



**Peter Bourbeau**  
Managing Director,  
Portfolio Manager



**Margaret Vitrano**  
Managing Director,  
Portfolio Manager

## Large Cap Growth Strategy

### Key Takeaways

- ▶ With bond yields falling, growth remained in favor during the quarter, capping a year that saw large cap growth stocks top large value stocks by the second-largest margin in history.
- ▶ Supported by strong stock selection among the Magnificent Seven, opportunistic management of earnings reset names and diversified contributions outside technology, the Strategy outperformed the benchmark for the quarter and full year.
- ▶ We believe broadening participation and an expected increase in volatility will be supportive of our diversified approach, leading us to increase exposure to cyclical and stable growth companies during the quarter in the financials, health care and consumer sectors.

### Market Overview

Stocks surged in the fourth quarter to end the year near all-time highs, boosted by plunging bond yields and growing optimism that the U.S. economy will pull off a soft landing. Signs of cooling inflation and a slowing labor market not only reversed a two-year climb in yields but also increased the likelihood that the Federal Reserve had completed its tightening cycle, sending the S&P 500 Index 11.69% higher for the quarter and 26.29% higher for the year. The technology-laden NASDAQ Composite advanced 13.56% for the quarter to finish up 43.42% for 2023.

With the 10-year Treasury yield declining 70 basis points during the quarter, growth remained in favor among larger cap stocks, with the benchmark Russell 1000 Growth Index rising 14.16% and outperforming the Russell 1000 Value Index by 467 bps. For the year, the growth index climbed 42.68%, outperforming value by over 3,100 bps, second only to 2020 as the largest performance differential in investment styles since both indexes launched in 1987.

Much of that differential can be attributed to the performance of the Magnificent Seven (Alphabet, Amazon.com, Apple, Meta Platforms, Microsoft, Nvidia and Tesla), a basket of mega cap growth stocks that accounted for 47.8% of the benchmark return for the quarter and 65.4% for 2023.

The ClearBridge Large Cap Growth Strategy maintains exposure to six of the seven stocks, with overweights in Amazon.com, Meta and Nvidia. Those three stocks, as well as Microsoft, were among the leading contributors to Strategy performance for the quarter. Microsoft and Nvidia continued to be supported by strong execution and leadership positions in the implementation of generative artificial intelligence (AI),

Amazon benefited from strong margin expansion across segments, most notably its core e-commerce business, while Meta saw accelerated revenue growth and share gains in online advertising.

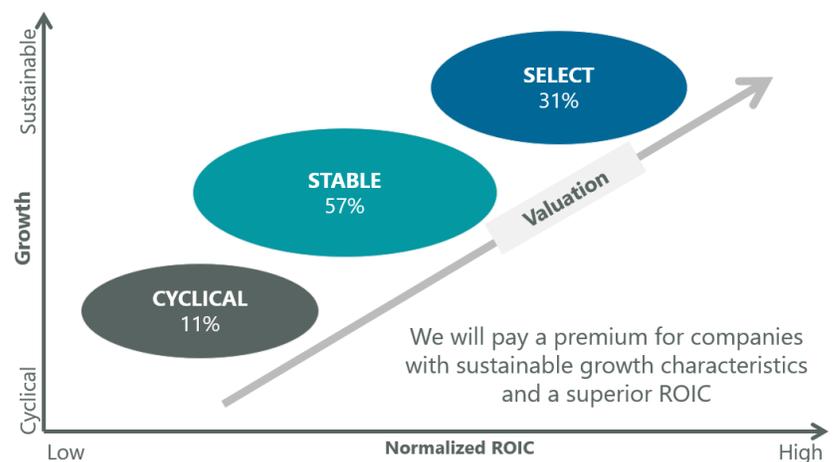
These are high-quality, cash flow generative businesses that we will continue to own, actively adjusting our positioning sizes based on risk/reward and portfolio construction priorities. With Nvidia shares more than tripling in 2023, we opportunistically took profits throughout the year, an approach that continued in the fourth quarter with additional trims that brought the position down to 6% of overall assets.

Active management of our mega cap exposure contributed to the Strategy outperforming the benchmark both in the fourth quarter and through the narrow leadership market of 2023. We also attribute these improved results to solid stock picking, being opportunistic in adding to or initiating new positions in growth companies at or near the bottom of their earnings cycle, and maintaining a commitment to diversification across our three buckets of growth: select, stable and cyclical.

### Portfolio Positioning

We tactically shifted our bucket allocations throughout the year to best position the portfolio for a slowing growth environment. While skeptical about the likelihood of a soft landing, we are less concerned about whether the economy falls into a recession than about the duration of that downturn. As a result, our actions in the fourth quarter involved taking some profits, consolidating small positions among select growth names and shifting more assets into companies in our stable and cyclical buckets. At quarter end, 57% of portfolio assets were in the stable bucket, 31% in the select and 11% in the cyclical.

Exhibit 1: Diversification Across the Spectrum of Growth



Growth bucket weightings as of Dec. 31, 2023. Source: FactSet, ClearBridge Investments.

Evolving our fundamental research and portfolio monitoring process to promote better ongoing collaboration with ClearBridge's Sector Analyst Team has enabled us to identify opportunities and risks more efficiently and take decisive actions in a timely manner. We exited our position in DexCom, for example, during the quarter by looking past the broadly negative noise about GLP-1 impacts on medical devices and understanding that our assumptions about DexCom's long-term growth rate, particularly in the Type-2 diabetes market, now seem more aggressive than we had previously thought. We directed the proceeds of the sale into our higher-conviction health care holdings, including Thermo Fisher Scientific and Stryker.

Other exits in the quarter included longtime software holding Splunk, whose data monitoring and security solutions are a key part of customer's enterprise application stack, ahead of its acquisition by Cisco Systems. We also sold Unity Software, a select growth name purchased in early 2022 to participate in the growth of the global video game market, as our thesis no longer remains valid. Via M&A, Unity has diversified away from its game engine subscription business into the less differentiated advertising segment and most recently saw negative customer reaction to price increases, calling into question the offering's pricing power.

We added some ballast to the stable bucket with the purchase of Intercontinental Exchange (ICE) in the financials sector. ICE operates securities exchanges, fixed income and data services as well as mortgage technology solutions. The timing of its recent acquisitions (Ellie Mae and Black Knight) has increased exposure to a mortgage market in a cyclical downturn, compressing the stock's multiple and offering an attractive entry point to build a position. Exchanges offer high operating margins, strong free cash flow generation and limited interest rate and credit risk while benefiting from the increasing complexity and globalization of capital markets and demand for data and analytics. ICE's business offers diversification across asset classes, high barriers to entry and wide competitive moats, supported by a mix of recurring revenues from data/service subscriptions and transaction-driven fees.

Other meaningful moves during the quarter included additions to cyclical growers we consider early cycle consumer plays: Target, a position initiated in the third quarter, and Estee Lauder. As earnings start to recover, these stocks and semiconductors tend to be among the first to move. We may be a little early and could see some choppiness in stock prices as job growth and consumer spending cool due to the lagged effects of Fed tightening, but we believe we're closer to the bottom in terms of economic activity and that both companies, as well as Union Pacific, are well-positioned to benefit as consumer sentiment improves and the economy begins to recover. Estee Lauder (as well as Nike) has underperformed as Chinese consumer spending has not rebounded as expected due to a sluggish economic reopening. However, we believe Estee Lauder has a stable

of relevant brands and should be able to return to mid- to high-single-digit revenue growth over the next two to three years, with commensurate profit recovery. We recently met with management and believe our thesis remains intact, giving us confidence to add to the position on weakness.

### **Outlook**

After the first three quarters of market returns dominated by the Magnificent Seven, market breadth improved to end 2023 with the small cap Russell 2000 Index rising 14.03% during the quarter and the Russell Midcap Index adding 12.82%. While AI will remain a key trend supporting parts of technology, we believe broadening participation should be supportive of our diversified approach. After healthy returns in 2023, parts of the IT sector, for example, appear fairly valued, leading to better risk/reward opportunities in other areas outside of technology and shadow tech.

Our discussions with company managements point to a broad macro deceleration, from package volumes at UPS, to weaker iPhone sales at Apple and weaker food revenues at Target. In addition, price cuts are no longer stimulating demand and costs are not falling as much as revenue. Taken together, we expect this to lead to greater volatility in the year ahead.

Against this backdrop, we want to own growth companies with cash flow support and where estimates have partly reset. We remain focused on several secular growth themes, including electric vehicles and China demand, two areas that suffered through headwinds in 2023 expected to recede in the new year. Our whiteboard of future opportunities also continues to broaden across industrials, financials and parts of technology.

### **Portfolio Highlights**

The ClearBridge Large Cap Growth Strategy outperformed its benchmark in the fourth quarter. On an absolute basis, the Strategy posted gains across the 10 sectors in which it was invested (out of 11 sectors total). The primary contributors to performance were the IT, industrials and communication services sectors.

Relative to the benchmark, overall stock selection contributed to performance. In particular, positive stock selection in the communication services, industrials and IT sectors drove results. Conversely, an underweight to IT, an overweight to health care and stock selection in the health care, real estate and utilities sectors detracted from performance.

On an individual stock basis, the leading absolute contributors were positions in Microsoft, Amazon.com, Netflix, Meta Platforms and Nvidia. The primary detractors were Aptiv, DexCom, Unity Software, Tesla and United Parcel Service.

**Past performance is no guarantee of future results. Copyright © 2023 ClearBridge Investments.**

All opinions and data included in this commentary are as of the publication date and are subject to change. The opinions and views expressed herein are of the portfolio management team named above and may differ from other managers, or the firm as a whole, and are not intended to be a forecast of future events, a guarantee of future results or investment advice. This information should not be used as the sole basis to make any investment decision. The statistics have been obtained from sources believed to be reliable, but the accuracy and completeness of this information cannot be guaranteed. Neither ClearBridge Investments, LLC nor its information providers are responsible for any damages or losses arising from any use of this information.

Performance source: Internal. Benchmark source: Russell Investments. Frank Russell Company ("Russell") is the source and owner of the trademarks, service marks and copyrights related to the Russell Indexes. Russell® is a trademark of Frank Russell Company. Neither Russell nor its licensors accept any liability for any errors or omissions in the Russell Indexes and/or Russell ratings or underlying data and no party may rely on any Russell Indexes and/or Russell ratings and/or underlying data contained in this communication. No further distribution of Russell Data is permitted without Russell's express written consent. Russell does not promote, sponsor or endorse the content of this communication.

Performance source: Internal. Benchmark source: Standard & Poor's.