

Franklin DynaTech SMA

Commentary | as of June 30, 2025

Key Takeaways

- **Markets:** Global equities collectively rose during 2025's second quarter (2Q25) after bouncing back from their April lows. Nine out of the 11 global equity sectors advanced; information technology (IT), communication services and industrials produced the highest returns, while energy and health care retreated. In terms of investment style, global growth stocks significantly outperformed their value counterparts, regardless of company size.
- **Contributors:** Favorable stock selectivity versus the benchmark Russell 1000 Growth Index was the primary supporting factor; to a much lesser extent, allocation choices across most sectors also boosted relative returns, including the portfolio's lack of exposure to consumer staples, materials and real estate companies.
- **Detractors:** Detrimental stock selection in the software and capital markets industries, selloffs for some biotechnology and medical technology-focused stocks, underweightings in rallying tech giants such as Microsoft and NVIDIA, and the 3.65% of uninvested portfolio assets sidelined in cash.
- **Outlook:** We remain optimistic about the resilience of the US economy even in this environment of policy uncertainty. Technology, in general—and artificial intelligence (AI), robotics and hyperscale cloud computing, in particular—is inherently disinflationary and a large enough force to affect the entire economy through increased productivity.

Performance Review

- Despite some of the greatest volatility the strategy has experienced since its 2015 inception, strong stock selection—particularly in the IT, industrials, consumer discretionary and health care sectors—helped it outperform its Russell 1000 Growth Index benchmark by a wide margin in an up market.
- Our biggest sector exposure over the past decade has been IT, and 2Q25 was no different. This has served us well, as nothing has come close to the performance of IT companies over the past 10 years. During 2Q25, we maintained a 2.4 percentage-point overweighting in IT (on average). At June-end, IT represented 50.38% of the portfolio, compared with the benchmark's 51.24% exposure; this was one of our lowest weightings versus the index in recent memory because innovation is spreading beyond IT into the entire economy.
- Within IT, maintaining a limited exposure to Apple gave us a major upside boost in relative terms as the share price fell more than 7%, but it was still the largest detractor in absolute terms. We also saw exceptional three-month rallies in overweighted or off-index IT holdings in various industries, led by Cloudflare in IT services; Celestica in electronic equipment, instruments and components; ServiceNow and AppLovin in software; and Broadcom and Taiwan Semiconductor Manufacturing in semiconductors and semiconductor equipment.
- Outside IT, notable contributors included Axon Enterprise (significant overweight) in industrials, off-benchmark Latin American e-commerce and fintech giant MercadoLibre in consumer discretionary, and GE Vernova in electrical equipment. GE Vernova posted an exceptional return amid business expansion across its Power, Wind and Electrification segments, along with a \$10.2 billion order backlog, signaling robust demand and operational efficiency, with analysts noting strong demand for power generation equipment. GE Vernova has been capitalizing on the global push for electrification and decarbonization, which has driven demand for equipment such as gas turbines, grid solutions, and renewable energy infrastructure. We expect to see ongoing robust global electricity consumption growth into 2026, reflecting a parabolic rise in demand for equipment to support data centers, AI infrastructure, and renewable energy integration.
- Given the magnitude and breadth of the strategy's 2Q25 gains, the detractors were comparatively mild. Among the 11 sectors tracked by the benchmark index, three were slight hindrances: financials, based on unfavorable stock selection; utilities, due to the strategy's lack of exposure; and a decline in the energy sector, where off-index oilfield services company Baker Hughes traded lower. Within financials, the quarterly gain for an overweighted stake in Mastercard fell significantly short of the benchmark average, while Tradeweb Markets (overweight) depreciated modestly.
- Elsewhere, relative outperformance in the IT sector was trimmed by underweighted Microsoft and NVIDIA as their shares rose significantly. Software industry results were further compromised by a lack of investment in Oracle (rose substantially), a loss for HubSpot (significant overweight), and an underweight in Palantir Technologies as its shares surged. In health care, off-benchmark Thermo Fisher Scientific (not held by June-end) sold off in the life sciences tools and services industry, while gains for an overweight stake in medical robotics specialist Intuitive Surgical lagged the index.

Outlook

- We are hopeful and enthusiastic about the potential and current productivity gains from AI, as its use cases continue to develop. Large language models (LLMs) are advancing at a fast pace, with the first returns on investment starting to coalesce, notably in the digital advertising space. Use cases are also being proven elsewhere, including in e-commerce, finance and health care. Additionally, AI developers are increasingly focused on achieving agentic AI. Areas where agentic AI is quickly taking shape include software development and deep research.
- We are tracking other bright spots for innovation in the economy beyond AI, including aerospace and defense, cryptocurrency, robotics, genomics and green energy. Regarding aerospace and defense, a new class of companies, including Palantir (held by the fund) and Anduril (not held) are challenging the primacy of large, established defense contractors. These nimble companies are developing new technologies, including autonomous drones and sophisticated military software. The crypto space is also maturing, with relevant applications in smart contracts and payment systems coming to the fore. The use cases for robotics are also accelerating as AI improves the software behind the hardware. Genomics is still early in its development, with scientists and managers addressing the complexities of the medicine to achieve regulatory approval. Finally, green energy initiatives continue to advance worldwide, with the cost curve—particularly for solar energy—coming down and with new ideas around nuclear and geothermal energy grabbing attention.

Top Equity Issuers (% of Total)

Holding	Portfolio
NVIDIA Corporation	10.81
Microsoft Corporation	8.16
Amazon.com, Inc.	7.90
Meta Platforms Inc Class A	5.89
Broadcom Inc.	4.40
Alphabet Inc. Class A	3.86
Mastercard Incorporated Class A	3.46
ServiceNow, Inc.	3.05
Axon Enterprise Inc	2.64
Tesla, Inc.	2.39

Sector Allocation (% of Total)

Sector	Portfolio
Information Technology	50.38
Consumer Discretionary	13.77
Communication Services	13.63
Health Care	7.39
Financials	6.58
Industrials	4.14
Energy	0.46
Cash & Other Net Assets	3.65

Average annual total returns (%) - as of June 30, 2025-PRELIMINARY

Product	3-Mo*	6-Mo*	YTD*	1-Yr	3-Yr	5-Yr	10-Yr	15-Yr	20-Yr	25-Yr	Inception	Inception Date
Net of Fees	23.44	8.47	8.47	14.36	23.47	11.16	13.86	—	—	—	13.86	6/30/2015
Pure Gross of Fees	24.02	9.55	9.55	16.64	25.93	13.39	16.13	—	—	—	16.13	6/30/2015
Benchmark 1	17.84	6.09	6.09	17.22	25.76	18.15	17.01	—	—	—	17.01	—
Benchmark 2	10.94	6.20	6.20	15.16	19.71	16.64	13.65	—	—	—	13.65	—

*Cumulative total returns

Benchmark(s)

Benchmark 1= Russell 1000 Growth Index

Benchmark 2= S&P 500 Index

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