ClearBridge Investments
A Legg Mason Company

1Q 2019 | Product Commentary

CLEARBRIDGE INTERNATIONAL GROWTH FUND

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Portfolio Managers

Average annual total returns and fund expenses (%)

as of March 31, 2019

Class A	3-mo	1-yr	5-yr	10-yr	Since Incept. (02/03/09)	Expenses Gross	Expenses Net
Excluding sales charges	14.14	0.69	7.07	13.82	13.48	1.16	1.16
Including effects of maximum sales charges	7.58	-5.11	5.81	13.14	12.82	1.16	1.16
MSCI EAFE Index	9.98	-3.71	2.33	8.96	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.

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

The MSCI EAFE Index is a free float-adjusted market-capitalization index designed to measure developed market equity performance, excluding the U.S. and Canada. The MSCI EAFE Index consists of the following 21 developed market country indexes: Australia, Austria, Belgium, Denmark, Finland, France, Germany, Greece, Hong Kong, Ireland, Italy, Japan, the Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland and the United Kingdom.

Key takeaways

- Stimulative economic policies and a bounce back of growth stocks from oversold positions drove strong performance for the market and the portfolio.
- We believe the resolution of geopolitical issues and continued strength on the consumer side will support international growth stocks going forward.
- We took advantage of performance gains to take profits and reposition the portfolio across the three types of growth companies we target.

Market overview

International equites staged a broad-based rally in the first quarter, rebounding from fourth-quarter lows on the likelihood of continued accommodation in Europe and China. The benchmark MSCI EAFE Index advanced 9.98%, the MSCI EAFE Small Cap Index added 10.65%, and the MSCI Emerging Market Index gained 9.93%. International growth stocks outperformed their value counterparts with the MSCI EAFE Growth Index up 12.04% for the quarter compared with a gain of 7.92% for the MSCI EAFE Value Index.

International markets rose in the face of stubbornly weak economic data, particularly on the manufacturing side, and ongoing geopolitical headwinds. Manufacturing activity in both Europe and China has been contracting, with the ongoing trade disputes between the U.S. and China contributing to this malaise, impacting the outlook for global growth. Rising input costs on both the commodity front – Brent crude oil was up 24% in the quarter and copper 15% – and wages, have been hurting margins and raised concerns over continued negative earnings impacts.

Offsetting industrial weakness, services PMI is decidedly more positive, with good job and wage growth in most regions. This has been positive for consumer spending, which, when combined with aggressive stimulus measures, have kept the non-manufacturing sectors of the markets in good shape. China has shifted from deleveraging to accommodative policies aimed at stimulating growth and consumption (rather than just increasing lending) and protecting against the negative effects of tariffs. Personal and value-added tax (VAT) cuts, increases in lending facilities and other actions by China are sizable, representing 2.8% of GDP, and they are focused on the consumer, state-owned enterprises and private companies.

The Chinese consumer has been particularly strong, both domestically and through tourism spending in places like Japan. Evidence of that strength has shown up in the performance of Alibaba, the Chinese e-commerce and media conglomerate that was one of the portfolio's best performers during the first quarter. Japanese cosmetics maker Shiseido has benefited from the return of tourism spending after fears of decline with the new Chinese e-commerce law in January, as has luxury goods group LVMH. The consumer portions of the portfolio were some of the best performers to start the year, with the companies we own meaningfully outperforming similar stocks in the benchmark.

Moving west, stocks in Europe and the U.K. represent more than half of the portfolio's exposure, and they managed to hold up against a political backdrop that remains very much unsettled. As of this writing, the Brexit situation remains unresolved, although we are optimistic about a neutral to positive outcome. A solution will likely be reached in April, and we think a "hard Brexit," as in the U.K. leaving the Common Union with trade governed by World Trade Organization (WTO) rules, is unlikely. The U.K. currently has three options: accept Prime Minister Theresa May's Brexit proposal; hold a second national referendum on Brexit – basically a re-vote by a British population with a much better understanding of what leaving the EU entails than three years ago; or revoke Article 50 altogether and remain in the EU as if nothing ever happened. The portfolio has limited exposure to domestic U.K. businesses, and we are optimistic that this will not remain a distraction much longer.

There is a strong chance a resolution will be reached before the broad elections for European Parliament on April 23. We expect these elections to result in the status quo, as the populist factions on the left and the right will have trouble forming coalitions. Stability in the EU Parliament should mean less risk for European equities, while a Brexit resolution would also be a positive for the market. Moving past these events, the biggest long-term risk for Europe is Italy. The fourth-largest economy in Europe is the only one that has made no labor or pension reforms, which makes it less competitive and gives Italy few options if it experiences a recession.

While the ECB has not made drastic moves like the Chinese government, its decision during the first quarter to keep interest rates lower for longer has sparked a rally in growth stocks. In a moderating economy like we are seeing across most of our target markets, growth investors can benefit from rising revenue and earnings and a lower cost of capital. Lower rates are also positive for merger and acquisition (M&A) activity.

Positioning

International growth stocks enjoyed some of their strongest gains in several years in the first quarter, and consistent with our valuation and risk-focused approach, we took some profits by trimming several positions. We also finished selling out of Vale, a Brazilian mining company and the world's largest producer of iron ore, as we saw more upside in other areas.

The proceeds of these sales were directed into several new names across our emerging, secular and structural growth buckets. This diversified approach allows us to access growth in all its forms while helping to control risk. In the emerging growth bucket of higher-risk companies with above-average top-line growth, we tapped into an attractive IPO market with the purchase of Spotify Technology. Spotify is the largest digital music streaming service available on a global basis that services not only subscribers in accessing music but also artists. The company spends significantly in data analytics to understand their fan base and their preferences in order to monetize and grow subscribers and artists. The company is disrupting both the terrestrial radio ad market and the traditional music distribution and promotion model. We believe the company is in the early innings of penetration and growth.

The purchase of Novartis, a Swiss-based global pharmaceutical firm, adds to our group of secular growers that typically offer ballast to the portfolio with limited volatility and good downside protection. Following the spinout of its eyecare business, Alcon, we believe Novartis will be a cleaner story, with potential upside to many of its pharmaceutical franchises. A new CEO is transitioning the company away from a conglomerate structure to focus on prescription medicines, increasing the pace of innovation and redeploying capital toward higher science advanced technology platforms.

We also established a new position in Taiwan Semiconductor (TSM), a name we have owned in the past. TSM is a classic structural growth company, where its future growth path should be much different than in the recent past, in this case due to what we see as a cyclical upswing in the semiconductor cycle. The stock is back to trading at trough multiples relative to the S&P 500 Index, and we think we are past the cyclical weakness in smartphones and cryptocurrency, as well as inventory restocking, and that new product cycles around data centers and 5G should reaccelerate growth. Additionally, TSM has seen a structural shift and is now leading in technological execution, allowing it better pricing, and potentially many more clients. The purchase of Spin Master, a Canadian toy maker and entertainment company, is another structural play that has a very interesting pipeline of new products. The Toys R Us bankruptcy caused the toy market, especially in the U.S., to become highly promotional, providing a one-time opportunity to get into a well-positioned company.

Outlook

While the U.S. is beginning to feel the effects of slowing earnings growth, EU earnings remain depressed and well off their past peak. We see several catalysts that could jump-start earnings over the course of 2019. We have seen currency headwinds rolling through many of the European companies, which has depressed attractive constant currency growth. We believe the FX effects should start to roll off in the second quarter and by the second half of the year and that this should improve investor sentiment around European equities. We have also been seeing higher producer prices, which should lead to pricing power taking hold across industries. This, in turn, should lead to revenue and operating results as price increases go through. And finally, the EU is more exposed to emerging markets than the U.S., and as emerging markets demand becomes less depressed, that should flow through to earnings.

With respect to China, we see recent consumer strength continuing. A resolution in trade negotiations would also help improve sentiment and provide companies all over the world a more predictable playbook from which to manage their businesses. We also expect China's efforts to expand the money supply begin to take effect later in the year, which should provide support to the struggling manufacturing side of their economy.

Fund highlights

During the first quarter, the ClearBridge International Growth Fund Class A shares generated a return of 14.14%, excluding the effects of sales charges. In comparison, the Fund's unmanaged benchmark, the MSCI EAFE Index, returned 9.98%. On an absolute basis, the Fund delivered gains across the nine sectors in which it was invested (out of 11 total), with the primary contributors coming from the financials, IT and industrials sectors.

On a relative basis, overall stock selection and sector allocation contributed to performance. In particular, stock selection in the financials and consumer discretionary sectors drove relative results. Stock selection in the IT, consumer staples and industrials sectors and an overweight to IT also aided performance. Conversely, stock selection in the materials sector detracted from relative performance.

On a regional basis, stock selection in Europe Ex UK, North America and emerging markets had the most significant positive impacts.

On an individual stock basis, the largest contributors to absolute returns in the quarter included Nestle, London Stock Exchange, Alibaba, Shiseido and Shopify. The main detractors from absolute returns included positions in Hansa Biopharma, Amdocs, Spin Master, MonotaRO and Vale.

During the quarter, in addition to the names mentioned above, we established positions in Adyen and Lightspeed POS, in the IT sector, and closed positions in Baidu, in the communication services sector, Keyence, in the IT sector, Voltabox, in the industrials sector, and Orix, in the financials sector.

Top contributors

Nestle, in the consumer staples sector, is a global food company. Financial numbers continue to surpass expectations, particularly on cash flow, and the market has more confidence in the CEO's execution in disposing of laggard businesses and acquiring new businesses with a higher growth trajectory.

London Stock Exchange, in the financials sector, is a leading global securities exchange and data provider. After Brexit fears in the fourth quarter, investors now understand that it has a limited impact on the company. In addition, recent results continued to confirm solid secular growth.

Alibaba, in the consumer discretionary sector, is a Chinese e-commerce conglomerate. Stimulus measures in China oriented toward consumption and better overall economic data and strong quarterly financial numbers led the stock's recovery from the fall in the fourth quarter.

Bottom contributors

MonotaRO, in the industrials sector, is a Japanese online retailer of industrial products. While top-line growth continues above expectations, increases in expenses to support that growth triggered some profit taking. Those stepped-up investments in logistics capacity, automation and data science will allow growth to continue far longer than market expectations.

Amdocs, in the IT sector, is a software provider to entertainment, media and communications companies. Short seller Spruce Capital published a lengthy report recommending that investors bet against the stock.

Vale, in the materials sector, is a Brazilian miner of industrial metals. An industrial accident at its Brumadinho dam at the end of January and fears of excess fines and charges caused stock to fall.

Top 10 equity holdings (%)	
Nestle SA	4.1
Shiseido Co Ltd	4.0
SAP SE	3.2
Diageo PLC	3.2
London Stock Exchange Group PLC	3.0
Rentokil Initial PLC	2.8
LVMH Moet Hennessy Louis Vuitton SE	2.5
Novartis AG	2.5
Canadian Pacific Railway Ltd	2.5
ICON PLC	2.5

Sector allocation (%)	
Financials	15.7
Information Technology	15.5
Consumer Staples	15.2
Industrials	14.6
Health Care	12.2
Consumer Discretionary	11.7
Materials	8.0
Communication Services	4.0
Energy	2.0
Utilities	0.0
Real Estate	0.0
Cash/Other	1.0

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.

Article 50 is a clause in the European Union's (EU) Lisbon Treaty that outlines the steps to be taken by a country seeking to leave the bloc voluntarily.

Brexit is an abbreviation of "British exit," which refers to the June 23, 2016 referendum by British voters to exit the European Union.

The **European Union (EU)** is an economic and political union established in 1993 by members of the European Community. The EU now comprises 28 countries after its expansion to include numerous Central and Eastern European nations.

European Central Bank (ECB) is the central bank responsible for the monetary system of the European Union (EU) and the euro currency.

FX (foreign exchange) is the market in which currencies are traded.

Gross domestic product (GDP) is the market value of all final goods and services produced within a country in a given period of time.

An **initial public offering (IPO)** is the process of offering shares in a private corporation to the public for the first time.

MSCI is an investment research firm that provides indices, portfolio risk and performance analytics and governance tools to institutional investors and hedge funds.

MSCI EAFE Index is a free float-adjusted market-capitalization index designed to measure developed market equity performance, excluding the U.S. and Canada. The MSCI EAFE Index consists of the following 21 developed market country indices: Australia, Austria, Belgium, Denmark, Finland, France, Germany, Greece, Hong Kong, Ireland, Italy, Japan, the Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland and the United Kingdom.

MSCI EAFE Growth Index captures large- and mid-cap securities exhibiting overall growth style characteristics across Developed Markets countries around the world, excluding the U.S. and Canada.

MSCI EAFE Small Cap Index is an index of small-cap representation across Developed Markets countries, excluding the U.S. and Canada.

MSCI EAFE Value Index captures large- and mid-cap securities exhibiting overall value style characteristics across Developed Markets countries around the world, excluding the U.S. and Canada.

MSCI Emerging Markets Index is a free float-adjusted market-capitalization index that is designed to measure equity market performance in the global emerging markets.

Organization of Petroleum Exporting Countries (OPEC) is an organization consisting of the world's major oil-exporting nations.

S&P 500 Index is an unmanaged index of roughly 500 stocks that is generally representative of the performance of larger companies in the U.S.

The **Sustainable Development Goals (SDGs)** are a collection of 17 global goals created by the United Nations in 2015.

The Institute for Supply Management's composite **PMI Index** (formerly the National Association of Purchasing Managers Index) is based on a survey of purchasing executives who buy the raw materials for manufacturing at more than 350 companies.

The **World Trade Organization (WTO**) is based on agreements signed by the majority of the world's trading nations.

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- A broad mix of equities, fixed income, alternatives and cash strategies invested worldwide
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- Over a century of experience in identifying opportunities and delivering astute investment solutions to clients

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. The manager's investment style may become out of favor and/or the manager's selection process may prove incorrect, which may have a negative impact on the Fund's performance. As a non-diversified fund, the Fund is permitted to invest a higher percentage of its assets in any one issuer than a diversified fund, which may magnify the Fund's losses from events affecting a particular issuer. The Fund may focus its investments in certain regions or industries, increasing its vulnerability to market volatility. 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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