricing power coming from regulatory barriers that limit the number of competitors and due to its proprietary intellectual property, which makes it a sole supplier of many certified aircraft parts. We believe the company will see long-term duration of growth ahead as it benefits from the expansion of the aerospace aftermarket and acquisitions in this still-fragmented space.

Among secular growth names, Broadcom was another notable addition. Through organic growth and accretive acquisitions, Broadcom has developed into one of the largest global technology providers serving a number of industries with its semiconductor and software products. The company generates high levels of earnings and free cash flow, which will be driven in the coming years by revenue growth and margin expansion due to the acquisition of VMware and strong adoption of the Broadcom's AI custom silicon chips. The acquisition of VMware is off to a good start and has shifted the business mix to 60% software and 40% semiconductors, enhancing growth prospects while also providing greater downside protection from higher recurring revenue. Also in the secular bucket, we added McKesson, the leading distributor of pharmaceuticals to retail drug stores, physicians' offices and hospitals in the U.S with the largest specialty drug and oncology business, the fastest growing, highest-margin segment of drug distribution. The company competes in a relatively stable oligopoly with two other major distributors. We believe McKesson can steadily compound earnings at a low-teens rate and possibly offer upside to its current multiple with credit for faster organic growth than peers.

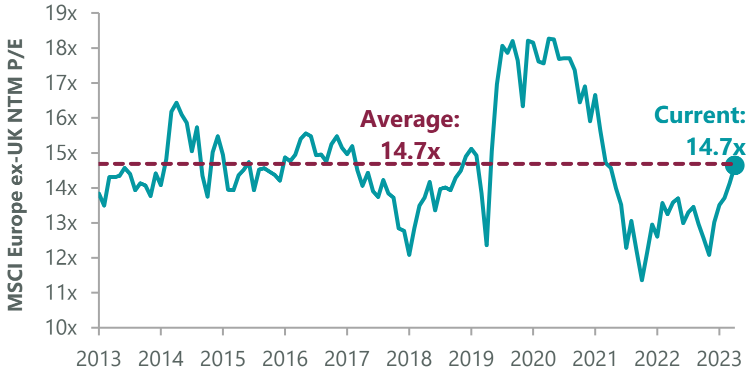
Among structural growth names, we initiated a position in French advertising holding company Publicis Groupe. The company has unique assets in Epsilon and Sapient that give it unmatched and difficult to replicate advantages in winning new business, retaining existing clients and transitioning to an AI-driven business model. We also added to Taiwan Semiconductor, the world's largest chip manufacturer. As the semiconductor cycle recovers from the downturn last year and capex investment grows due to AI, the demand for chips will also increase. In the U.S., we added Old Dominion Freight Line, the second largest less-than-truckload (LTL) provider in North America with a national footprint. Transportation has experienced a longer than usual freight recession that could create a constructive macro setup going forward. The potential for nearshoring/reshoring of industrial manufacturing and localisation of retail distribution are also potential longer-term tailwinds for this industry. We believe Old Dominion is well-positioned for continued share gains in a large, consolidated LTL market and capable of generating durable revenue growth on the back of volume and pricing increases. In the emerging growth bucket, in addition to Zealand Pharma we started a position in Monday.com, which offers front office software-as-a-service that enables organisations to build custom applications and solutions for project management, customer relationship management, marketing and software development. The company has low cross-selling penetration across its existing customers and stands to expand as its platform broadens. Monday.com is fundamentally sound with best-in-class free cash flow margins.

To make room for these new names, we exited several holdings facing weak short- to medium-term demand, like cosmetics and skin care maker Estee Lauder, which continues to see tepid spending among Chinese consumers, and U.K. spirits company Diageo.

Outlook

Recent results validate the need for investors seeking global exposure to include growth equities in their portfolio. The U.S., which represents the Strategy's largest exposure, continues to show economic and earnings resilience as a soft landing comes into view. The macro picture in Europe remains muddled with Germany in particular showing weakness, but markets appear to be looking past recent disappointing GDP growth in the region as evidenced by improvements in the Citi Economic Surprise Index. Investor flows into Europe are also demonstrating green shoots after an extended period of outflows, with a pickup in share buyback activity being a catalyst.

Exhibit 2: European Equities Trading at Lower Relative Valuations

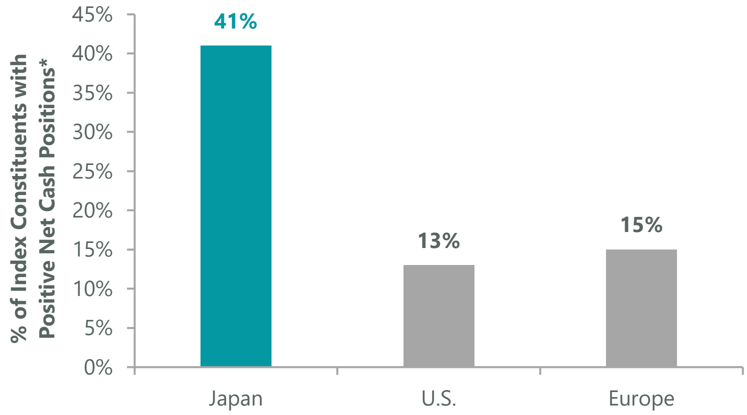


NTM P/E: P/E based on next twelve-month consensus earnings expectations. Data as of 31 March 2024. Source: FactSet, MSCI.

We continue to believe international growth equities in general, and European stocks in particular, look quite attractive (Exhibit 2). Judging by forward P/E multiples, the eurozone is trading at less than two-thirds the U.S. — its cheapest relative levels since before the COVID-19 pandemic. Given an improving rate environment and the resilience companies there have shown through the Russia-Ukraine war and an inflation scare, we maintain confidence in our European overweight.

Meanwhile, in Japan, the actions taken by the government and exchanges to improve corporate returns and encourage greater equity ownership are beginning to flow through to better earnings. Companies are also sitting on high cash levels that can be directed to shareholder-friendly activities such as buybacks and dividends (Exhibit 3).

Exhibit 3: Corporate Japan Flush with Cash



*Positive net cash positions ex-financials. U.S: S&P 500, Europe: MSCI Europe, Japan: MSCI Japan. Data as of 31 March 2024. Source: FactSet, MSCI, S&P

To capture these opportunities, we remain committed to our valuation approach to growth and diversification across the different types of growth companies represented by our buckets. While the U.S. remains our largest area of focus, we continue to source new growth ideas across international markets.

Portfolio Highlights

During the first quarter, the ClearBridge Global Growth Strategy outperformed its MSCI ACWI benchmark. On an absolute basis, the Strategy experienced positive contributions across seven of the nine sectors in which it was invested (out of 11 total), with the IT and communication services sectors the primary contributors while the financials sector was the main detractor.

On a relative basis, overall stock selection and sector allocation contributed to performance. In particular, stock selection in the communication services, health care and materials sectors and an overweight allocation to the IT sector aided results. Conversely, stock selection in the financials sector detracted from performance.

On a regional basis, stock selection in North America (primarily the U.S.), Europe Ex U.K., and an underweight allocation to emerging markets supported performance while stock selection in Japan and emerging markets proved detrimental.

On an individual stock basis, the largest contributors to absolute returns in the quarter included Nvidia, Eli Lilly, Meta Platforms, Microsoft and Amazon.com. The greatest detractors from absolute returns included positions in Apple, TravelSky Technology, HDFC Bank, Adobe and Zai Lab.

In addition to the transactions mentioned above, we initiated positions in Guidewire Software in the IT sector, EQT AB in the financials sector, Daifuku in the industrials sector and MoonLake Immunotherapeutics in the health care sector. We exited positions in Karuna Therapeutics and Daiichi Sankyo in the health care sector, Workday and Xero in the IT sector, TravelSky Technology in the consumer discretionary sector, Sysco in the consumer staples sector, EDP in the utilities sector, Computershare and Waste Connections in the industrials sector and Edenred and Deutsche Boerse in the financials sector.