

2Q 2019

Separately Managed Accounts

Product Commentary

# CLEARBRIDGE SMALL CAP GROWTH PORTFOLIOS

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## Small Cap Growth Portfolios

### Annualized returns net and gross of fees - PRELIMINARY

(%) as of June 30, 2019

	1-mo	QTR	YTD	1-yr	3-yr	5-yr	7-yr	10-yr
Net of fees	7.74	4.22	19.53	3.63	16.78	8.15	11.60	13.15
"Pure" gross of fees	7.99	4.99	21.26	6.74	20.25	11.37	14.92	16.52
Russell 2000 Growth Index	7.70	2.75	20.36	-0.49	14.69	8.63	12.87	14.41

**The strategy returns are preliminary composite returns, subject to future revision (downward or upward). Please visit [www.leggmason.com](http://www.leggmason.com) for the latest performance figures. YTD numbers are not annualized.**

Monthly, quarterly and YTD numbers are not annualized. **Past performance is no guarantee of future results.** Please see the GIPS® endnotes for important additional information regarding the portfolio performance and for effects of fees. Management and performance of individual accounts may vary for reasons that include the existence of different implementation practices and model requirements in different investment programs.

**Fees:** Gross performance shown does not reflect the deduction of investment management fees and certain transaction costs, which will reduce portfolio performance. Net performance includes the deduction of a 3.0% annual wrap fee, which is the maximum anticipated wrap fee for equity and balanced portfolios. Actual fees may vary. For fee schedules, contact your financial professional, or if you enter into an agreement directly with Legg Mason Private Portfolio Group, LLC (LMPPG), refer to LMPPG's Form ADV disclosure document.

Returns reflect the reinvestment of dividends and other earnings.

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

**Russell 2000 Growth Index** measures the performance of the small-capitalization growth sector of the United States equity market. It is a subset of the Russell 2000 Index,

which measures the performance of the small-capitalization sector of the U.S equity market.

## Key takeaways

- Stocks ended the quarter slightly higher while enduring significant volatility related to trade tensions, regulatory actions and slowing growth.
- We were active buyers through the turbulence, participating in a handful of IPOs and establishing several other new positions.
- The Portfolio's focus on companies with sustainable business dynamics backed up by robust capital discipline enabled it to hold up well during "risk-off" periods.

## Market overview and outlook

Macbeth's reflection on life seems an apt characterization of second-quarter equity market dynamics. The small-cap growth market basically ended where the quarter began, but oh what fury in between:

- Early May reports of a China trade deal were dashed. Acrimony broke out with sanctions on both sides (Huawei, rare earths, etc.). At quarter end, negotiators and Presidents Trump and Xi gathered at the Osaka G-20 meeting to work on key differences. Trade anxieties were compounded by the Trump administration's promise of unilateral tariffs on Mexico as a cudgel to slow the flow of Latino immigrants to the U.S.;

the Mexican agreement in early June blunted that suggestion.

- Real-time economic statistics in a variety of areas and regions showed deceleration or deterioration, while interest rates collapsed (the 10-year U.S. Treasury ended the second quarter at 2.0%) and the U.S. yield curve inverted.
- Overhangs from the Department of Justice and the Federal Trade Commission, as well as Congressional hearings on the big Internet platforms, caused a swoon in the higher growth Internet/software sector.

As one market commentator aptly noted, “Investors are getting chopped up between covering underweights/shorts and flocking back into old favorites.” The stock market continues to be whipped around by factors and baskets; we continue to take advantage of that as active long-term investors focused on business development and crucial portfolio company fundamentals.

During this period of slowing profit growth expectations (which we expect to be reaffirmed during second-quarter earnings season), we continued to be busy.

While growth investors were centered on what turned out to be the less-than-splashy initial public offering (IPO) debuts of Lyft and Uber, we participated in three successful IPOs where we are looking to build a long-term presence. Revolve Group, in the consumer discretionary sector, is an online-only fashion retailer that differentiates itself through a heavy reliance on data to drive product development and social media influencers to market its products. The company is profitable and continues to be run by a pair of entrepreneurs who founded the brand in 2003. PagerDuty, in the information technology (IT) sector, provides a cloud-based incident and internal surveillance platform for IT teams. Integrated with numerous software products and partners, the company’s software identifies system degradation or outages and notifies appropriate personnel in a variety of ways to avert or minimize enterprise technology incapacity. Grocery Outlet, in the consumer staples sector, is a deep-discount, opportunistic brand grocer selling both low-cost branded goods and staples. The company has an innovative owner/partner structure that drives localized experience as well as competitive returns.

We also began starter positions in two other investments. Glaukos, in the health care sector, is an innovative ophthalmic tech company with a range of minimally invasive ocular stent implants to reduce pressure within the eye from glaucoma, a

leading cause of vision impairment and blindness. The company has an established implantable business with direct distribution in 17 countries, as well as a host of related pipeline products. Among these is iDose, which is used for drug delivery within the eye, potentially obviating the need for glaucoma drops, which have poor patient adherence and compliance. iDose is in phase 3 trials.

Bandwidth, in the communication services sector, provides a cloud-based software platform that enables businesses to run voice and text communications across mobile and other connected devices. As a vertically integrated provider of software and networking, it has a unique value proposition relative to newer software providers or legacy network players and consequently has built substantial market share with leading hyperscale technology, consumer, and enterprise software customers. The company has recently expanded its sales force to take advantage of the secular growth of communications shifting to the cloud and proliferating through app usage. Following this period of reinvestment, the company should see both accelerating revenue and profitability growth as it competes in a rapidly expanding communications end market.

In-the-top-five holding Medidata Solutions agreed to be purchased by Dassault Systemes at a decent premium. We’ve seen the business dramatically expand and develop in the six years since Medidata entered the Small Cap Growth Portfolios. We also bade farewell to two unsuccessful investments: biotechnology firm Acorda Therapeutics, which was hurt by concerns about product uptake and capital availability, and media measurement provider comScore, which sold off on capital concerns and management instability.

We also experienced a few fundamental disappointments that we view as transitory. Drug maker Heron Therapeutics unexpectedly received a complete response letter from the FDA for its non-opioid treatment for post-surgery pain, which will delay commercial rollout for approximately a year. In addition, chipmaker Inphi was down mid-quarter, due to the Commerce Department’s ban on shipments to Chinese telecom equipment maker Huawei, before recovering as trade tensions eased.

Overall, however, the Portfolio held up well during “risk-off” periods. Our relentless attention to sustainable business dynamics backed up by robust capital discipline is a critical foundation. During the jarring May small-cap correction, the Portfolio outperformed the Russell 2000 Growth benchmark. That outperformance is consistent with the Portfolios’ long-term favorable upside/downside capture.

## Portfolios' highlights

The ClearBridge Small Cap Growth Portfolios returned 4.99% (gross of fees) for the second quarter. In comparison, the benchmark Russell 2000 Growth Index returned 2.75% for the same period. Over the longer term, the Portfolios have outperformed the benchmark for the 1-, 3-, 5-, 7- and 10-year periods ended June 30, 2019 (gross of fees).

On an absolute basis, the Portfolios had gains across seven of the 10 sectors in which they were invested during the quarter (out of 11 sectors total). The primary contributors to performance were the industrials and health care sectors.

In relative terms, the Portfolios' outperformance was driven by stock selection and sector allocation. Specifically, stock selection in the health care, consumer staples, industrials and consumer discretionary sectors and an underweight to health care drove results. Meanwhile, stock selection in the communication services sector had a negative impact on relative performance.

The biggest contributors to absolute returns during the second quarter included Insulet, Medidata Solutions, Trex, Copart and Fox Factory. Positions in comScore, Heron Therapeutics, Lions Gate, Surgery Partners and New Relic were the greatest detractors from absolute returns.

In addition to the transactions mentioned above, we also closed a position in Integrated Device Technology, in the IT sector.

## Top contributors<sup>1</sup>

	Contribution to equity return %
Insulet Corporation	0.71
Medidata Solutions, Inc.	0.65
Trex Company, Inc.	0.57
Copart, Inc.	0.57
Fox Factory Holding Corp.	0.47

Source: FactSet.

The leading individual contributors to performance for the quarter included:

**Insulet (PODD)**, in the health care sector, is a medical device manufacturer that develops insulin infusion systems for diabetes patients. The stock was lifted by quarterly results that topped forecasts and an upward revision to full-year earnings guidance.

**Trex (TREX)**, in the industrials sector, manufactures and markets wood alternative decking products for residential and commercial customers. Trex overcame a production snafu which led to supply disruptions during peak selling season, and it announced a new \$200 million capex plan that should provide significant capacity runway, allowing revenue to reaccelerate.

**Copart (CPRT)**, in the industrials sector, is an essential service provider to the insurance industry, recycling or disassembling (for parts) vehicles that have been totaled. Copart has an irreplaceable real estate network of over 200 yards and the logistics to process/scrap/tow/sell. The company reported very strong trends in its first quarter, with non-U.S. markets maturing well (+13% units) and U.S. volumes continuing to be strong (+3%).

<sup>1</sup> Source: FactSet. Portfolio characteristics are based on a model portfolio, not an actual client account. The model portfolio is a hypothetical portfolio whereby the portfolio characteristics are based on simulated trading and account activity of a client account invested in this strategy. The model portfolio assumes no withdrawals, contributions or client-imposed restrictions. Portfolio characteristics of individual client accounts may differ from those of the model portfolio as a result of account size, client-imposed restrictions, the timing of client investments, market conditions, contributions,

withdrawals and other factors. Please see Endnotes for additional information. This information does not constitute, and should not be construed as, investment advice or recommendations with respect to the sectors and securities listed, and it should not be used as the sole basis for any investment decision. **Past performance is no guarantee of future results.**

## Bottom contributors<sup>2</sup>

	Contribution to equity return %
comScore, Inc.	-0.42
Heron Therapeutics, Inc.	-0.32
Lions Gate Entertainment Corp.	-0.24
Surgery Partners, Inc.	-0.23
New Relic, Inc.	-0.21

Source: FactSet.

The leading detractors from performance for the quarter included:

**comScore (SCOR)**, in the communication services sector, is a media measurement provider, tracking consumer behavior and advertising across media platforms. The stock sold off following the resignation of two top executives and the announcement of a cost reduction plan. We subsequently exited the position, as the company's multi-year restructuring plan has been further delayed by these recent events.

**Heron Therapeutics**, in the health care sector, is a pharmaceutical maker with an existing anti-nausea treatment for patients going through chemotherapy. The stock sold off as the FDA issued a negative opinion on its next-generation non-opioid painkiller in clinical trials that will push back commercial approval.

**New Relic (NEWR)**, in the IT sector, provides cloud-based application management software to monitor enterprise performance and infrastructure capabilities. The stock has been under some pressure due to perceived increased competition from private and recently public competitors. Its fiscal year 2020 guidance also reflected short-term investment spending.

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### Market capitalization<sup>3</sup>

Market cap breakdown (\$)	Portfolio weight	Benchmark weight
Above 50 billion	0.00	0.00
25-50 billion	0.00	0.00
10-25 billion	7.76	1.97
3-10 billion	54.26	37.55
0-3 billion	37.99	60.48
<b>Weighted average market cap (\$bil)</b>	<b>4.62</b>	<b>2.86</b>

Source: FactSet.

### Top 10 equity holdings<sup>3</sup>

	Percent of equity
Trex Co Inc	3.46
Insulet Corp	3.35
ICON PLC	3.08
Fox Factory Holding Corp	2.91
Copart Inc	2.76
Wix.com Ltd	2.69
Monro Inc	2.48
Cornerstone OnDemand Inc	2.44
Chegg Inc	2.36
Aspen Technology Inc	2.29
<b>Total number of holdings</b>	<b>72</b>

Source: FactSet.

### Sector highlights<sup>3</sup>

#### Average sector weightings and performance (%)

Gross of fees from 03/31/19 to 06/30/19

Sector	Port. weight	Port. return	Bench-mark*	Bench-mark*	Weight diff.	Active contrib.
Information						
Technology	29.58	3.42	18.66	3.58	10.91	0.04
Health Care	20.71	7.14	25.91	0.51	-5.21	1.48
Industrials	18.40	11.21	18.04	9.27	0.36	0.39
Consumer						
Discretionary	14.97	4.21	14.94	1.68	0.03	0.40
Financials	5.32	2.64	7.21	4.73	-1.89	-0.13
Consumer Staples	4.79	10.20	2.97	0.83	1.82	0.40
Communication						
Services	1.75	-31.81	3.31	-4.53	-1.57	-0.48
Materials	1.33	7.73	3.42	0.94	-2.09	0.13
Energy	1.28	-14.75	1.79	-8.97	-0.51	-0.03
Real Estate	0.31	-11.30	3.23	-0.19	-2.91	0.06
Utilities	0.00	0.00	0.52	4.28	-0.52	0.00
Cash	1.58	0.00	0.00	0.00	1.58	-0.05

\*Benchmark: Russell 2000 Growth Index.

Source: FactSet.

<sup>3</sup> Source: FactSet. Portfolio characteristics are based on a model portfolio, not an actual client account. The model portfolio is a hypothetical portfolio whereby the portfolio characteristics are based on simulated trading and account activity of a client account invested in this strategy. The model portfolio assumes no withdrawals, contributions or client-imposed restrictions. Portfolio characteristics of individual client accounts may differ from those of the model portfolio as a result of account size, client-imposed restrictions, the timing of client investments, market conditions, contributions,

withdrawals and other factors. Please see Endnotes for additional information. This information does not constitute, and should not be construed as, investment advice or recommendations with respect to the sectors and securities listed, and it should not be used as the sole basis for any investment decision. **Past performance is no guarantee of future results.**

## Important information

Any information, statement or opinion set forth herein is general in nature, is not directed to or based on the financial situation or needs of any particular investor, and does not constitute, and should not be construed as, investment advice, a forecast of future events, a guarantee of future results, or a recommendation with respect to any particular security or investment strategy or type of retirement account. Investors seeking financial advice regarding the appropriateness of investing in any securities or investment strategies should consult their financial professional.

Please refer to [www.leggmason.com](http://www.leggmason.com) for more information about the Portfolio, including objective, risks and investment process. The information presented does not constitute and should not be construed as investment advice with respect to any investment discussed. There is no guarantee that investment objectives will be met. An investor cannot invest directly in an index. Investments are not FDIC insured or guaranteed by any government agency. Values may fluctuate due to market conditions and other factors.

### Past performance is no guarantee of future results.

Separately managed accounts (SMAs) are investment services provided by Legg Mason Private Portfolio Group, LLC (LMPPG), a federally registered investment advisor. Client portfolios are managed based on investment instructions or advice provided by one or both of the following Legg Mason-affiliated subadvisors: ClearBridge Investments, LLC and Western Asset Management Company. Management is implemented by LMPPG, the designated subadvisor or, in the case of certain programs, the program sponsor or its designee.

These materials are being provided for illustrative and informational purposes only. The information contained herein is obtained from multiple sources that are believed to be reliable. However, such information has not been verified, and it may be different from the information included in documents and materials created by the sponsor firm in whose investment program a client participates. Some sponsor firms may require that these materials be preceded or accompanied by investment profiles or other documents or materials prepared by such sponsor firms, which will be provided upon a client's request. For additional information, documents and/or materials, please speak to your financial advisor.

## Risks

All investments involve risk, including loss of principal, and there is no guarantee that investment objectives will be met.

Substantial investments may be made in speculative and/or small-cap and mid-cap companies, which involve a higher degree of risk and volatility than investments in larger, more established companies. In addition, because the investments may be concentrated in a limited number of industries and companies, the Portfolios may involve heightened risk. The investment process may change over time.

While most investments are in U.S. companies, investments may also be made in ADRs and other securities of non-U.S. companies in developed and emerging markets, which involve risks in addition to those ordinarily associated with investing in domestic securities, including the potentially negative effects of currency fluctuation, political and economic developments, foreign taxation, and differences in auditing and other financial standards. These risks are magnified in emerging markets.

Diversification does not assure a profit or protect against market loss.

## Definitions and additional information

An investor cannot invest directly in an index, and unmanaged index returns do not reflect any fees, expenses or sales charge.

**Capital Expenditure (capex)** are funds used by a company to acquire or upgrade physical assets such as property, industrial buildings or equipment.

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.

**Food and Drug Administration (FDA)** is a government agency established in 1906 with the passage of the Federal Food and Drugs Act.

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 **Group of 20, or G20**, is a group of finance ministers and central bank governors from 19 of the world's largest economies, including those of many developing nations, along with the European Union.

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

**Russell 2000 Growth Index** is an unmanaged index of those companies in the small-cap Russell 2000 Index chosen for their growth orientation.

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

## ClearBridge Small Cap Growth SMA – GIPS® endnotes (\$USD) — Ending December 31

Strategy inception date: November 2008; Composite creation date: October 2008

Period	Total return (net)	Total return (*pure gross)	Russell 2000 Growth Index return	Number of portfolios	% of bundled fee portfolios in the composite	Composite dispersion	Composite 3 Yr. Standard Deviation	Benchmark 3 Yr. Standard Deviation	Total composite assets at end of period (USD million)	% of firm assets	Total firm assets at end of period (USD million)
2018	1.21%	4.25%	-9.31%	122	100	0.43%	16.67%	16.69%	43.6	0.0%	106,083.4
2017	20.00%	23.54%	22.17%	25	100	0.38%	14.67%	14.80%	31.4	0.0%	119,187.1
2016	3.56%	6.67%	11.32%	15	100	0.14%	16.56%	16.91%	22.9	0.0%	100,936.9
2015	-6.12%	-3.28%	-1.38%	28	100	0.16%	15.16%	15.16%	38.7	0.0%	92,536.4
2014	2.21%	5.28%	5.60%	45	100	0.35%	13.58%	14.02%	48.1	0.0%	100,721.5
2013	44.11%	48.30%	43.30%	14	100	0.72%	15.55%	17.52%	5.9	0.0%	85,024.7
2012	14.55%	17.95%	14.59%	7	100	n/m	18.19%	21.01%	1.6	0.0%	54,624.3
2011	-0.40%	2.60%	-2.91%	<5	100	n/m	19.83%	24.65%	0.5	0.0%	50,870.8
2010	22.38%	26.00%	29.09%	<5	100	n/m	n/a	n/a	0.5	0.0%	55,366.5
2009	36.65%	40.64%	34.47%	<5	100	n/m	n/a	n/a	0.1	0.0%	53,522.7

\*Pure gross of fee returns do not reflect the deduction of any expenses, including transaction costs, and are presented as supplemental to the net of fee returns.

n/m - Information is not statistically meaningful due to an insufficient number of portfolios in the composite for the entire year.

### Compliance Statement:

ClearBridge Investments, LLC claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. ClearBridge Investments, LLC has been independently verified for the periods January 1, 1997 - December 31, 2017. The verification reports are available upon request.

Verification assesses whether (1) the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and (2) the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. Verification does not ensure the accuracy of any specific composite presentation.

### Firm Information:

ClearBridge Investments, LLC ("ClearBridge") is a wholly owned subsidiary of Legg Mason, Inc. ("Legg Mason"). The investment advisory business now known as ClearBridge was registered in September 2005 to facilitate Legg Mason's acquisition of substantially all the equity asset management businesses known as Citigroup Asset Management. These former businesses serve as the foundation of ClearBridge and its claim of GIPS compliance for institutional accounts through predecessor firms, effective as of January 1997. In June 2008, ClearBridge combined this business with its retail business to form a single GIPS firm. As of April 1, 2013 and January 1, 2016, ClearBridge's affiliates, Global Currents Investment Management, LLC, and ClearBridge, LLC, respectively, have become part of the ClearBridge GIPS firm.

### Composite Information:

The ClearBridge Small Cap Growth SMA composite consists of discretionary wrap accounts with an account minimum of US \$25,000. Accounts within the composite seek long-term capital growth by investing primarily in U.S. small capitalization growth stocks. The strategy is implemented by Legg Mason Private Portfolio Group, LLC (LMPPG).

LMPPG claims compliance with the Global Investment Performance Standards (GIPS®) and has been independently verified for the periods January 1, 2013 - December 31, 2017. The verification reports are available upon request. Verification assesses whether (1) the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and (2) the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. Verification does not ensure the accuracy of any specific composite presentation. The main risks of this strategy are General Investment Risk, Small Cap Risk, High Volatility Risk and Non-U.S. Investment Risk. Non-fee-paying seed capital portfolios represented the following percentage of composite assets: 100% as of December 2008 and 2009; 36% as of December 2010 and 2011; 13% as of December 2012.

### Input and Calculation Data:

The fee schedule currently in effect is 3.00% on all assets. Net of fee composite returns are calculated by reducing each monthly composite pure gross rate of return by the highest "bundled" fee charged (3.00%) annually, prorated to a monthly ratio. The "bundled" fee includes transaction costs, investment management, custodial, and other administrative fees. Effective January 1, 2013, the number of portfolios reflects a change from prior periods due to an aggregation of accounts as reported by one sponsor. As of January 2014, the internal dispersion of annual returns is measured by the asset-weighted standard deviation of portfolio returns included in the composite for the entire year. For prior years, the equal-weighted standard deviation was used. The composite employed a 10% significant cash flow policy which was discontinued in January 2012. A list of composite descriptions is available upon request. Policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request. Past performance is not necessarily indicative of future results.

### Benchmark Information:

The Russell 2000® Growth Index measures the performance of those Russell 2000 companies with higher price-to-book ratios and higher forecasted growth values. Benchmark returns are not covered by the report of independent verifiers.

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