

Franklin DynaTech SMA

Commentary | as of December 31, 2025

Key Takeaways

- Markets:** Global equities made further gains in the fourth quarter of 2025 (4Q25), rounding off a year of strong returns for the asset class. Despite some mixed economic signals and investor concerns about the stretched valuations of many technology-related stocks, investors remained broadly optimistic about artificial intelligence (AI) advancements and the potential for a continued easing of US monetary policy. A backdrop of robust corporate earnings and a constructive shift in US-China relations underpinned sentiment, as did the US Federal Reserve's interest-rate reductions.
- Detractors:** Stock selection in the communication services, industrials and consumer discretionary sectors.
- Contributors:** Industry-level outperformance was most evident in biotechnology (due to stock selection); specialty retail (stock selection); electronic equipment, instruments and components (aided foremost by overweighting); and semiconductors and semiconductor equipment (overweighting and stock selection).
- Outlook:** We expect continued technological transformation driven by core development themes around the byte, the atom and the gene. Gains across the economy from generative and agentic AI, robotics and genomics may even accelerate this rate of change. Our fundamental research gives us an edge in predicting when new technologies are likely to be adopted and monetized as the economic paradigm shifts.

Performance Review

- The DynaTech strategy (pure gross of fees and net of fees) underperformed the Russell 1000 Growth Index as five out of 11 sectors detracted, mainly due to security selection. At period-end, the portfolio maintained its overweight positions in key growth sectors such as information technology (IT), consumer discretionary and communication services; combined, they covered more than 79% of the portfolio (on average), and they all declined in value. Within the strategy's core IT sector allocation, relative returns were boosted slightly by stock selection, but the portfolio and index both posted sub-1% losses. Keeping roughly a quarter of the benchmark exposure to Apple was a hindrance as Apple shares rose nearly 7%. Fourteen out of 16 software holdings sold off, though an underweighting in Microsoft provided some relative support as its share price dropped.
- Individual stock performance varied, with several AI infrastructure plays facing execution challenges and established leaders like Apple navigating management transitions. Portfolio concentration in growth-oriented tech names created both opportunities and risks in this environment, with successful picks in emerging AI beneficiaries like Celestica and Shopify offset by disappointments in tech giants facing operational headwinds, including key overweight detractor Meta Platforms.
- For IT and many tech-adjacent companies, 4Q25 may have marked a "strategic inflection" with a move away from speculative AI-driven growth narratives toward greater scrutiny of profitability, balance sheets and sustainable growth models. That shift means companies that cannot convincingly show near-term earnings or realistic growth trajectories risk being rerated or punished disproportionately—and many in the IT sector fall into that "at risk" category. We continue to invest selectively, favoring tech and tech-adjacent companies offering clear paths to profitability rather than pure growth/AI hype.
- In communication services, overweighting and stock selection worked against us in the entertainment industry, where Roblox, a popular online platform for user-created games and virtual experiences, and all other holdings sold off.
- Consumer discretionary detractors were concentrated among off-index, non-US e-commerce companies such as Sea (Asia) and MercadoLibre (Latin America), partially offset by a share-price gain of more than 5% for US-based Amazon.com (overweight). In the hotels, restaurants and leisure industry, DoorDash (overweight) traded substantially lower.
- Industrials sector investments fell by over 12%, with the downside anchored by the aerospace and defense (A&D) industry, where Axon Enterprise (overweight) declined sharply. A&D stocks faced "risk-off" headwinds following strong rallies earlier in 2025. For Axon—which straddles defense, law enforcement technology and public-safety software—and many other firms in the A&D space, there was growing investor unease over tighter government budgets and changing spending patterns.
- On the upside, overall allocation choices had a mildly positive impact on the strategy's relative returns. A lack of exposure to the consumer staples, utilities, real estate and materials sectors proved beneficial as all four traded lower on the index.
- In health care, biotechnology holdings collectively rose more than 23%, led by key overweight contributor Natera. Genetic testing company Guardant Health also rallied.
- In IT, off-index Celestica's rally was helpful, as were robust gains for off-index or overweight semiconductor stocks like Taiwan Semiconductor Manufacturing and others.

Outlook

- We are hopeful and enthusiastic about current and potential productivity gains from AI, as its use cases continue to develop.** Large language models and Generative AI continue to advance rapidly, with returns on investment increasingly visible as deployments scale beyond experimentation. Early monetization has been most evident in digital advertising, while adoption is accelerating across e-commerce, financial services, health care and manufacturing, where AI is improving decision-making, automating knowledge work, and enabling predictive maintenance through digital twins (virtual replicas of physical assets, systems or processes that mirror their real-world behavior using real-time data, simulations and analytics). A key evolution is the shift from assistive tools toward agentic AI (systems capable of planning, reasoning and acting autonomously). This is already taking shape in software development, enterprise workflows and deep research. In medicine, multimodal AI models are enabling earlier and more accurate diagnoses, including the analysis of patient sounds. In 2026, we expect business attention to shift further toward application-layer software and vertically integrated solutions, as maturing agentic systems begin to drive durable productivity gains across the broader economy.

Top Equity Issuers (% of Total)

Holding	Portfolio
NVIDIA Corporation	11.72
Amazon.com, Inc.	7.98
Microsoft Corporation	7.50
Alphabet Inc. Class A	6.36
Broadcom Inc.	5.51
Meta Platforms Inc Class A	4.98
Apple Inc.	3.82
Tesla, Inc.	2.73
Shopify, Inc. Class A	2.73
AppLovin Corp. Class A	2.68

Average annual total returns (%) - as of December 31, 2025-PRELIMINARY

Composite	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	-0.77	7.76	16.89	16.89	29.09	7.75	14.65	—	—	—	13.96	6/30/2015
Pure Gross of Fees	-0.27	8.83	19.22	19.22	31.65	9.92	16.94	—	—	—	16.24	6/30/2015
Benchmark 1	1.12	11.75	18.56	18.56	31.15	15.32	18.13	—	—	—	17.38	—
Benchmark 2	2.66	11.00	17.88	17.88	23.01	14.42	14.82	—	—	—	14.08	—

*Cumulative total returns

Benchmark(s)

Benchmark 1=Russell 1000 Growth Index

Benchmark 2=S&P 500 Index

The strategy returns shown are preliminary composite returns, subject to future revision (downward or upward).

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The composite is comprised of accounts that are separately managed accounts (SMAs) managed in accordance with the strategy.

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