

Franklin U.S. Focused Growth 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 generally robust corporate earnings and a constructive shift in US-China relations underpinned sentiment, as did two reductions in policy interest rates by the US Federal Reserve. International developed market and emerging market stocks outperformed, while US equities lagged. Globally, value stocks narrowly outpaced their growth counterparts.
- **Detractors:** Unfavorable stock selection versus the benchmark Russell 1000 Growth Index in the communication services, information technology (IT), consumer discretionary, financials and industrials sectors.
- **Contributors:** Underweighting in consumer staples and a strategic lack of portfolio exposure to the underperforming utilities, real estate, materials and energy sectors, all of which declined on the index. IT holdings garnered mild support from a combination of underweighting and stock selection in the software industry, while consumer discretionary holdings were aided by strong stock selection and underweighting in the specialty retail industry.
- **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 U.S. Focused Growth strategy (pure gross of fees and net of fees) had mixed 4Q25 results and underperformed its benchmark based on security selection, offset slightly by effective allocation choices across several sectors and industries.
- We kept strategic overweight positions across key growth sectors such as IT, consumer discretionary and communication services at period-end; when combined, these allocations averaged more than 81% of the portfolio, and they all declined. Keeping roughly a quarter of the benchmark's average exposure to IT bellwether Apple (purchased during the period) was a hindrance as Apple shares bucked the IT sector's downtrend and rose modestly. All five of the portfolio's software holdings also sold off, including heavily-overweighted AppLovin and Cadence Design Systems, though underweight Microsoft provided some relative-return support as its share price dropped. The portfolio also lagged the index's gain among semiconductor industry stocks as we lacked exposure to several companies that rallied solidly on the index.
- For IT and many tech-related firms, 4Q25 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 what we believe are 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, sustained double-digit percentage losses in 4Q25. In the interactive media and services industry, maintaining roughly twice the benchmark weight in Meta Platforms proved detrimental as its share price fell about 10%.
- Consumer discretionary detractors were concentrated among off-index, non-US e-commerce companies such as Sea (Asia), partially offset by the gain in US-based Amazon.com (overweight). In the hotels, restaurants and leisure industry, the overweighting in DoorDash was about five times the benchmark average, which proved detrimental as its share price fell substantially.
- In terms of key contributors, biotechnology holdings benefited from stock selection and collectively rose more than 28%, led by key overweight contributor Natera. In health care equipment and supplies, our solitary investment in Intuitive Surgical was an outlier to the upside while most of its industry peers sold off on the index.
- In consumer staples, the strategy incurred a much smaller 4Q25 loss than the index in Costco Wholesale because we liquidated the portfolio's position and subsequently avoided the brunt of the selloff. Within IT, a few off-index or overweighted semiconductor-related holdings advanced solidly, including Taiwan Semiconductor Manufacturing. Results in IT were further supported by the rallies in off-index Shopify (IT services) and other holdings.

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." A key evolution is the shift from assistive tools toward agentic AI, which refers to 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. 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. At the same time, we are tracking other bright spots for innovation in the economy beyond AI, including space, defense, cryptocurrency, robotics, genomics and green energy.

Top Equity Issuers (% of Total)

Holding	Portfolio
NVIDIA CORP	13.48
MICROSOFT CORP	9.43
AMAZON.COM INC	8.71
ALPHABET INC	7.31
BROADCOM INC	5.87
META PLATFORMS INC	5.07
APPLE INC	4.87
TAIWAN SEMICONDUCTOR MANUFACTURING CO LTD	3.79
TESLA INC	3.45
SHOPIFY INC	3.04

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	-2.30	5.34	14.43	14.43	30.56	8.42	—	—	—	—	18.42	3/31/2020
Pure Gross of Fees	-1.57	6.90	17.83	17.83	34.40	11.65	—	—	—	—	21.93	3/31/2020
Benchmark	1.12	11.75	18.56	18.56	31.15	15.32	—	—	—	—	23.00	—

*Cumulative total returns

Benchmark(s)

Benchmark = Russell 1000 Growth Index

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

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Investors cannot invest directly in an index, and unmanaged index returns do not reflect any fees, expenses or sales charges.

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The **Russell 1000 Growth Index** measures the performance of the large-cap growth segment of the U.S. equity universe.

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Source: FTSE.

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