ClearBridge Investments
A Legg Mason Company

2Q 2019 | Product Commentary

CLEARBRIDGE DIVIDEND STRATEGY FUND

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Portfolio Managers

Average annual total returns and fund expenses (%)

as of June 30, 2019

Class A	3-mo	1-yr	5-yr	10-yr	Since Incept. (11/06/92)	Expenses Gross	Expenses Net
Excluding sales charges	5.50	15.18	9.35	12.65	8.89	1.06	1.06
Including effects of maximum sales charges	-0.59	8.57	8.06	11.98	8.65	1.06	1.06
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.

S&P 500 Index is an unmanaged index of common stock performance.

Key takeaways

- Dividend Strategy continued to post solid returns during the second quarter, driven by strong gains in the financials, consumer staples and materials sectors.
- The Federal Reserve's pivot toward accommodative monetary policy boosted markets, but it raises serious questions about the health of the economy and the role of monetary policy.
- While current trade conflicts may be resolved with new trade agreements, the apogee of globalization has passed, and the world is entering a new era of increased nationalism and more restrictive trade.

Market overview and outlook

The stock market rose 4.3% in the second quarter and is now up 18.5% for the year. Dividend Strategy continued to post solid returns during the period, driven by strong gains in the financials, consumer staples and materials sectors. As we discussed in our first-quarter letter, the market's rise has occurred despite a slowdown in the economy. Deteriorating economic fundamentals have driven the Federal Reserve to adopt a more accommodative stance, and markets have cheered.

The market has now begun to price in two interest rate cuts over the next 12 months. The interest rate on the 10-year Treasury ended the quarter at 2.0%, down from 2.4% at the end of the first quarter and 2.7% at the end of 2018. While we welcome the rise in asset prices, we believe that economic

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

concerns persist, and further stock market gains are likely to be modest.

All else being equal, investors' Pavlovian reaction to bid up the markets at the mere mention of lower rates makes sense. Mathematically, lower interest rates warrant higher asset prices. Further, lower interest rates should boost economic activity and thereby drive better growth and earnings.

After a decade of unprecedented monetary policy, however, we wonder if the knee-jerk rise in stock prices makes as much sense as it once did. Interest rates have been at ultra-low levels for 10 years, yet global economic growth has been unable to sustainably break out of the doldrums. Do central banks believe that cutting interest rates now will meaningfully boost economic activity? Or, are they more concerned with keeping capital markets from rolling over?

In our view, the need to cut rates to keep the markets afloat raises serious questions about the strength of the global economy and the role of central banks. We also wonder if a rate cut is the right tonic to fix what ails the economy.

It seems to us that the biggest headwind to recent economic growth has been the escalation in trade wars. It goes without saying that lower interest rates do nothing to address these tensions. While these trade conflicts may be resolved with new trade agreements, we do not think the world will return to the laissez-faire trade environment that prevailed until recently. The political environment has changed (both in the U.S. and abroad), and the new nationalism underpinning current trade conflicts is unlikely to dissipate soon. This changing approach to trade is a paradigm shift for the global economy, with many and varied ramifications. We feel confident that the markets have not adequately digested or priced in these changes, as no one yet knows all the multi-variant ways this retreat from globalization will impact economies, sectors and companies.

In constructing our portfolios, we focus on the things we can control. We select world-class companies with dominant franchises, growing top lines, strong balance sheets, recurring revenues, high returns, prodigious free cash flow and growing dividends. For example, our focus on energy infrastructure companies such as Kinder Morgan and Williams, our two largest energy holdings, gives us exposure to companies with long-term contracts, predictable revenue streams and less sensitivity to commodity prices than the broader energy sector. These companies benefit from the growing volume of oil and gas production in the United States while being largely insulated from the ups and downs of commodity prices. As a result, while the energy sector has been one of the worst performers in the broad market of late due to concerns about slowing global growth, our energy holdings have outperformed the broad sector in 2019. Additionally, Kinder Morgan was able to raise its dividend by 25% in the second quarter, while Williams raised its dividend by almost 12% in the first quarter.

Our materials holdings are also making strong contributions. Here we are focused on relatively less cyclical coatings and specialty chemical companies that have dominant market positions, high returns and strong free cash flow, such as Linde, an industrial gas provider to a variety of industries and a top contributor in the second quarter. On average, our materials holdings have raised their dividends by 8% in the past year.

After a strong start to 2019, the market's rise has continued, albeit at a slower pace. In a lower-growth world characterized by increased volatility and uncertainty, we continue to believe that a diversified portfolio of high-quality companies with the ability to raise their dividends on a sustainable basis is a good place to be.

Fund highlights

For the quarter ended June 30, 2019, the ClearBridge Dividend Strategy Fund — Class A shares had a cumulative return of 5.50%, 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 nine of the 11 sectors in which it was invested for the quarter. The main contributors to Fund performance were the financials, consumer staples and information technology (IT) sectors. The industrials and energy sectors, meanwhile, detracted from absolute results.

On a relative basis, stock selection added to performance for the quarter. In particular, stock selection in the consumer staples, financials and IT sectors contributed positively to relative returns. An overweight to the financials sector and an underweight to the health care sector also proved beneficial. Conversely, stock selection in the industrials sector detracted from relative performance, as did an underweight to the IT sector.

On an individual stock basis, the largest contributors were Blackstone, Microsoft, American International Group, Walt Disney and MetLife. Positions in 3M, Bank of New York Mellon, Qualcomm, Alphabet and United Parcel Service were the main detractors from absolute returns in the quarter.

During the quarter we exited positions in Costco, in the consumer staples sector, Wells Fargo and Bank of New York Mellon, in the financials sector, and AT&T, in the communication services sector. The portfolio received but did not retain shares of DowDuPont spin-offs Corteva (CTVA) and Dow (DOW), and we exited our position in the remaining DuPont de Nemours (DD) business. In addition, Blackstone converted from a limited partnership structure to a C-corporation structure.

Top contributors

Walt Disney (DIS), in the communication services sector, is an entertainment company that conducts operations in media networks, parks and consumer products, studio entertainment and DTC (direct-to-consumer) content. 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 incremental currency translation headwinds. The company has been executing well and it's seeing continued success with Office 365 and its Azure cloud services platform.

American International Group (AIG), in the financial services sector, is a large, diversified insurance company. Shares were up after the company reported meaningful progress on initiatives designed to generate consistent underwriting profits for its property and casualty (P&C) operations. As underwriting changes continue to filter through the profit and loss (P&L) over the coming quarters, margin improvement should be sustainable.

Bottom Contributors

Bank of New York Mellon (BK), in the financials sector, is one of the world's largest global asset servicing firms. Revenue and earnings growth has been pressured by sustained competitive pressures along with a dynamic interest rate environment.

3M (MMM), in the industrials sector, is a global, diversified firm that sells products based on adhesives and films. Shares fell after first-quarter earnings and organic sales growth missed expectations. Investors are also growing concerned about litigation surrounding PFAS.

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, partially owing to trade uncertainty. Transformation initiatives already under way should support margin improvement in the coming years.

Top 10 equity holdings (%)	
Microsoft Corp	4.1
Blackstone Group Inc/The	2.9
Home Depot Inc/The	2.8
Comcast Corp	2.7
Merck & Co Inc	2.5
American Tower Corp	2.4
Apple Inc	2.4
United Technologies Corp	2.3
JPMorgan Chase & Co	2.1
Mastercard Inc	2.1

Sector allocation (%)	
Financials	17.2
Information Technology	13.1
Consumer Staples	11.9
Industrials	10.7
Health Care	8.3
Communication Services	8.0
Materials	7.8
Energy	7.2
Consumer Discretionary	5.7
Utilities	3.2
Real Estate	2.4
Cash/Other	4.4

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.

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.

The **Federal Trade Commission, or FTC,** is the federal agency responsible for stopping business practices that are either anticompetitive or unfair to consumers.

Free cash flow (FCF) is a measure of financial performance calculated as operating cash flow minus capital expenditures.

Laissez-faire is a policy of minimum governmental interference.

The **S&P 500 Index** is an unmanaged index of common stock performance.

Polyfluoroalkyl substances (PFAS) are chemicals used by some manufacturers.

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. Real estate investment trusts (REITs) are closely linked to the performance of the real estate markets. REITs are subject to illiquidity, credit and interest rate risks, and risks associated with small- and mid-cap investments. 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. Derivatives, such as options and futures, can be illiquid, may disproportionately increase losses, and have a potentially large impact on Fund performance. Dividends may fluctuate and a company may reduce or eliminate its dividend at any time. Fixed income securities involve interest rate, credit, inflation and reinvestment risks; and possible loss of principal. As interest rates rise, the value of fixed income securities falls.

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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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