

CLEARBRIDGE VALUE TRUST

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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. Expenses		
					(02/02/09)	Gross Net	
Excluding sales charges	2.44	4.70	6.25	11.63	13.47	1.06	1.06
Including effects of maximum sales charges	-3.45	-1.33	5.00	10.97	12.82	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 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

- Having global bond and equity markets in total disagreement is not unique to the second quarter, but the magnitude of cross-market dissonance has been increasing.
- There are several scenarios where the pricing embedded in both bond and equity markets could prove to be spectacularly wrong.
- With no evidence of inflation and some mounting signs of a global slowdown, we have worked hard to diversify the cyclical exposure in the portfolio so it can be much less dependent on macro forecasts and more robust to a broad range of potential outcomes.

Market overview

One of the biggest paradoxes in financial markets is that investors are forced to accept irreducible uncertainty about the future, and yet we collectively cling to forecasts in a desperate attempt to reduce the irreducible. Basically, when it comes to the future, no one knows, but everyone wants to know. Dealing with this paradox leads most people down a path of either stubborn denial of uncertainty or grudging acceptance. Investors should choose the acceptance route. Our expectations-driven investment process helps turn the uncertainty of the future into an advantage. To illustrate, this letter will walk through a few steps, starting with a macro forecasting exercise and then drilling into portfolio construction and some individual stock examples.

Evaluating forecasts is always challenging, even in hindsight, as most forecasters are skilled in the art of using vague

probabilistic terms that makes the forecast “appear” correct across a broad range of outcomes. However, let’s pretend there was a perfect second-quarter forecast that got all the Trump tweets right and knew the trade war was going to intensify, global growth was going to slow, and fears of a recession were going to increase to such a degree that Fed easing was back on the table. If you had this perfect forecast, there would still be the challenge of predicting market outcomes, and how easy would that be?

There would certainly be some forecasting logic to support the second quarter’s global plunge in interest rates, but maybe not to the degree that has priced a new record \$13 trillion in bonds at negative yields. Combine that global abundance of bonds that guarantee a long-term loss with the continued inversion of the U.S. Treasury yield curve, and the world’s sovereign debt markets have priced in a very high probability of recession. How does that extreme embedded expectation reconcile itself with U.S. equity indexes at record highs, and very benign credit spreads? Even with global central banks’ artificially low rates acting as liquidity-driven rocket fuel for almost all asset prices, we struggle to see how even the world’s greatest forecast could cut through the noise and fit a macro and market forecast into a cohesive package.

Having global bond and equity markets in total disagreement is not unique to the second quarter, but the magnitude of cross-market dissonance has been increasing. Why? We suspect it’s a powerful feedback loop between capital flows and price momentum. During the second quarter, capital flows to bonds versus equities reached record levels. This added a tremendous amount of fuel to bond markets already supported by the major central banks, especially with resurrected hopes the U.S. Federal Reserve is getting back in the easing game. The capital flows that did target equities were guided by the deep feedback channels that have come to favor what has worked over this market cycle, specifically U.S. tech stocks. As a result, tech ended up as the best-performing sector year to date, but it wasn’t due to fundamentals. According to Bernstein research, the 12-month outlook for revenue and earnings growth is worse for tech than the overall U.S. market. Despite these fundamental headwinds, tech valuation multiples have expanded over 40% so far in 2019, versus a still-healthy 20% multiple expansion for the overall market, with the tech sector now trading at a 15-year high versus the broader market.

This divorce from underlying fundamental reality is why feedback loops ultimately lead to excess and then dramatic reversals. The current challenge for investors, however, is the massive divergence in what feedback has priced into these two

major asset classes. Bonds are increasingly priced for a recession and little else; a recession would ultimately crush tech stocks, which remain cyclical despite current narratives focused on cycle-escaping secular growth. There are also scenarios where the pricing embedded in both markets could prove to be spectacularly wrong.

The value of diversifying cyclical exposure

A core goal of our investment process is to invert the forecasting challenge and build diverse portfolios that are not reliant on a narrow or extreme set of scenarios. In some ways achieving greater diversification than the indexes has never been easier, given the shift away from active management. With so much capital concentrated in the major U.S. equity indexes, passive exposure has become increasingly less diversifying. More and more people are skewed to U.S. assets, and particularly U.S. tech. If anything, this feedback process is accelerating, but it is also dependent on extrapolation and is increasingly vulnerable to change.

The gift for active managers, if you make what has been a difficult choice to diverge from the index, is that there are myriad ways to create much more diverse portfolios vis-à-vis the index. Greater diversity makes a portfolio much less dependent on macro forecasts and more robust to a broad range of potential outcomes. We think we have achieved this diversification goal, and it has been achieved without sacrificing a valuation or fundamental advantage versus the index. As we highlighted in last quarter’s update, we continue to enjoy a portfolio with better earnings estimate revisions than the broader market. This has also translated into a higher starting cash dividend yield than the market, with better growth prospects. What’s the catch?

Well, one of the great divergences in the market is the now-extreme valuation difference between growth and value stocks at a broad level. Expensive stocks are getting more expensive and cheap stocks are getting cheaper, and in a classic sign of feedback the divergence is accelerating. As this process has continued, many value stocks are already reflecting a recession. As a result, the market is paying us a nice premium to take on the macro risk from cyclical stocks in the form of attractive free cash flow yields, good existing returns, clean balance sheets and capital returns through buybacks and dividends that are well above the market.

Portfolio positioning

One of the best ways to capture this value premium is in the financials sector, which remains our biggest overweight. Investors remain wary of financials, given their near-death

experience during the Great Financial Crisis (GFC), but regulated U.S. financials stocks have gone from too little capital during the GFC to excess capital. This excess capital is being paid out through dividends and buybacks that are generating at or above a 10% total yield for many of our holdings. This yield is in the top decile of the broader U.S. equity market and is a massive compounding advantage in a world with over \$13 trillion in negative yielding debt. In many ways, the regulatory response of the GFC has paid big benefits for financials shareholders, and regulatory risk has moved on to the much-beloved tech sector.

An added benefit of financials is that the stocks embed a free option on what we think would be the biggest surprise for markets: a policy mistake that leads to higher sovereign interest rates. Financials stocks would be one of the few and the biggest beneficiaries of a shift in the macro environment to higher rates. To be clear, this would be the ultimate surprise, as there is no evidence of risks being built into so-called risk-free sovereign yields and no sign of inflation inflecting higher; and interest rates have just gone the other way in a dramatic fashion. However, we think policy risk that could drive such a change is rising dramatically. We have an executive branch that is trying to politicize the Fed, coupled with an increased belief that debt can be monetized to support fiscal expansion. If anything, the longer inflation stays dormant and term premiums built into interest rates remain negative, the more policy will shift away from the initial conditions that give us the policy flexibility we enjoy today: the extreme political independence of the Volcker Fed.

Risks that can be conceptualized but not observed in any data are always the greatest risks for investors. The current observed data support a healthy fear of deflation, and that risk is accordingly dearly priced in almost all assets. On the other side, what we consider the tail risk of higher rates is all theory and in no current data, but we are rapidly establishing new ground on the policy front. The risks of the unobserved, however, are what market turning points are made of. At turning points, markets have proven to be non-ergodic, which is a fancy way of saying that observed past probabilities no longer apply to future outcomes. One of the great historical examples was that a root cause of the GFC was that housing prices had never declined in aggregate, until they did. The result was a record amount of capital destruction on, ironically, AAA-rated assets. As market cycles age, the assets that are most cherished are often the most dangerous, even when they are considered the safest assets. With indexes losing diversification and “safe” bond yields once again approaching

record-low levels, we think policy risk could prove to be this cycle’s non-ergodic match.

However, with no evidence of inflation and some mounting signs of a global slowdown, we have worked hard to diversify the cyclical exposure in the portfolio. The most differentiated way we have tried to do this is through a top-10 position in the royalty gold streamer Royal Gold. The stock enjoys a tight correlation with the price of gold, which has made it a highly diversifying and defensive position. In addition, given the mounting policy risks we are observing, if there is ever a time to own gold, we think it’s now.

Besides gold, with defensive stocks in great demand, especially during the second quarter, our challenge has been to buy individual defensive stocks without paying a steep defense valuation premium. We want insurance on the cheap. These opportunities have typically come by buying sustainably high dividend yields in out-of-favor sectors, such as what we did with MLPs in energy. We also will buy a stable defensive business after an unsustainable dividend has been cut to a sustainable level. Buying after a cut has often led to good outperformance, as the market seems to initially underappreciate the improved footing as a company addresses its issues and the long-term prospects for a return to dividend growth. Finally, there are also times when companies in traditional defensive areas, like utilities and staples, fall below business value and we can buy quality when no one wants it. This contrarian approach to defense has worked well for us and has accomplished our goal of diversifying the cyclical value exposure.

One area of defense that has not worked well for us, but may be starting to see better days, is drug stocks. As several large biotech and pharmaceutical stocks declined over the last few years, we built out a large portfolio of positions trading well below our assessment of business value. Unfortunately, the valuation multiples on these stocks declined to a much deeper level than we expected, which has made these stocks anything but defensive. The root cause of the valuation compression has been fears about the underlying business models as drug price inflation has slowed, and there are lingering concerns of a regulatory backlash. Unlike the rest of health care, we think these regulatory and pricing risks are now fully reflected in our holdings, and the stock prices are now embedding long-term value destruction from research and development (R&D). Historically, buying R&D when it is heavily discounted by the market has been a good long-term strategy, and it was a major factor in the announced strategic acquisition of two of our holdings, Celgene and Allergan, so far in 2019. Even at

substantial deal premiums, both stocks are still trading well below market valuation multiples and our assessment of long-term value. Thus, we think these will prove to be good deals, as the acquirers are getting cash flows at a discount and R&D optionality for free. Most importantly, these deals should stabilize sector valuations, and allow some of the defensive characteristics of these stocks to come through for the portfolio.

Consistent with the diversification strategy we discussed above, our new investments this quarter were split between two high dividend yield stocks and two heavily discounted cyclical value stocks.

Starting on the yield side, we invested in tobacco stock, Altria. Unlike most staple stocks, Altria is cheap at 10x earnings and a 6.6% cash dividend yield, as the market has real concerns about its business model from lower-risk nicotine products. However, we think the erosion in the traditional combustible cigarette market will be slower than what the stock embeds. In addition, we think Altria is well-positioned for various disruption scenarios, due to its aggressive investments in new market-leading products, including Juul (vaping), IQOS (heat but not burn), and most recently On! (nicotine pouch). As a result, we think Altria stock is much better hedged against change than the market believes, and that continued earnings growth and a compounding dividend will close some of the historically wide discount to the staples group.

On the high-yield front in cyclical sectors, we added Energy Transfer, a \$38 billion market cap MLP that owns and operates a diverse portfolio of natural gas, natural gas liquids and crude midstream assets. The stock is trading at a deep discount of over 30% to most of its midstream peers. At this discounted price, the dividend yield of 8.4% does not reflect its growing high-quality and diversified asset base. The discount is due to legacy issues with a complex ownership structure, concerns about governance and excessive leverage. However, substantial changes have been and are being made to address these issues, and declining capital spending will drive ample cash flows to materially reduce debt. With a high and sustainable dividend yield, more than 85% fee-based earnings stream, and a very low correlation with the cyclical side of the portfolio, Energy Transfer is a classic example of defense in a value wrapper.

On the deep-value cyclical side we invested in a recently spun-off life insurance company AXA Equitable Holdings. The life insurance sector is one of the most depressed sectors in the market, as it is seen as extremely vulnerable to macro risks from low interest rates. These macro concerns have resulted in a very depressed valuation for AXA, with the stock trading at

3x forward earnings, adjusted for its 65% ownership of publicly traded asset manager, Alliance Bernstein. The stock is under additional market pressure, as its parent company has been selling down the 39% of AXA shares it still owns. We believe that AXA's interest rate risk has been greatly reduced from robust reserves, derivative hedging strategies and the ongoing decline in its higher-risk variable annuity book. Despite the macro headwinds, AXA generates a low-double-digit return on equity and generates enough free cash flow to sustain and grow an almost 3% cash dividend while buying back roughly 5% of the stock. These favorable current fundamentals and extremely low valuation gives us a positive carry option if interest rates ever do move higher.

Finally, we are slowly building a position in Corteva, the global agriculture science leader in seeds and crop protection that was recently spun off from DuPont. The stock has been pressured since the spinoff by a confluence of factors resulting in lower near-term financial results, including a weak corn planting season, unfavorable weather, U.S.-China trade tensions and African Swine Fever. We like the long-term secular growth opportunities and the strong competitive moat of the business. We believe the stock will ultimately outperform as multiple short-term headwinds dissipate, and as post-spin-off operating metrics improve.

One of the first things investors learn about is the virtue of the only free lunch in finance: diversification. As market feedback loops drive the indexes toward concentrated extremes, the opportunity and obligation of active managers is to keep diversification on the menu. Diversification will always be critical as investors can never escape the paradox of uncertainty, and portfolios must maintain a robustness to surprise. Our investment process embraces the reality of irreducible uncertainty, as our long-time goal is to build diverse portfolios with embedded expectations well below what history has delivered and a wide range of potential futures.

Fund highlights

During the second quarter of 2019, the ClearBridge Value Trust – Class A shares generated a total return of 2.44% 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 six of the 11 sectors in which it was invested during the quarter. The primary contributors to the Fund's performance were the financials and information technology (IT) sectors. The main detractors were the health care and energy sectors.

In relative terms, the Fund underperformed its benchmark during the quarter primarily due to stock selection decisions. Stock selection in the health care, communication services and consumer discretionary sectors detracted the most from relative returns during the period. Conversely, stock selection in the financials and IT sectors boosted relative results. In allocation, an overweight to the energy sector detracted, while an overweight to the financials sector added to relative performance.

On an individual stock basis, the greatest contributors to absolute returns during the quarter included positions in American International Group, Microsoft, Allergan, Royal Gold and Qualcomm. Mylan, Alphabet, Encana, Fluor and Capri were the largest detractors from absolute performance.

Besides the new positions discussed above, portfolio activity for the period included sales of ABB and Fluor, in the industrials sector, and Biogen, Universal Health Services and Merck, in the health care sector.

Top contributors

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.

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 is seeing continued success with Office 365 and its Azure cloud services platform.

Allergan (AGN), in the health care sector, is a specialty pharmaceutical maker offering branded and generic drugs, including Botox, as well as over-the-counter treatments. The stock rose over 25% after rival drug maker AbbVie confirmed acquisition of Allergan for \$188.24/share in a cash and stock transaction for a transaction equity value of ~\$63B.

Top detractors

Mylan (MYL), in the health care sector, sold off after reporting a revenue miss in Europe, although overall earnings were ahead of consensus, and again after lawsuits were filed alleging generic drug makers of conspiring to raise medicine prices. The top line miss was mainly due to currency, and

operating income was in line. With further new product launches (\$1.1B in total in 2019), we found the severe stock price drop inconsistent with the fundamental trajectory, especially given the improving U.S. generic market condition. We have reason to believe first-quarter headwinds were due to one-off issues in Europe and that cash flow should recover starting in the second quarter. Meanwhile, the first settlement reached between the government and generic company Heritage Pharmaceuticals of \$7.1M regarding price fixing suggests MYL's legal liability should be manageable.

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 DOJ and FTC, meanwhile, are reviewing large tech companies for potential abuses of monopoly power. However, Google shares are inexpensive even on the reduced growth expectations, and they appear to reflect no value at all for operations such as Waymo.

EnCana (ECA), in the energy sector, produces and distributes natural gas throughout North America. Encana delivered its sixth consecutive earnings beat driven by increased production volumes and higher oil price realizations. At the same time, income fell year over year due to lower natural gas sales price, quarterly revenue decreased 6% year over year and sentiment in the energy sector remained extremely challenged, driving down the stock.

Outlook

Global bond and equity markets are in total disagreement: the world's sovereign debt markets have priced in a very high probability of recession, while U.S. equity indexes are at record highs. The current challenge for investors is the massive divergence in what feedback has priced into these two major asset classes. In equities, tech ended up as the best-performing sector in the first half of 2019, but it wasn't due to fundamentals. According to Bernstein research, the 12-month outlook for revenue and earnings growth is worse for tech than the overall U.S. market. This divorce from underlying fundamental reality is why feedback loops ultimately lead to excess and then dramatic reversals.

Given the difficulty of forecasting macroeconomic and market developments, a core goal of our investment process is to invert the forecasting challenge and build diverse portfolios that are not reliant on a narrow or extreme set of scenarios. Greater diversity makes a portfolio much less forecast dependent and more robust to a broad range of potential outcomes. We think we have achieved this diversification goal, and it has been achieved without sacrificing a valuation or fundamental advantage versus the index.

Top 10 equity holdings (%)	
Microsoft Corp	6.1
Alphabet Inc	5.2
Allergan PLC	4.5
American International Group Inc	4.3
Oracle Corp	3.6
Kinder Morgan Inc/DE	3.3
Synchrony Financial	3.3
Wells Fargo & Co	3.3
Royal Gold Inc	3.1
Alexion Pharmaceuticals Inc	2.8

Sector allocation (%)	
Financials	21.6
Information Technology	15.4
Energy	11.0
Health Care	10.7
Consumer Discretionary	7.3
Consumer Staples	6.9
Communication Services	6.5
Industrials	6.3
Utilities	4.2
Materials	4.1
Real Estate	1.8
Cash/Other	4.2

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.

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.

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

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 **Great Financial Crisis** was the recessionary period between December 2007 and June 2009 caused primarily by the U.S. housing market bubble collapsing.

A **master limited partnership (MLP)** is a type of business venture that exists in the form of a publicly traded limited partnership.

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

U.S. Treasuries are direct debt obligations issued by the U.S. government and backed by its "full faith and credit." The U.S. government guarantees the principal and interest payments on U.S. Treasuries when the securities are held to maturity.

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

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- A broad mix of equities, fixed income, alternatives and cash strategies invested worldwide
- A diverse family of specialized investment managers, each with its own independent approach to research and analysis
- 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. 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. 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. Because this Fund expects to hold a concentrated portfolio of securities, and invests in certain regions or industries, it has increased vulnerability to market volatility.

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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.

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.

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