

Performance Review

- Global equities collectively posted strong gains for the first quarter of 2024 (1Q24) as they extended a five-month rally. Better-than-expected fourth-quarter 2023 (4Q23) earnings reports, growth opportunities tied to artificial intelligence (AI) and optimism about an economic soft landing in certain regions bolstered investor sentiment. Meanwhile, expectations for interest-rate cuts in the United States and Europe diminished amid cautious central bank comments, along with some higher-than-anticipated US inflation data. As measured by MSCI indexes in US-dollar terms, developed market equities collectively reached a new record high and modestly outperformed a global index, while emerging market and frontier market equities significantly underperformed it. Global growth stocks outpaced global value stocks. Although information technology (IT) and communication services stocks began to slip toward the back of the global equity sector rankings in March as the rally broadened in scope to include previous laggards, they retained their distinctions as the top two performers (out of 11 sector groups in total) for the entire quarter. The standout industry-level performers in IT were semiconductor, semiconductor materials/equipment, and systems software companies, while tech hardware makers and IT services firms lagged. Overall support stemmed from demand for generative AI (genAI) that has gone parabolic, with many equity analysts attempting to reset their valuation targets and earnings forecasts across the widening AI ecosystem. One thing remained certain: No one knows for sure just how high the demand for AI will go if this boom continues, just as it was implausible for many analysts in early 2023 to perceive how an AI-driven semiconductor company like NVIDIA (held by the fund) would soon be generating successive quarters of triple-digit percentage revenue and earnings-per-share growth.

QUARTERLY KEY PERFORMANCE DRIVERS

| | Stocks | Sectors |
|--------|---------------------------------------|---|
| HELPED | Apple (Significant Underweight) | Information Technology, or IT (Stock Selection, Significant Overweight) |
| | NVIDIA (Significant Overweight) | Industrials (Stock Selection) |
| | ASML Holding (Off-Benchmark Exposure) | Consumer Discretionary (Underweight) |
| HURT | Meta Platforms (Underweight) | Communication Services (Underweight, Stock Selection) |
| | MongoDB (Significant Overweight) | Health Care (Stock Selection) |
| | MercadoLibre (Off-Benchmark Exposure) | Energy (Overweight) |

- Relative to its Russell 1000 Growth benchmark, the fund's performance was supported foremost by favorable stock selection, while allocation decisions across sectors and industries had a slightly negative impact. Relative gains were highly concentrated in the IT sector, which averaged about 58% of the portfolio's composition. Historically, this core allocation ranges between 40% and 60%, so we were at the high end of the historical norm. An overweight in NVIDIA, which had a massive rally, and an underweight in Apple, which sold off, provided most of the relative outperformance in IT as they represented 6.7% and 10.7% of the capitalization-weighted benchmark versus respective exposures of 10.3% and 1.7% in the portfolio—both of which worked to our advantage. China's economic growth remains weak and Chinese consumers are buying fewer of Apple's iPhones and other hardware, while the company simultaneously faces stiffer competition from Chinese producers of similar consumer goods. Overall revenue was up 2% year-over-year in fiscal 1Q24, but fiscal 2Q24 guidance came up short of consensus estimates for iPhone, services and overall revenue—which means it was shaping up to be Apple's fifth revenue decline in the past six quarters. NVIDIA, whose semiconductor chips are supplying a massive wave of computer and data-center upgrades and have made advanced AI possible, reported strong quarterly earnings and predicted another huge sales gain in the first three months of 2024. Its market capitalization has increased by more than US\$1 trillion in 2024 thus far, with many investors expressing confidence it should remain a prime beneficiary of the AI computing boom as digital and AI capabilities continue to generate tangible value across sectors. Aside from kicking off an upgrade cycle, AI is benefiting from the maturation and convergence of powerful technologies, including the rollout of 5G networks that show how much faster information can be transmitted over the new system. Key contributor ASML Holding (not part of the index), a major semiconductor fabrication equipment manufacturer, reported above-consensus earnings despite the Dutch government preventing ASML from shipping its most high-tech systems to China. This is crucial as ASML essentially has a monopoly in the most advanced type of circuit-drawing, called extreme ultraviolet lithography. Our high-conviction positioning in rallying Lam Research and five other semiconductor stocks reinforced our IT results with smaller net contributions to both relative and absolute returns. In the software industry, owning less than half the benchmark exposure to the declining shares of Adobe helped, as did benchmark-topping gains for cybersecurity specialist CrowdStrike Holdings (known for crowdsourcing data to identify attackers, which is how it derived its name) and a handful of other overweighted or off-index companies that topped the benchmark.
- In the industrials sector, sublethal weaponry and law enforcement software maker Axon Enterprise was a standout performer in the aerospace and defense industry given returns in excess of 20%. To a lesser extent, the fund's lack of exposure to underperforming real estate and consumer staples stocks further enhanced relative strength. In the communication services sector, Google-parent Alphabet's shares rebounded (following a February selloff) when it revealed signs of real progress in AI after some investors believed they saw its AI initiatives becoming overshadowed by nimble competitors amid fresh threats to its core search business from companies using the new technology. Alphabet was a sturdy contributor in absolute terms, while relative returns were aided by the portfolio's lighter-than-index exposure as its shares rose only about 8%, which was more than three percentage points below the index's 1Q24 gain.

- In the communications services sector, we increased the fund's position in top overall detractor Meta Platforms during the period, but it was still underweighted versus the index. This hindered results as Meta's stock rose nearly 40% based on significantly better-than-expected 4Q23 financial results during a complex business rationalization phase. We believe the social media-oriented tech conglomerate's focus on efficiency and its use of AI-enhanced features throughout its services have changed the company's outlook for the better. The same can be said for segments of health care, where we added to key underweight detractor Eli Lilly as we believe the GLP-1 (glucagon-like peptide-1) drug class could continue to surprise to the upside. Relative returns were also constrained by detrimental stock selection in the health care equipment and supplies industry, where a heavily overweighted position in IDEXX Laboratories (veterinary diagnostic tools, laboratory tests and software for veterinary practice management) failed to advance. And though our underweighting in the consumer discretionary sector (averaging 11.3% of total net assets compared with 15.1% for the benchmark) proved beneficial, we would have fared better if not for the selloff in off-index MercadoLibre, a Latin America-focused e-commerce conglomerate similar to key contributor Amazon.com. Its shares backtracked as narrowing gross margins and expectations for decelerating business growth seemed to overshadow a strong 4Q23; the company's profits were also impacted by a one-time tax liability. MercadoLibre's lull comes after a prolonged growth streak, and we still favor MercadoLibre as it continues to execute well and, in our view, high-margin businesses like its integrated advertising platform, as well as strategic priorities like shipping, have plenty of room to grow despite already serving 218 million unique active users across its e-commerce and fintech platforms in 2023.

Outlook & Strategy

- **In 2024, we believe secular trends are transforming our world at an unprecedented pace and, as a result, the future may arrive faster than investors expect.** Foundational change in the cost to create and transmit data—amplified by increased regulation and demographic shifts—may foster an environment that accelerates economic change. Our fundamental research gives us an edge in predicting when new technologies will be adopted and monetized as the economic paradigm shifts.
- **We continue to see steady long-term adoption of e-commerce, software-as-a-service, social networking, cloud, medical technologies and e-payments.** We are also optimistic about five main platforms that we believe will contribute to the economy: disruptive commerce, genomic advancements, intelligent machines, energy transformation and exponential data.
- **Last year was a tale of two stock markets: the Magnificent Seven (mega-capitalization technology-oriented leaders) and the rest of the S&P 500.** The Magnificent Seven represented only 1.4% of companies in the S&P 500 Index but contributed 70% of the index's gains during 2023—an extraordinarily high “concentration effect.” The narrowness of last year's gains is not unprecedented in history. We suspect that this period of massive economic change—often referred to as the Fourth Industrial Revolution—may give us additional big, new companies like the Magnificent Seven. These changes are only beginning to unfold.
- **Currently, we can see the Third Industrial Revolution laying down the foundational general-purpose technologies that will aid the Fourth Industrial Revolution.** That we can spot several potential general-purpose technologies—starting with AI today and likely expanding to include genomics and robotics—bolsters our confidence in this view. These emerging innovations suggest that this next era may produce more new companies that will use them to solve hard problems across all economic segments. Under these auspices, we find it increasingly likely that the ranks of the Magnificent Seven could expand.
- **At the beginning of 2023, 58% of economists forecasted a recession. In contrast, we felt this prediction was too pessimistic, and our intuition was proven correct.** Technology, in general—and AI, robotics and cloud computing, specifically—are inherently deflationary and large enough to affect the entire economy through increased productivity. The United States is the leader in the Third and Fourth Industrial Revolutions and, because of this, we think the United States should have the lowest inflation and highest gross domestic product of the G7 economies. We saw evidence of this in lower inflation and better markets at the end of 2023. We expect disinflation trends to generally hold during 2024.
- **We are hopeful and enthusiastic about AI and its potential to become a major tech platform.** Within AI, large-language models (LLMs) specifically had a breakthrough year in 2023 and continued to do so in 1Q24. In response, companies raced to build all the new hardware (e.g., chips) and infrastructure (e.g., cloud) that will serve as the rails for LLMs in the years to come. The excitement around LLMs is deafening but not unmerited. AI may become the next large platform in technology and could rival the internet, mobility, and cloud in importance. If 2023 was the year of the hardware buildout, then we think that 2024 and 2025 will likely see attention shift to applications and software harnessing AI.
- **We believe generative AI and LLM technologies are productivity-enhancing in a way that social media and mobility were not.** Progress in AI should eventually benefit the entire economy. Although tech innovations continue to dominate the news, technological progress is not limited to the IT or communication services sector. As a diversified fund, we look in all corners of the economy.
- **Health care is one particularly bright spot for innovation.** In our opinion, GLP-1s (glucagon-like peptide-1 hormones), the drug class responsible for weight loss, could have a greater impact on human lives than even AI. GLP-1s may assist in treating chronic diseases, including helping to prevent heart attacks, strokes, kidney disease, cirrhosis of the liver and even addiction to alcohol, tobacco and gambling. Beyond this, the US Food & Drug Administration (FDA) gave the green light to two cell-based gene editing treatments for sickle-cell disease, a genetic disorder of the blood that afflicts patients with anemia and episodes of extreme pain. This marks an amazing milestone in medicine; scientists are now able to edit a gene in a safe and effective way to treat a disease. These gene editing drugs were only two of 55 new drugs approved in 2023, which was a banner year for health care innovation in general. For context, 55 is the highest number of new drugs approved in any of the past 30 calendar years. It's important to point out that the sickle-cell drugs weren't the only genomic drugs approved, just the first specifically to use gene editing. In fact, the FDA approved five different cell and gene therapies in 2023 versus five in total during the previous five years. These approvals are important because research-and-development spending needs to show results to keep innovation moving forward. In the future, this technology could potentially treat thousands of diseases, including cancer, heart disease, hemophilia, blindness, AIDS (acquired immunodeficiency syndrome), cystic fibrosis, Huntington's disease, muscular dystrophy and even COVID-19. We believe it likely won't stop here.

- **Change continues to occur at a rapid rate, innovation in the economy is accelerating, and we are still just at the beginning of the Fourth Industrial Revolution.** This revolution is a transformation at the foundational level of the byte, the atom and the gene that we believe can create tremendous long-term value for investors while benefiting society as a whole. We continue to invest in secularly growing, innovative companies with compounding revenue, earnings, free cash flow, and sustainable competitive advantages over the next three-, five- and 10-year periods, according to our analysis.

Product Details¹

| | |
|----------------|--|
| Inception Date | 06/30/2015 |
| Benchmark | Russell 1000 Growth Index S&P 500 Index |

Performance Data^{2,3}

Average Annual Total Returns (USD %)

| | 3 Mths | YTD | 1 Year | 3 Year | 5 Year | Since Inception (06/30/2015) |
|------------------------------------|--------|-------|--------|--------|--------|------------------------------|
| Franklin DynaTech SMA - Pure GROSS | 14.42 | 14.42 | 41.76 | 6.27 | 15.45 | 15.59 |
| Franklin DynaTech SMA - NET | 13.61 | 13.61 | 37.74 | 3.18 | 12.11 | 12.25 |
| Russell 1000 Growth Index | 11.41 | 11.41 | 39.00 | 12.50 | 18.52 | 16.44 |
| S&P 500 Index | 10.56 | 10.56 | 29.88 | 11.49 | 15.05 | 13.34 |

Calendar Year Returns (USD %)

| | 2023 | 2022 | 2021 | 2020 | 2019 | 2018 | 2017 | 2016 |
|------------------------------------|-------|--------|-------|-------|-------|-------|-------|-------|
| Franklin DynaTech SMA - Pure GROSS | 45.91 | -38.97 | 15.23 | 54.84 | 35.09 | 2.71 | 36.87 | 1.36 |
| Franklin DynaTech SMA - NET | 41.78 | -40.83 | 11.90 | 50.47 | 31.24 | -0.29 | 32.97 | -1.59 |
| Russell 1000 Growth Index | 42.68 | -29.14 | 27.60 | 38.49 | 36.39 | -1.51 | 30.21 | 7.08 |
| S&P 500 Index | 26.29 | -18.11 | 28.71 | 18.40 | 31.49 | -4.38 | 21.83 | 11.96 |

Past performance is not an indicator or a guarantee of future performance.

Investment Team

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Years with Firm 58
Years Experience 58

Matthew Moberg
Years with Firm 24
Years Experience 26

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2. Performance information is based on the Franklin DynaTech SMA Composite. Net of fee returns are reduced with a model of 3% for equity and balanced strategies and 1.5% for fixed income strategies. Prior to 1/1/2020, net returns were net of actual total wrap fees and non-fee paying accounts used a model fee. Accounts in the composite may have been charged trading expenses in addition to the standard bundled fee which may reduce pure gross performance. Gross of fee returns for wrap account may be pure gross before wrap fees, including brokerage fees related to trading expenses for transactions executed through the sponsor. Pure gross of fee returns do not reflect the deduction of any expenses, including transaction costs. Returns assume the reinvestment of dividends, interest, and realized and unrealized capital gains and losses.

3. Source for Index: FactSet. Indexes are unmanaged, and one cannot invest directly in an index. They do not reflect any fees, expenses or sales charges.

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