

Franklin DynaTech SMA

Commentary | as of March 31, 2026

Key Takeaways

- **Markets:** Global equity markets generally declined during the first quarter of 2026 (1Q26) amid heightened volatility, as geopolitical tensions and shifting macroeconomic dynamics weighed on investor sentiment. The conflict in the Middle East emerged as a destabilizing factor, disrupting energy markets and amplifying inflationary pressures. In terms of investment style, value stocks outperformed their growth-oriented peers, reflecting a rotation away from high-valuation-multiple sectors and rising inflation concerns. Large-capitalization equities underperformed those in the mid- and small-cap tiers, as investors sought opportunities in more cyclically sensitive areas of the market. Sector rotation saw commodity-linked industries benefit from higher energy prices, while the information technology (IT) and consumer discretionary sectors faced pressure amid concerns over AI-driven disruptions to established business models.
- **Detractors:** Unfavorable stock selection in the consumer discretionary, industrials, financials, health care and communication services sectors, plus a lack of exposure to consumer staples, materials, real estate and utilities companies, all of which fared better than the benchmark index.
- **Contributors:** Effective security selection in the semiconductors and semiconductor equipment industry; an underweighted exposure to software stocks; and beneficial stock selection among pharmaceuticals companies.
- **Outlook:** We are enthusiastic about current and potential productivity gains from AI as its use cases evolve. Generative and agentic AI continue to advance rapidly, with returns on investment increasingly visible as deployments scale beyond experimentation.

Performance Review

- Although the DynaTech strategy (pure gross of fees and net of fees) fared better than the Russell 1000 Growth Index with its core IT sector holdings (averaging 51% of total net assets), it underperformed most of the 10 other major equity sectors.
- Consumer discretionary holdings were weak in both absolute and relative terms. All sector holdings traded lower, with the key detractors focused on e-commerce companies such as off-index Sea (sold by period-end) and Amazon.com (overweight), though positions in app-based delivery platform provider DoorDash (overweight) and an app-based used vehicle sales company also sustained substantial losses. In the absence of any serious company-specific setbacks, these stocks were broadly impacted by investors rotating away from high-multiple consumer internet names into those perceived as safer, more predictable earnings plays—particularly after a long run of growth stocks outperforming. A surprise announcement of new US tariffs on imported goods further drove broad selling in consumer-facing stocks that rely on global supply chains, as investors began modeling higher costs and lower profit margins. That overall shift from momentum/optimism to fundamental valuation discipline impacted e-commerce and online services disproportionately in the selloff. We're still generally positive on these holdings for the longer term.
- Despite solid 1Q26 rallies for Ascendis Pharma and other off-index biotechnology holdings, health care investments (averaging about 8% of the portfolio) declined overall, with results versus the index hindered by adverse security selection in the biotech and health care providers/services industries, with several holdings coming down from multiyear highs.
- In the industrials sector (averaging 5% of the portfolio), heavily-overweighted aerospace and defense industry positions in Axon Enterprise and Karman Holdings anchored the downside along with Vertiv Holdings (sold by period-end) in electrical equipment, partially offset by robust returns for specialty construction/engineering and electrical equipment industry companies that saw heightened demand from data center, energy grid and power generation projects.
- Most of the other major detractors reduced our measure of outperformance in the IT sector, including an underweighted stake in Apple as its share price fell less than the index; substantial losses for Shopify (not an index component) and other IT services industry holdings; and double-digit percentage declines for AppLovin, ServiceTitan (sold by period-end) and other overweighted or off-index software stocks.
- Semiconductor and semi-equipment holdings (averaging 26% of total net assets) were a source of strength in relative terms, as the strategy's 0.8% decline compared well to the index's 4.8% drop in the same industry. Some off-benchmark or overweight semi stocks posted robust gains, including key contributors Taiwan Semiconductor Manufacturing, ASML Holding, Monolithic Power Systems, KLA and Lam Research. The semi space was still seeing vigorous structural demand tied to AI infrastructure and advanced computing. Chipmakers with visible quarterly earnings "beats," strong 2026 guidance, or clear demand paths linked to AI or data center build-outs tended to separate themselves from selective weakness across the broader IT sector. We also maintained a large yet underweight exposure to Microsoft, which aided results in the software industry as it fell much further than the index. There were a few other, smaller tech-related contributors, including Cloudflare (overweight) in IT services, and off-index Celestica (electronic equipment, instruments and components).
- In the energy sector, oilfield services stocks like TechnipFMC rallied with strong double-digit percentage gains.

Outlook

- **We believe the increasing focus on generative and agentic AI is warranted, as adoption continues to broaden across industries and the productivity benefits are becoming more visible.** At the same time, innovation remains diverse, with advances occurring across areas such as space and defense, robotics, health care, genomics and energy. We view technology, including AI, robotics and hyperscale cloud computing, as inherently disinflationary, with the potential to drive productivity gains across the broader economy.
- **We expect continued technological transformation driven by advances in data, automation and life sciences.** While short-term market movements may reflect valuation shifts or changing sentiment, these do not alter our long-term perspective. As long-term investors, we remain focused on identifying innovative companies whose growth potential and pace of adoption may be underappreciated, consistent with the portfolio's objective of long-term capital growth.

Top Equity Issuers (% of Total)

Holding	Portfolio
NVIDIA Corporation	12.21
Amazon.com, Inc.	8.12
Alphabet Inc. Class A	6.71
Microsoft Corporation	6.48
Broadcom Inc.	5.78
Meta Platforms Inc Class A	4.81
Apple Inc.	4.21
Taiwan Semiconductor Manufacturing Co., Ltd. Sponsored ADR	2.68
Tesla, Inc.	2.52
Shopify, Inc. Class A	2.24

Average annual total returns (%) - as of March 31, 2026-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	-10.92	-11.81	-10.92	17.67	16.80	4.90	13.04	—	—	—	11.36	6/30/2015
Pure Gross of Fees	-10.23	-10.47	-10.23	21.16	20.26	8.05	16.40	—	—	—	14.68	6/30/2015
Benchmark 1	-9.78	-8.76	-9.78	18.81	21.18	12.76	16.83	—	—	—	15.83	—
Benchmark 2	-4.33	-1.79	-4.33	17.80	18.32	12.06	14.16	—	—	—	13.27	—

*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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