ClearBridge Investments
A Legg Mason Company

2Q 2019 | Product Commentary

CLEARBRIDGE LARGE CAP GROWTH 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. (08/29/97)	Expenses Gross	Expenses Net
Excluding sales charges	5.10	13.29	13.73	15.69	9.14	1.05	1.05
Including effects of maximum sales charges	-0.94	6.78	12.39	15.01	8.85	1.05	1.05
Russell 1000 Growth Index	4.64	11.56	13.39	16.28	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/individualinvestors.*

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 **Russell 1000 Growth Index** measures the performance of those Russell 1000 companies with higher price-to-book ratios and higher forecasted growth values. Investors cannot invest directly in an index, and unmanaged index returns do not reflect any fees, expenses or sales charges.

Key takeaways

- A dovish tone by the Federal Reserve sparked a June rally that continued a strong run for the market.
- Our diversified approach to targeting growth stocks at different stages of their business life cycle led us to several new opportunities during the second quarter.
- We are maintaining a balance of offense and defense in the portfolio in anticipation of what we expect to be a volatile period that is typical late in the market cycle.

Market overview

Equities endured a roller coaster ride during the second quarter on the way to finishing at new record highs. The S&P 500 Index gained 4.30% during the quarter and is up 18.54% year to date, its best first-half showing since 1997. Meanwhile, the Russell 1000 Index added 4.25%, while the Russell Midcap Index rose 4.13%. Growth stocks again led the way, with the benchmark Russell 1000 Growth Index gaining 4.64% for the quarter to post a first-half return of 21.49%, topping its value counterpart by 80 basis points (bps) for the quarter and 525 bps year to date.

The U.S. Federal Reserve jump-started the latest up leg for equity markets, as June remarks by Fed Chairman Jerome Powell took a decidedly dovish tone that hinted at future interest rate cuts. Both stocks and bonds rallied on the news, with the 10-Year U.S. Treasury yield retreating to finish the second quarter 40 basis points lower at 2.0%. A suddenly accommodative Fed, joining the easy monetary policy pledge of the European Central Bank, helped ease volatility caused by heightened trade tensions between the U.S. and China – including the banning of U.S. company sales to Chinese telecom equipment provider Huawei, President Trump's threat to impose tariffs on Mexico, and increasing signs of a slowing global economy.

Markets got a further boost late in the quarter on optimism that the G-20 summit would bring the U.S. and China closer to a trade truce. Despite perceived progress, much remains to be worked out over what the trade framework will ultimately be and how that will affect global supply chains. The companies we own in the Large Cap Growth Fund can do well in a low growth environment as long as they know the rules. But the administration's backtracking on trade policy and its use for non-economic reasons – President Trump lifted the Huawei ban, and suspended the latest round of Chinese tariffs at the G-20 meeting, and backed off a threat to impose tariffs on Mexican imports for poor immigration enforcement at its southern border – creates uncertainty on capital spending. We are seeing a pause in activity across industries, from semiconductors to steel companies.

Clearly global economic activity is pausing, and those companies that can grow organically should trade at a premium, since growth is scarce. Investors are willing to pay up to own stocks that can thrive on their own, which has driven up the valuation of portfolio holdings such as Visa and PayPal, which are at the forefront of a massive shift to electronic payments, as well as warehouse retailer Costco and spice & seasonings maker McCormick.

We are also seeing a premium in parts of information technology (IT), which is in the midst of a secular shift to cloud-based workflows. One of the top priorities of the CEOs and CTOs we speak with is to get their data out of on-premise servers and into the cloud, which offers lower costs, better security, lower latency and hence better performance. In-the-top-five holdings Microsoft and Amazon.com benefited during the quarter from continued strong performance in the cloud parts of their businesses, while Equinix, an operator of data centers, also delivered solid results.

Nutanix, a maker of cloud software that enables storage, computing and networking to operate as a single platform, could also see significant upside from helping companies transition to the hybrid cloud. The company was a detractor in the second quarter, however, as it faces increased competition in what is known as the "hyperconverged infrastructure market" and also works through execution issues in moving its business from a licensing to a subscription model. Software makers Palo Alto Networks (information security) and Splunk (data analytics and network security) are also in the midst of business model transitions during which billings and cash flow are often out of sync, causing volatility around short-term results. Like Nutanix, these companies are leaders in their markets and should benefit over time from recurring, subscription-based revenues.

While the cloud and software-as-a-service are powerful trends, we worry that passive flows into the largest stocks in the market are causing growth benchmarks to become overly skewed toward IT and communication services. The portfolio remains underweight in IT, and we will continue to be selective in adjusting our positioning in the sector. Our diversified approach to targeting growth stocks at different stages of their business life cycle led us to several new opportunities during the second quarter.

Portfolio positioning

We participated in the IPO for Uber Technologies, which operates the world's leading ride-share platform. Uber, as well as our first-quarter purchase of Grubhub, reflect our approach of seeking out select growth companies that are increasing revenues at above-average rates by applying new or emerging business models to large addressable markets. Both Uber and Grubhub are aggressively investing in new market opportunities and should see profits follow in the years to come.

Uber, which is classified in the industrials sector, is applying its delivery platform to the ride-share, food delivery and freight logistics industries. The newly public company has a sizable lead over its main competitor in the global ride-share market – 78% of Uber rides in 2018 were outside the U.S. – and we believe it is well positioned in the more competitive, but potentially very large, global food delivery market. While the company will face challenges such as regulatory risks, insurance costs, driver compensation and competition, we believe Uber has scale, top-tier management and share leadership that position it well to thrive profitably longer-term.

New holding C.H. Robinson Worldwide also falls in the industrials sector. However, we view the freight transport and logistics firm as a stable growth company with the industry leadership and financial strength to deliver consistent earnings. C.H. Robinson is the share leader in the highly fragmented market that connects truck drivers with less-than-truckload freight shipments. We see potential for higher operating margins from its technology investment and view fresh food shipped in temperature-controlled trailers as a significant growth opportunity. The company's profitability is more dependent on volume than pricing, which should help balance the risks of growing competition.

In addition to researching new growth opportunities, we constantly monitor existing holdings to ensure our thesis for owning them is intact and that each position is contributing effectively to overall portfolio performance. We exited a position in Biogen following the surprise announcement that the biotechnology firm was cancelling clinical trials for Alzheimer's treatment aducanumab. We have always recognized the risks in Biogen's pipeline, and we continue to see value in its multiple sclerosis and Spinraza franchise; however, the cancellation of its Alzheimer's program could negatively impact the stock's discounted cash flow and long-term risk/reward profile.

The departure of Biogen, combined with the earlier sales of Regeneron Pharmaceuticals and Celgene, has brought down our biotechnology exposure at a time when the industry is in the crosshairs of potential prescription drug pricing and health care reform. We continue to maintain a meaningful allocation to health care, which was a significant contributor to performance during the second quarter on strength in animal health provider Zoetis and Thermo Fisher Scientific, a company we profiled last quarter. With the political season in full swing, eliminating private insurance has become a popular talking point. We believe this is a highly unworkable solution and would require nationalizing all hospitals and primary care. We view access to quality health care as a bipartisan priority and believe that portfolio holding UnitedHealth Group should play a key role in this initiative.

Oil services provider Schlumberger was also sold, as capital spending on exploration & production in its key markets outside the U.S. have taken much longer to recover than expected. While rising oil prices should benefit the company, less-than-crisp execution has held back the stock. Yum China Holdings, which operates KFC, Taco Bell and Pizza Hut restaurants in the world's second-largest economy, was sold as improved execution caused the shares to reach full valuation.

Outlook

We enter the second half against a mixed economic backdrop and a far from settled geopolitical landscape. On the corporate front, earnings growth has been good but a step down from the great results of 2018 ,as the benefits of comprehensive tax reform recede and year-over-year comparables get tougher. The market is also nearing full valuation. Caution is creeping into the IT sector as a semiconductor recovery is being pushed out and hyperscale vendors are digesting previous capacity additions. Regulation of the largest IT and Internet companies could also remain a headwind through the 2020 election cycle.

As discussed above, we have been actively repositioning the portfolio to prepare for these uncertainties. By owning a diversified range of companies with different growth drivers, we are able to maintain a balance of offense and defense in anticipation of what we expect to be a volatile period typical in the later stages of a market cycle.

Fund highlights

For the quarter ended June 30, 2019, the ClearBridge Large Cap Growth Fund — Class A shares had a cumulative return of 5.10%, excluding the effects of sales charges. In comparison, the Fund's unmanaged benchmark, the Russell 1000 Growth Index, gained 4.64%.

On an absolute basis, the Fund had gains across nine of the 10 sectors in which it was invested (out of 11 sectors total). The primary contributors to performance were the IT and communication services sectors.

On a relative basis, overall stock selection contributed to performance. Specifically, stock selection in the communication services and health care sectors was the primary contributor to relative returns. Stock selection in the materials, real estate and consumer staples sectors also helped. On the negative side, stock selection in the consumer discretionary and IT sectors hurt relative performance.

On an individual stock basis, leading individual contributors to absolute returns in the second quarter included positions in Facebook, Microsoft, Walt Disney, Qualcomm and Visa. Nutanix, Alphabet, Palo Alto Networks, W.W. Grainger and Nvidia were the biggest detractors.

During the second quarter, the Fund initiated new positions in Uber Technologies and C.H. Robinson Worldwide, in the industrials sector, and closed positions in Biogen and Regeneron Pharmaceuticals, in the health care sector, Schlumberger, in the energy sector, Yum China, in the consumer discretionary sector, and Red Hat, in the IT sector.

Top contributors

In terms of individual stocks, the top contributors to Fund performance for the quarter included:

Facebook (FB), in the communication services sector, manages a family of online social networking platforms with around 2.7 billion monthly active users and generates revenue principally through advertising. The shares trended higher on the back of strong impressive quarterly results that topped revenue forecasts on strong user engagement and revenue per user. Facebook continues to invest aggressively in its businesses, has tripled the number people it employs to work on issues of data privacy and security in recent years, and has shown a willingness to work with others on issues of regulation, oversight and consistency.

Walt Disney (DIS), in the communication services sector, is a media company that owns a range of entertainment brands including Disney, Marvel, Pixar and Star Wars. It also owns broadcaster ABC and cable channel ESPN, and it recently acquired the film and TV assets of 21st Century Fox. Shares trended higher after the company's analyst day, at which Disney laid out details regarding the investment cost and profit opportunity it envisions for its streaming services expected to launch in November.

Qualcomm (QCOM), in the IT sector, is a developer of wireless communications products and technologies that it licenses to handset makers. The stock was boosted by a long-awaited settlement with Apple over licensing fees. After a bruising two and a half years of litigation, Apple agreed to resume payments to Qualcomm and it will use their chips in future iPhones. Given Apple's scale, this is important both financially and as a testament to the value of Qualcomm's intellectual property. The company also lost its case to the FTC regarding unfair licensing practices, and this court case may add volatility to the shares as it moves through the appellate court. We also have visibility into the ramp-up of 5G smartphones, which should be a positive over the next several years, given its leadership position in 5G.

Bottom contributors

The bottom contributors to Fund performance for the quarter included:

Nutanix (NTNX), in the IT sector, is a developer of cloud platform services and software. The company holds significant market share in a software solution called hyperconverged infrastructure (HCI). The stock de-rated as sales execution issues and higher sales turnover combined with continued investment in lead generation efforts caused the company to deliver weaker-than-expected earnings guidance. We believe this is a short-term headwind and maintain confidence that Nutanix's HCI offering will develop into a leading cloud solution.

Alphabet (GOOGL), in the communication services sector, is a global leader in Internet search, advertising and video through its YouTube channel. The company is also on the vanguard of artificial intelligence, machine learning and cloud. The stock sold off on reports that the Department of Justice will launch a probe into its search practices combined with slowing revenue growth in its core search business.

W.W. Grainger (GWW), in the industrials sector, is a leading supplier and servicer of industrial equipment across a range of commercial markets. First-quarter results that missed revenue forecasts due to modestly weaker-than-expected demand in the U.S. and Canada and a deteriorating manufacturing environment weighed on the stock.

Top 10 equity holdings (%)	
Amazon.com Inc	6.4
Facebook Inc	5.2
Microsoft Corp	4.7
Visa Inc	4.3
Alphabet Inc	3.7
UnitedHealth Group Inc	3.0
Adobe Inc	2.9
Walt Disney Co/The	2.6
Zoetis Inc	2.4
Thermo Fisher Scientific Inc	2.3

Sector allocation (%)	
Information Technology	28.1
Consumer Discretionary	14.0
Communication Services	13.5
Health Care	12.3
Industrials	9.9
Consumer Staples	5.9
Financials	5.0
Materials	3.6
Real Estate	1.9
Energy	1.3
Cash/Other	4.6

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.

A **basis point (bp, or bps)** is equal to 1/100th of 1%, or 0.01%.

A **discounted cash flow (DCF)** is a valuation method used to estimate the attractiveness of an investment opportunity.

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.

The **Russell 1000 Index** measures the performance of the 1,000 largest companies in the Russell 3000 Index, which represents approximately 92% of the total market capitalization of the Russell 3000 Index.

The **Russell 1000 Growth Index** measures the performance of those Russell 1000 companies with higher price-to-book ratios and higher forecasted growth values. (A price-to-book ratio is the price of a stock compared with the difference between a company's assets and liabilities.)
The **Russell Midcap Index** is a complete subset of both the Russell 1000 and the Russell 3000.

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

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Clarion Partners
ClearBridge Investments
EnTrustGlobal
Martin Currie
QS Investors
RARE Infrastructure
Royce & Associates
Western Asset

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- A broad mix of equities, fixed income, alternatives and cash strategies invested worldwide
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What should I know before investing?

Equity securities are subject to price fluctuation and possible loss of principal. 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. 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.