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## Global Value Improvers Strategy

### Key Takeaways

- ▶ Global equities rose in the second quarter, as positive earnings, stabilising inflation and the first interest rate cuts in the cycle overcame increased political uncertainty from global elections.
- ▶ The Strategy outperformed its benchmark, as strong stock selection in our industrials and health care holdings overcame detractors in the financials sector.
- ▶ Eliminating waste and pollution, circulating products and materials and regenerating nature are three basic principles at the heart of the circular economy that align with ClearBridge's fundamental ESG framework.

### Market Overview

Global equities rose in the second quarter, with the MSCI World Index returning 2.63%, as largely positive corporate earnings, signs of stabilising inflation and the first rate cuts from central banks in Europe and Canada overcome increased political uncertainty from a number of elections worldwide. Continued investor enthusiasm for AI-related companies helped drive strong performance in growth stocks, with the MSCI World Growth Index returning 6.35%, while the benchmark MSCI World Value Index declined 1.20%. As a result, growth extended its year-to-date lead versus value to over 1,100 basis points.

The U.K. proved the best-performing region in the benchmark, overcoming a mid-quarter pullback due to increased uncertainty spurred by the call for early elections, as reports showed a stabilising GDP, a steady increase in consumer confidence and a continued easing of inflation indicators. Asia Ex Japan also saw positive overall performance as China, which has struggled with weaker domestic consumption and issues in its real estate market, also saw positive performance due to a pickup in export data. Japan, the best-performing market in the first quarter, delivered the weakest regional performance as investors took pause after a strong run-up and a weakening of the yen.

International investors faced an onslaught of political elections during the quarter. In the U.K., Prime Minister Rishi Sunak called for a new national election several months earlier than expected, resulting in a widely anticipated landslide victory for the opposition Labour party — the most meaningful power shift in over a decade. European markets also saw increased volatility due to the surprise gains by far-right parties in European parliamentary elections, leading to further

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We remain  
constructive on the  
ongoing reforms  
in Japan.

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uncertainty about the future of fiscal and policy agendas in France after President Macron called for snap elections in July, which ended with no clear winner. Mexican equities and the peso retreated meaningfully after incoming President Claudia Sheinbaum's Morena party made substantial electoral gains, raising concerns over potential judicial reforms that would allow for easier constitutional changes. Opposition parties also won victories in Korean and Indian elections, causing concerns over the impact that new alliances and deals may have on government policies.

The ClearBridge Global Value Improvers Strategy outperformed its benchmark in the second, as strong stock selection in the industrials sector overcame headwinds to our holdings in the financials sector.

Despite the prospect of higher-for-longer interest rates, fatigued consumer spending and global economic weakness, our industrials holdings continued to see robust performance. Top-performing holding Hitachi continues to benefit from the demand and buildout of data centres and upgrading of global electrical grids. After a decade of meaningful restructuring, Hitachi has now become a model for value creation in Japan, which in turn motivates its management team to find further avenues for growth and returns. French industrials company Nexans, which makes cable systems for offshore wind farms, subsea interconnections, power transmission, telecom networks, fiberoptics and electrical systems, also saw positive performance as the market priced in higher demand for power and grid investment from additional AI demand.

Stock selection in the health care sector positively contributed, led by the strong performance of U.K.-based global biopharmaceutical company AstraZeneca. The company's share price rallied from a strong showing of results from several of its existing and pipeline oncology products presented at the American Society of Clinical Oncology annual meeting in June, highlighting the breadth and depth of its leadership in oncology treatments and particularly within breast and lung cancer — the two largest oncology markets. The positive reception at the presentation further reinforces our conviction in the company's ambitious long-term growth targets that it announced during the quarter.

Stock selection in the financial sector, meanwhile, weighed on relative performance as political uncertainty, particularly in Europe, resulted in broadly higher risk premiums and bond spreads. Such was the case with BNP Paribas, a French banking and financial service, which was particularly impacted as investors contemplated market unfriendly policies such as new bank taxes and threats to Europe's banking union that have been discussed by both far left and right parties amid European elections. Spanish bank Banco Bilbao Vizcaya Argentaria (BBVA), a top-performing holding in the first quarter, also saw a pullback as the bank's planned acquisition of Spanish peer Sabadell transformed into a takeover bid,

spurring investor concerns that a prolonged takeover or engorged premium to complete it could dilute its strong performance in Mexico and dampen its overall returns.

Regionally, stock selection in Japan was a positive contributor for the quarter, driven primarily by Hitachi. Overall, we remain constructive on the ongoing reforms in Japan. In addition, we see management teams more willing to engage with investors to improve governance practices and ultimately include shareholders in their capital allocation decisions.

Stock selection in North America also proved beneficial, with the largest contributor being U.S. headquartered Oracle — the dominant provider of on-premise database software for large enterprises globally. The company's share price rose after it reported strong backlog growth and signed a new client in OpenAI, which intends to use Oracle's cloud infrastructure to train its AI models. The shares also received tailwinds from its announced partnership with Google's Cloud Platform (GCP) to build Oracle's cloud infrastructure directly into GCP, which we believe will help accelerate the growth of Oracle's cloud database services.

Conversely, stock selection in Europe Ex U.K. weighed on performance due to the increases in political uncertainty and concerns that growing nationalistic movements within these countries could ultimately weaken the eurozone overall. Additionally, construction slowdowns in the U.K. and Europe placed several of our holdings in the region under additional pressure.

### **Portfolio Positioning**

We added a new position in Siemens Energy, in the industrials sector, a German energy technology company that manufactures a wide range of products such as transformers, wind turbines and electrical equipment, and that provides crucial services to facilitate the global energy transition. We believe that the growing need to upgrade long-neglected energy grids globally will prove a long-term tailwind to the company.

We also initiated a new position in PayPal, in the financials sector, which operates financial technology platforms to enable digital and mobile payments globally. We see PayPal as an interesting turnaround opportunity as the stock suffered in recent years due to difficult Covid comparisons and ineffective management strategy. Under new leadership, there is a renewed sense of urgency to refocus the business and integrate PayPal's multiple premium assets and bring out the power inherent in its platform to resume profit growth. With a modest valuation and low embedded expectations, there is significant upside if new management can right the ship.

We trimmed our exposure to Vertiv during the quarter on recent strength. A global manufacturer of power, precision cooling and infrastructure management systems for mainframe

computer, server racks, and critical process systems, Vertiv continues to see elevated demand in the AI value chain and anticipation of greater demand for data centre components. Data centres running AI servers consume five times more power, generate five times more heat and require ten times more cooling. Vertiv's products improve data centre power efficiency and are solutions to the environmental challenges posed by the rapid growth of AI data centres. While we continue to have strong long-term conviction in the company and maintain a meaningful position, we made the decision to capture gains and trim the position size.

### Outlook

The [ClearBridge Global Value Improvers Strategy](#) targets companies which are both undervalued and underappreciated for their ESG progress. In recent months, political risk and policy uncertainty have become an increasing overhang on equity markets, particularly as it relates to important ESG areas such as renewables and energy policy, Labour regulation and immigration, to name a few. Our overall view is that concerns are overblown. For example, in the U.S., there are still different scenarios for the outcome of the election. Even in the most extreme case of a Republican sweep, a full repeal of the Inflation Reduction Act (IRA) would be difficult and unfavourable to many states where it has been a meaningful job creator. Even stress testing a full repeal scenario, many of the benefits to a company like U.S. renewable power producer AES, for example, already existed prior to IRA passage and would now just return to the situation before the bill with the biggest negative impact being the need to have those tax credits extended periodically since their first expiration in 2007.

Offsetting this, we believe surging data centre demand will continue to provide additional tailwinds for both growth and returns. In the EU, recent French election results seem to indicate that the risk of far-right control in EU has decreased, while renewables and, more broadly, the energy transition, continue to receive support across society. Overall, we believe that these sentiment swings will prove to be temporary and provide opportunities for us to add interesting new ideas to power the portfolio in the coming years.

### Portfolio Highlights

The ClearBridge Global Value Improvers Strategy outperformed its MSCI World Value Index benchmark during the second quarter. On an absolute basis, the Strategy had gains across six of the 10 sectors in which it was invested (out of 11 sectors total). The industrials and health care sectors were the main contributors, while the financials sector was the main detractor.

On a relative basis, overall stock selection benefited performance. Specifically, stock selection in the industrials, health care, communication services and IT sectors, an

underweight to the consumer discretionary sector and overweight allocation to the utilities sector positively contributed. Conversely, stock selection in the financials sector, an underweight to the IT sector and an overweight to the industrials sector weighed on performance.

From a regional standpoint, stock selection in Japan and North America as well as an overweight allocation to the U.K. benefited performance. Conversely, stock selection in Europe Ex U.K. and an out of benchmark allocation to emerging markets weighed on performance.

On an individual stock basis, Hitachi, AstraZeneca, Oracle, Unilever and Nexans were the leading contributors to absolute returns during the quarter. The largest detractors were Banco Bilbao Vizcaya Argentaria, PT Bank Rakyat Indonesia, Coty, Compass and Fiserv.

### **Plastic Alchemy: Transforming Waste into Profit**

The Ellen MacArthur Foundation lists three basic principles of the circular economy: eliminating waste and pollution, circulating products and materials, and regenerating nature. These principles align with some key parts of ClearBridge's fundamental ESG framework, notably factors such as resource efficiency, recycling, product life cycle management, renewable generation and land usage, which we engage on as part of ongoing company research. By reducing energy use, stress on the environment and pollution, the circular economy is also linked to mitigating climate change and conserving biodiversity.

Many ClearBridge holdings thus contribute to the circular economy as they either execute on best practices or make improvements in these areas. We have often highlighted Trex as exemplary of the circular economy. Trex is the market share leader of wood-alternative composite decking. Trex's low-maintenance and high-quality decking products are composed of 95% recycled wood fibres and plastic, making use of waste that would otherwise end up in landfills. Trex has continued to innovate and advance plastic recycling processes. Recently, as the demand for "clean streams" of plastic waste has increased in different parts of the economy, Trex has upgraded technology to be able to accept "dirtier" streams of plastic waste into the manufacturing process. This allowed Trex to begin using additional quantities of waste plastic that would otherwise never be recycled, without compromising product quality standards. Trex products are more durable and have a longer life than traditional wood decking, therefore reducing overall raw material usage and end-product manufacturing. Finally, the quality and durability of the product saves consumers money through less frequent replacements and lower maintenance and upkeep costs.

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Food waste is an avoidable crisis that has both environmental and societal costs.

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#### Molecular Recycling Takes a Step Forward

While companies like Trex are making clear gains on plastic recycling, a circular economy that solves for plastics use remains a challenge. Regulatory bodies are stepping up requirements, such as the EU's new rules to reduce, reuse and recycle packaging, provisionally agreed upon in March 2024. Under the new rules, plastic packaging must also include minimum recycled content. Helping companies meet these new rules will be ClearBridge holding Eastman Chemical, which makes a range of advanced materials, chemicals and fibres for everyday purposes, among them plastics for food packaging.

In a recent engagement with Eastman Chemical we discussed two different chemical recycling technologies it has developed: polyester renewal technology (PRT) and carbon renewal technology (CRT). PRT recycles polyester-based materials such as soda bottles, carpet fibres and even clothing, breaking down their basic molecules until they are indistinguishable from materials made from virgin or nonrecycled content. CRT operates in a similar way but can take a broader range of plastic types and replaces the use of coal as a feedstock to make fibres. Combining these two technologies gives Eastman a competitive advantage in molecular recycling, as it can take most types of waste plastics (Exhibit 1). Ironically, securing feedstock (i.e., waste plastic) has been a bottleneck to scaling molecular recycling as competitor technologies not using Eastman's dual technologies often require the waste plastic to be separated purely according to grade, which waste and recycling companies do not readily offer. Eastman's dual technology approach allows it to accept most plastic grades, making it less reliant on waste companies' sorting.

Eastman's first recycling plant is now operational in Tennessee, which will supply its internal Advanced Materials lines while also proving out the technology. The company is already working toward a second plant in Texas that will have Pepsi as its anchor customer. In the second plant, not only will Eastman help Pepsi meet its recycled content goals, but it is also expected to receive long-term, take-or-pay volume commitments, for doing so. This should greatly improve earnings visibility, and in turn, potentially valuation.

Exhibit 1: Eastman Chemical’s Molecular Recycling Methods

Plastic Type	Common Uses	Eastman Molecular Recycling	
		PRT	CRT
 PETE	Bottles, Textiles, Carpet, Films, Forms	Yes	Yes
 HDPE	Thicker Bottles, Containers	No	Yes
 PVC	Pipes, Wiring, Sheeting	No	Not Yet (2 <sup>nd</sup> Generation)
 LDPE	Film, Bags	No	Yes
 PP	Medical	No	Yes
 PS	Food Containers, Utensils	No	Yes
 OTHER	Baby Bottles, Water Jugs	No	Yes

Source: Eastman Chemical

Sustainable Food Needs Sustainable Plastic

As the case of Eastman Chemical suggests, plastic is central to sustainable food. Accordingly, companies in the food industry can advance the circular economy through practices such as recycling, reducing or improving the sustainability of packaging and reducing landfill waste. Canadian grocer Loblaw can make an impact with all three of these practices.

In a recent engagement with Loblaw, we discussed its goal of making 100% of its control brand and in-store plastic packaging recyclable or reusable by 2025. This would put it in compliance with the Golden Design Rules (GDR), a set of rules established by the Consumer Goods Forum, made up of leading international retail and consumer goods companies, to benchmark packaging design, emphasising the reduction of materials and the removal of problematic elements.

Noteworthy steps along the way have involved changes to Loblaw’s protein packaging, which used to come in polystyrene foam trays; the vast majority now are packaged in clear recycled PET trays, which are accepted in all the municipalities in which the store operates and allow for greater detectability in the recycling stream. The shift to PET trays for mushrooms led to 39.9 million trays entering the recycling stream in 2023. Removing the plastic window from 10 kg potato bags allowed 23 million bags to be more easily recycled in 2023. In addition, extending expiry dates for its PC Money Account and PC

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Producer responsibility incentivises brand owners to increase the recyclability of their packaging while empowering them with control over the recycling systems.

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Mastercard physical cards should prevent more than 10,000 kgs of plastic waste in the next 12 years.

Loblaw's advances in these areas also speak to its power to use its size to change the industry, as it communicated its GDR standards to hundreds of control brands and national brand vendors, effectively dictating a new national industry standard for plastic packaging. While navigating recycling standards and practices that vary from municipality to municipality, to improve recycling rates overall Loblaw supports extending producer responsibility, a system that give brand owners responsibility of both the cost and performance of recycling systems, incentivising them to increase the recyclability of their packaging while empowering them with control over the recycling systems themselves.

Food waste is an avoidable crisis that has both environmental and societal costs, and linking food as an organic resource in a circular economy can reduce land use and better support growing populations. Loblaw has set a goal to send zero food to landfill by 2030, a goal supportive of Sustainable Development Goal 12: Responsible Consumption and Production, in particular target 12.3, to halve global food waste by 2030. The company is currently ramping up data collection on food waste but achieved over 78,000 metric tons of diverted food waste in 2023, with most going to composting, animal feed and redistribution of food surplus to food charities.

#### Supplying the Auto Aftermarket

LKQ is also focused on recycling heavy materials. LKQ is the largest wholesale distributor of alternative parts for the auto aftermarket in North America and Europe. It provides "like kind and quality" (LKQ) auto parts as lower-cost alternatives to those provided by auto OEMs. It is the largest wholesale distributor of collision parts (used to repair vehicle exteriors) in the U.S. and Canada and the largest distributor of mechanical parts (used to repair internal components) in Europe. LKQ also runs its own salvage and recycling operations. As the world's largest recycler of cars at end-of-life, recovering 90%+ of the materials from scrap cars for reuse or recycling, LKQ supports resource efficiency and responsible consumption as an investable theme.

In a recent engagement with LKQ we had an extensive discussion about how it has become increasingly efficient over time at inventorying and selling more parts from its salvage vehicles, which reduces the amount of parts going for scrap and increases LKQ's margins, as it earns higher revenues from same fixed cost of goods.

#### Circular Economies Span All Sectors

One powerful aspect of the circular economy is how, although with differing dynamics and levels of challenges, every sector may contribute. ClearBridge will continue to share key



company advances and engagements on the topic as our holdings innovate to operate more efficiently and enable a more resilient economic system, with fewer emissions and less waste.

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