2Q 2019 | Product Commentary

CLEARBRIDGE APPRECIATION FUND

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Portfolio Managers

Average annual total returns and fund expenses (%)

as of June 30, 2019

					Since Incept.	Expenses	
Class A	3-mo	1-yr	5-yr	10-yr	(03/10/70)	Gross	Net
Excluding sales charges	5.90	14.60	10.02	13.14	10.41	0.97	0.97
Including effects of maximum sales charges	-0.19	8.02	8.73	12.48	10.27	0.97	0.97
S&P 500 Index	4.30	10.42	10.71	14.70	N/A	-	-

Performance shown represents past performance and is no guarantee of future results. *Current performance may be higher or lower than the performance shown. Investment return and principal value will fluctuate, so shares, when redeemed, may be worth more or less than the original cost. Class A shares have a maximum front-end sales charge of 5.75%.Total returns assume the reinvestment of all distributions at net asset value and the deduction of all Fund expenses. Total return figures are based on the NAV per share applied to shareholder subscriptions and redemptions, which may differ from the NAV per share disclosed in Fund shareholder reports. Performance would have been lower if fees had not been waived in various periods. Returns for less than one year are cumulative. For the most recent month-end information, please visit www.leggmason.com*

Gross expenses are the Fund's total annual operating expenses for the share class(es) shown.

Net expenses are the Fund's total annual operating expenses for the share classes indicated and would reflect contractual fee waivers and/or reimbursements, where these reductions reduce the Fund's gross expenses. These arrangements cannot be terminated prior to December 31, 2020 without the Board's consent. In periods of market volatility, assets may decline significantly, causing total annual Fund operating expenses to become higher than the numbers shown in the table above.

The **S&P 500 Index** is a market capitalization-weighted index of 500 widely held common stocks. Investors cannot invest directly in an index, and unmanaged index returns do not reflect any fees, expenses or sales charges.

Key takeaways

- Stocks recorded strong returns, completing the best first half since 1997, while Treasury yields declined and the inversion of the yield curve indicated real concern about the economy.
- We still feel that the robust U.S. consumer will keep us out of recession in 2019, and the market's technical picture is good.
- In general, companies with strong prospects see them reflected in their stock prices. However, valuations alone have a poor record of forecasting future market returns.

Market overview and outlook

During the second quarter the stock and bond markets sent very different signals about the health of the world economy. Stocks recorded returns of 4.3%, completing the best first half since 1997, up 18.5%. By contrast, the decline in 10-year U.S. Treasury yields from 2.40% to 2.01% and the inversion of the yield curve indicated real concern about the economy. Gold prices echoed bond market worries, spiking from $1,220 to $1,332. Oil prices fell only slightly for the quarter, from $59.3/bbl to $58.5, but prices were volatile, ranging between $51 and $66. Apart from oil and gold, commodity prices were down.

Two themes drove stock performance during the quarter. We saw a safety trade through May caused by economic fears, and then a "don't fight the Fed" rally in June. The strongest sectors were financials, materials and technology, a bit of an odd mix.

INVESTMENT PRODUCTS: NOT FDIC INSURED • NO BANK GUARANTEE • MAY LOSE VALUE

Financials stocks were volatile during the quarter, showing strength on first-quarter results, weakness on yield concerns, then a rebound in June. Technology stocks benefited from confidence in continued strong earnings growth, especially in the software sector. Materials stocks with defensive characteristics, such as specialty chemicals and gold, led that group higher. The commodities portion of materials were some of the worst stocks in the market. The weakest sectors were energy and health care. Health care stocks were hurt by polls indicating that President Trump could be vulnerable in the 2020 election, and discussion of "Medicare for All" by some of the most liberal of the Democratic candidates.

U.S. economic data weakened in the second quarter, with the significant caveat being that the most important component, employment, remained excellent. Consumer data continued to be stronger than manufacturing.

Manufacturing was weak worldwide. Two-thirds of the countries that report Purchasing Managers Indexes (PMIs) showed numbers below 50, indicating shrinking manufacturing sectors. The trade dispute with China and President Trump's periodic threats of tariffs with numerous countries made it difficult for producers to make capital investment decisions. Companies questioned their supply chains, uncertain what costs would be. The June U.S. ISM Manufacturing Index (PMI) reading fell to 51.7, down from the high 50s seen last year. Hurt by the industrial economy, S&P 500 profits are expected to decline in the second quarter and again in the third.

Consumer numbers saw some very modest fraying at the edges. Employment results remained robust. Payroll employment gains were weak in May at 75,000, but they bounced back in June to 224,000. Unemployment claims rose from a 40-year low of 201,000 in early May to 222,000 in late June, but the absolute level is very low. Continued strength in employment will limit Federal Reserve rate cuts going forward. There were sharp declines in the June University of Michigan consumer sentiment survey and the Conference Board's consumer confidence survey, but the absolute results are still very good. Auto sales of 17.1 million were better than expected. Housing starts and permits were down low single digits versus a year ago. We need to wait until the key months of September and October to see if lower rates will stimulate housing sales.

Stock valuations are full. The Buffett Indicator, the market cap of the S&P 500 divided by U.S. GDP, at 1.3:1, is the second highest in history. In general, companies with strong prospects see them reflected in their stock prices. However, valuations alone have a poor record of forecasting future market returns. U.S. bank balance sheets are very strong, and the group is one of the few areas of the market with real valuation support. If the U.S. does not go into recession, banks will outperform. The risk that a Democrat could be elected president next year has hurt health care stocks. Valuations of selected drug and HMO stocks are compelling if a moderate Democrat is elected or if President Trump is re-elected. The several-year decline in consumer staples volumes seems to be easing. Increased inventories at retailers are necessary to support one-day deliveries. Earnings estimates for the group do not yet reflect the improved prospects.

We still feel that the robust U.S. consumer will keep us out of recession in 2019, and the market's technical picture is good. The market's advance to all-time highs has been broad. The Appreciation strategy of owning large, high-quality stocks is well-suited for today's market, offering upside participation if the economy continues to grow and preserving capital if global weakness becomes more problematic.

Fund highlights

For the quarter ended June 30, 2019, the ClearBridge Appreciation Fund — Class A shares had a cumulative return of 5.90%, excluding the effects of sales charges. In comparison, the Fund's unmanaged benchmark, the S&P 500 Index, returned 4.30%.

On an absolute basis, the Fund had gains in all 11 of the sectors in which it was invested during the quarter. The main contributors to the Fund's performance were the information technology (IT), financials and communication services sectors. The industrials and utilities sectors contributed the least.

In relative terms, the Fund outperformed its benchmark due to stock selection. In particular, stock selection in the energy, IT and consumer staples sectors contributed the most to relative performance. Conversely, stock selection in the industrials sector detracted.

On an individual stock basis, the biggest contributors to absolute returns during the quarter included positions in Microsoft, Walt Disney, Anadarko Petroleum, JPMorgan Chase and Visa. The greatest detractors from absolute returns were positions in 3M, Alphabet, Raytheon, United Parcel Service and Exxon Mobil.

During the quarter, we exited our position in Anadarko Petroleum. The Strategy also received shares of Corteva (CTVA) and Dow (DOW) following their spin-off from holding

DowDuPont (DWDP), the remaining segment of which is now called DuPont de Nemours (DD) and is held in the Strategy. Shares of Dow were sold, while shares of Corteva were retained.

Top contributors

The leading individual contributors to Fund performance for the quarter included:

Walt Disney (DIS), in the consumer discretionary sector, is an entertainment company that conducts operations in media networks, studio entertainment, theme parks and resorts, consumer products, and interactive media. Disney shares rose over 12% in one day when the company unveiled its pricing strategy and long-term subscriber/financial expectations for Disney+, its forthcoming streaming service, which will include Disney, Pixar, Marvel, Star Wars, National Geographic and Fox content.

Microsoft (MSFT), in the IT sector, is one of the largest software companies in the world. Microsoft posted an impressive earnings beat and maintained its previous guidance despite an incremental currency drag. The company, which reached a market cap of $1 trillion in April, has been executing well and is seeing continued success with Office 365 and its Azure cloud services platform.

JPMorgan Chase (JPM), in the financials sector, is a large diversified financial services company with significant businesses in retail, wholesale and investment banking. Financials moved in sync with the broad market in the second quarter, showing strength on first-quarter results and as optimism on U.S.-China trade tensions raised expectations for increased business activity and a more accommodative Fed offered potential support to the economy. The Fed's annual stress tests of large banks (Dodd-Frank Act Stress Tests (DFAST)) confirmed that banks can weather very challenging economic and market conditions, and CCAR showed that almost every large bank had sufficient capital to increase the amount of capital that will be returned to shareholders over the next year via dividends and share buybacks.

Bottom contributors

The bottom individual contributors to Fund performance for the quarter included:

3M (MMM), in the industrials sector, is a diversified industrial that sells products based on adhesives and films. Shares fell after first-quarter earnings and organic sales growth missed expectations. A planned business unit realignment, coupled with headcount reductions, should help operating margins recover in the coming quarters.

Alphabet (GOOG), in the communication services sector, operates the dominant Web search engine in Google, as well as other online media, advertising, technology and tools. Shares slid as Alphabet reported disappointing revenue performance due to foreign currency pressures and Google ad revenue growing at its slowest pace since 2015. Search growth appears to be slowing down, driven by peaking mobile penetration, while Cloud growth has slowed as well. A partial offset to these two negatives is that YouTube appears to be growing faster than originally expected. The Department of Justice (DOJ) and Federal Trade Commission (FTC), meanwhile, are reviewing large tech companies for potential abuses of monopoly power. However, Alphabet shares are inexpensive even on the reduced growth expectations, and they appear to reflect no value at all for operations such as Waymo.

United Parcel Service (UPS) is the world's largest package carrier. The stock fell after the company missed first-quarter earnings expectations, partly due to weather. Shares were also weighed down by concerns of a global slowdown as economic data decelerated and interest rates collapsed. Transformation initiatives already under way should support margin improvement in the coming years.

Top 10 equity holdings (%)	
Microsoft Corp	6.4
Berkshire Hathaway Inc	3.4
JPMorgan Chase & Co	3.4
Comcast Corp	3.2
Visa Inc	2.9
UnitedHealth Group Inc	2.8
Alphabet Inc	2.7
Apple Inc	2.6
Home Depot Inc/The	2.6
Merck & Co Inc	2.3

Sector allocation (%)	
Information Technology	21.2
Financials	15.2
Health Care	14.0
Communication Services	12.8
Industrials	8.3
Consumer Staples	6.1
Materials	6.1
Consumer Discretionary	5.9
Energy	5.7
Real Estate	1.8
Utilities	0.7
Cash/Other	2.1

Percentages are based on total portfolio as of quarter end and are subject to change at any time. For informational purposes only and not to be considered a recommendation to purchase or sell any security.

Definitions and additional terms:

Please note that an investor cannot invest directly in an index, and unmanaged index returns do not reflect any fees, expenses or sales charges.

Buyback is the repurchase of outstanding shares (repurchase) by a company in order to reduce the number of shares on the market.

Comprehensive Capital Analysis and Review (CCAR) is a regulatory framework introduced by the Federal Reserve in order to assess large banks and financial institutions.

The United States **Department of Justice (DOJ),** is a department of the U.S. government, responsible for the enforcement of law and administration of justice.
Dodd-Frank Act Stress Tests (DFAST) is a bank stress test.
The **Federal Trade Commission (FTC)** is the federal agency responsible for stopping business practices that are either anticompetitive or unfair to consumers.
The **Federal Reserve Board ("Fed")** is responsible for the formulation of policies designed to promote economic growth, full employment, stable prices, and a sustainable pattern of international trade and payments.
Gross domestic product (GDP) is the market value of all final goods and services produced within a country in a given period of time.

A **health maintenance organization (HMO)** is a network or organization that provides health insurance coverage for a monthly or annual fee.
The **Institute for Supply Management's ISM Manufacturing Index** or **PMI Index** is based on a survey of purchasing managers at more than 300 manufacturing firms, and monitors changes in production levels from month to month. A reading above 50 indicates expansion of the manufacturing segment of the economy, below 50 suggests a contraction, and a reading of 50 indicates no change.
The **S&P 500 Index** is an unmanaged index of common stock performance.

The **yield curve** shows the relationship between yields and maturity dates for a similar class of bonds.

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What should I know before investing?

Equity securities are subject to price fluctuation and possible loss of principal. Small- and mid-cap stocks involve greater risks and volatility than large-cap stocks. Short selling is a speculative strategy. Unlike the possible loss on a security that is purchased, there is no limit on the amount of loss on an appreciating security that is sold short. International investments are subject to special risks, including currency fluctuations and social, economic and political uncertainties, which could increase volatility. These risks are magnified in emerging markets.

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Portfolio holdings and sector allocations may not be representative of the portfolio manager's current or future investment and are subject to change at any time.

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