

Performance Review

- Stock markets worldwide were turbulent over the first quarter of 2025 (1Q25), with major US equity indexes—the S&P 500 Index, Dow Jones Industrial Average and NASDAQ Composite Index—sustaining overall declines. Four out of the 11 S&P 500 sectors retreated, with consumer discretionary and information technology (IT) selling off the most. Conversely, the energy sector was a bright spot for performance as many investors turned more defensive. Small-capitalization stocks struggled, followed by large- and mid-cap equities. Within IT, semiconductor stocks faced significant declines, although IT services showed some resilience by declining modestly compared to the rest. The communication services sector performed better than IT but was still near the bottom of the sector rankings. Despite mostly upbeat and ahead-of-consensus quarterly corporate earnings reports, market sentiment in both sectors was cautious due to concerns about earnings growth and potential tariff-driven stagflation (economic stagnation and persistently high inflation), along with other geopolitical tensions. Inflation data released during the quarter also raised concerns about higher interest rates, which tend to impact growth stocks like those in the IT sector. The new tariffs added to uncertainty and were seen as a source of increased costs for technology-focused companies reliant on global supply chains. In response to these factors, many tech companies announced layoffs as part of their cost-cutting measures. This could lead to a leaner workforce and potentially more efficient operations, with companies increasingly focusing on artificial intelligence (AI) and automation to drive future growth. As the market adjusts to these changes, some companies may emerge stronger and more focused on core competencies, while others may face challenges in adapting and maintaining market share. Another key factor behind the IT weakness was the selloff in AI-related stocks with the introduction of China's DeepSeek-R1 (the company is not a portfolio holding)—a groundbreaking family of reinforcement learning (RL)-driven AI models that combine advanced reasoning capabilities with open-source accessibility (intended to rival industry leaders like OpenAI, which is not held by the strategy, and Google, a subsidiary of portfolio holding Alphabet). DeepSeek's unveiling raised concerns about the extent of US tech spending on AI models, US AI-focused companies' pricing power, and America's leadership in the global AI race.

QUARTERLY KEY PERFORMANCE DRIVERS

	Stocks	Sectors
HELPED	Costco Wholesale (Significant Overweight)	Financials (Stock Selection)
	Mastercard (Significant Overweight)	Consumer Staples (Overweight)
	Tradeweb Markets (Significant Overweight)	—
HURT	ServiceNow (Significant Overweight)	Information Technology, or IT (Stock Selection)
	Tesla (Overweight)	Industrials (Stock Selection, Underweight)
	NVIDIA (Overweight)	Health Care (Stock Selection)

- The US Focused Growth strategy saw negative absolute returns in five out of seven equity sector allocations during 1Q25, and it underperformed the Russell 1000 Growth Index based on a combination of unfavorable stock selection and, to a much lesser extent, allocation choices across 11 sectors. The strategy was not invested in four sectors: utilities, energy, real estate and materials; while the lack of utilities stocks had essentially no impact on relative performance, the lack of exposure to the other three were minor hindrances as they all appreciated on the index. Much of the portfolio weakness was concentrated in the IT sector, which comprised about 44% of total net assets (on average). In general, the strategy and the Russell benchmark were affected as many investors shifted their preferences from growth- to value-oriented stocks, and from US to international equities (US-based holdings covered 89.1% of the portfolio at period-end). The IT sector faced multiple challenges, including software companies such as ServiceNow, AppLovin (purchased during the period) and Cadence Design Systems. The shares of NVIDIA, Taiwan Semiconductor Manufacturing (not part of the index), Broadcom, Marvell Technology (bought and sold during the period) and other semiconductor companies integral to AI developments also sold off after performing well ahead of the 1Q25 market correction. While our longer-term positive outlook on semiconductors remains intact and we believe the recent adjustments have moderated equity valuations, investor sentiment in this cyclical industry has become more cautious over the past few months due to concerns about the profitability and sustainability of AI. Elsewhere in IT, an overweighted stake in the IT services industry further hampered relative returns as Cloudflare and one other, minor detractor sustained double-digit percentage losses. Although our newly initiated position in Cloudflare (network services aimed at enhancing cybersecurity, performance and reliability) shed value during the intra-quarterly period during which it was held, Cloudflare and other cybersecurity stocks gained ground in 1Q25 as a whole in conjunction with recent news about hacking attacks—including on the US Department of Treasury—originating from China. In addition to its content-delivery network services, Cloudflare is also a leading provider of distributed-denial-of-service mitigation and other cybersecurity tools. The company has been seeing encouraging sales growth, and we believe it should benefit from the rise of AI. Cloudflare continues to identify new opportunities through its industry field research, which found positive demand indicators and signs of tailwinds taking shape in areas such as edge-computing services.
- The strategy was invested in all but one of the seven technology-centric, mega-capitalization companies often referred to as the “Magnificent Seven”—Microsoft, Amazon.com, Alphabet (Google), NVIDIA, Meta Platforms (Facebook), Tesla and Apple. While the first six were portfolio holdings covering a combined 47.6% of total net assets at March-end, Apple's absence was beneficial in relative terms as its share price fell about 11%. While these innovative bellwether companies delivered significant standalone gains over the past two calendar years, they all had negative returns in 1Q25 as many investors rotated away from momentum stocks. Within the group, our results versus the index were hurt by overweightings in NVIDIA, Tesla and Amazon as their share prices fell further than the Russell 1000 Growth Index. Unlike these three, our overweight positioning in Meta was beneficial in relative terms as its losses were milder than the benchmark average, while keeping lighter-than-index weightings in Alphabet and Microsoft helped as their share prices suffered bigger declines than the benchmark. There was a common theme for Amazon, Microsoft and Alphabet as they reported generally impressive calendar 4Q24 financial results, but investors reacted negatively to their slight cloud computing-related misses.

The earnings reports made clear that the robust pace of capital expenditures (capex) for AI data centers should continue in 2025. That has raised the bar across Big Tech, especially for the cloud businesses, where a growth slowdown was inevitable, though we still think this is a durable investment theme for the longer term. Amazon, which pioneered the public cloud category with Amazon Web Services (AWS), now sees a roughly 20% annualized growth rate from its AWS cloud business, down from over 50% five years ago. Alphabet and Microsoft may be experiencing a similar trend despite the brisk pace of overall spending to build out AI capabilities. Meta's stock price, meanwhile, was insulated somewhat by the fact that it has no public cloud operations. Google Cloud Platform and Microsoft Azure are still growing about 30% annually, but the latest earnings suggest that growth may be decelerating. Amazon projected around US\$105 billion in capex in 2025, a 27% rise from 2024, which was 57% over 2023. Microsoft has guided to US\$80 billion in capex for its fiscal year (FY) ending in June, up 80% from FY 2024, which was up 58% from the year before. Alphabet estimated capex of US\$75 billion in 2025, up 43% from 2023, which was up 63% from 2022. Meta Platforms is joining the trend, with a forecast of US\$60 billion to US\$65 billion of capex in 2025, up 68% at the midpoint from 2024, which was up by 37% from the year before. Meta differs from the others mentioned above in that it doesn't have a cloud unit that rents out servers; these new data centers are all for Meta's use. Investors want to know how long it will take for revenue and profit to begin flowing from them. Rolling out sales-generating AI services will take time, but the immediate area where new AI revenue has emerged is in accelerated growth rates in the cloud units of Amazon, Microsoft and Alphabet. Tesla, meanwhile, broadly missed consensus expectations in its 4Q24 financial report and guided down for 2025. Weakening electric vehicle (EV) sales and unabsorbed fixed costs were problematic for Tesla as sales shrank in 4Q24. Separately, our channel checks of Tesla's suppliers appeared to confirm the more muted company outlook for 2025, some of which was said to be related to battery shortages. We believe Tesla has an underlying EV demand problem that's not helped by Chief Executive Officer Elon Musk's political involvements in the Trump administration, and we are monitoring the situation closely. Tesla is still busy rolling out exciting AI initiatives, including its move into driverless paid rides in test cities like Austin (Texas, USA), the company's intention to begin Cybercab production in 2026, and its plans to produce between 2,000 and 10,000 Optimus humanoid robots this year. Like several other strategy holdings, Tesla is greatly intensifying its focus on "autonomy" and increased AI training compute. Our research indicates Tesla's Cortex AI is designed as a real-world AI system specifically tailored to handle complex, dynamic situations in the physical world, like autonomous driving, by processing massive amounts of sensor data from a car in real-time, making it significantly different from a text-based large language model (LLM); essentially, Cortex is optimized for immediate decision-making in the real world, whereas an LLM is better-suited for tasks like generating text or answering questions based on large amounts of text data.

- Among the notable contributors outside the IT sector, substantially overweighted positions in Mastercard (credit/debit card and enhanced digital payment processing/security solutions) and Tradeweb Markets supported positive absolute and relative returns in the financials sector—a rare combination for a downbeat quarter such as this. In particular, Tradeweb is a leading global operator of electronic marketplaces for trading various financial instruments, including rates, credit, equities, and money markets. The company provides platforms for institutional, wholesale and retail clients to trade fixed income, derivatives and ETFs (exchange-traded funds). Tradeweb reported a record total trading volume of US\$59.6 trillion and a record average daily volume (ADV) of US\$2.71 trillion in March. This represented a 49.9% year-over-year (y/y) increase in ADV. Clearly, the increased market volatility drove higher trading activity, benefiting Tradeweb's electronic trading platforms, but we also recognize the fruition of the company's longer-term goals as it has achieved significant market-share gains across various asset classes, including US government bonds, European government bonds, and credit derivatives. Elsewhere, in the consumer staples distribution and retail industry, key contributor Costco Wholesale's share price reached a record high as it benefited from several positive factors in a challenging environment, including robust sales, equity analyst upgrades, and strong growth in its e-commerce operations. We note that Costco's value proposition remains strong as its ability to offer value and competitive pricing resonates well with consumers facing elevated prices for food and other items, which is clearly helping the company maintain steady foot traffic and membership renewals. An off-index consumer discretionary sector position in Latin American e-commerce and fintech platform provider MercadoLibre (broadline retail industry) was a standout, as was "last mile" delivery services platform provider DoorDash in the hotels, restaurants and leisure industry. Overall weakness in the health care sector (due to adverse stock selection) was partially mitigated by surgical robotics specialist Intuitive Surgical (overweight), which aided results in the health care equipment and supplies industry despite falling out of favor with investors in March. Tariff concerns seemed to play a role in that late-period selloff as the company was improving on a fundamental basis, according to our analysis. Intuitive announced 4Q24 revenues that were ahead of consensus expectations due primarily to a shift in system placement mix to sales rather than leases, while procedure growth of 18% y/y remained consistent sequentially, and the 2025 procedure growth guidance of 13% to 16% was in line with consensus expectations. Intuitive continues to execute well within a notably large, multibillion-dollar market opportunity that we believe it could lead. Intuitive's management issued a number of cautionary comments regarding the business outlook, but we expect a potentially strong year aided by the expanded launch of the company's da Vinci 5 system. Finally, aside from active investments, the strategy received a relative-return boost from a 2.3% average cash position during a time of equity market stress and widespread declines.

Outlook & Strategy

- **While we believe the excitement around the progress in generative AI (GenAI) and data-driven experimentation is merited as a widening array of industries test AI's novel business applications, other parts of the economy are also exciting.** For instance, we have a major US housing shortage just as the millennial generation is maturing into its homebuying phase. Additionally, novel drug development and regulatory approvals have accelerated in recent years, manifesting perhaps most obviously in the world's voracious demand for the new weight-loss drugs: GLP-1s (glucagon-like peptide-1 hormones). It bears repeating that technology, in general—and AI, robotics and hyperscale cloud computing, in particular—is inherently disinflationary and a large enough force to affect the entire economy through increased productivity. Because of this, we remain optimistic about the resilience of the US economy even in this environment of policy uncertainty.
- **We expect continued technological transformation driven by core development themes around the byte, the atom and the gene.** Gains across the economy from GenAI, robotics and genomics may even accelerate this rate of change. Our fundamental research gives us an edge in predicting when new technologies will likely be adopted and monetized as the economic paradigm shifts.

- **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 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. We suspect that this period of massive economic change may give us additional big, new companies.
- **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) continue to advance at a fast pace, with the latest LLMs trained to “reason” rather than “memorize,” a result that has the best iterations solving advanced crossword puzzles and generating entire codebases for new video games. Exciting use cases are being proven out in advertising (e.g., portfolio holding AppLovin) and e-commerce (e.g., portfolio holding Shopify), with the benefits showing up today. Additionally, AI developers are increasingly focused on achieving agentic AI, which we would argue is already present in at least one instance in the language capability of the models. These agentic AI-infused LLMs can translate hundreds of languages on par with most humans. Other areas where agentic AI is taking shape quickly include software development and deep research. We believe the future is bright in other sectors of the economy, too, especially in medicine, where LLMs can now be used to diagnose illness from patient sounds (like coughs). For the rest of 2025, we think attention will likely continue to shift to applications and software harnessing AI.
- **We think the potential disruptive implications from DeepSeek—a cost-effective rival to other leading AI models—are overstated.** If anything, DeepSeek’s breakthroughs in efficiency are a positive for the overall AI ecosystem, signaling a path forward for cheaper access to AI for many consumers and businesses. We anticipate continued strong demand for compute because progress at the leading edge is still resource-intensive—the most advanced models require a great number of GPUs (graphics processing units), more than currently available, to train.
- **We are tracking other bright spots for innovation in the economy beyond AI, including space, defense, cryptocurrency, robotics, genomics and green energy.** Space is undergoing a renaissance, with private-public partnerships beginning to dominate. Some goals over the longer term include interplanetary travel, mining on the moon, and increasing satellite efficacy. Regarding the aerospace and defense industry, a new class of companies including Anduril and Palantir (neither of which are held by the strategy) are challenging the primacy of the large, established defense contractors. These nimble companies are developing innovative new technologies, including autonomous drones and sophisticated military software. The crypto space is 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 FDA (US Food & Drug Administration) 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.

Product Details¹

Inception Date	03/31/2020
Benchmark	Russell 1000 Growth Index

Performance Data^{2,3}

Average Annual Total Returns (USD %)

	3 Mths	YTD	1 Year	3 Year	5 Year	Since Inception (03/31/2020)
Franklin U.S. Focused Growth SMA - Pure GROSS	-12.42	-12.42	3.34	8.95	18.38	18.38
Franklin U.S. Focused Growth SMA - NET	-13.10	-13.10	0.33	5.78	14.96	14.96
Russell 1000 Growth Index	-9.97	-9.97	7.76	10.10	20.09	20.09

1. A composite is an aggregation of one or more portfolios into a single group that represents a particular investment objective or strategy. The composite return is the asset-weighted average of the performance results of all the fully discretionary portfolios in the composite. The composite return information provided herein includes the returns of Franklin Templeton, high-net-worth individual and institutional client portfolios and with respect to any periods prior to the inception of Franklin Templeton, reflects the performance of any such other portfolios.

Calendar Year Returns (USD %)

	2024	2023	2022	2021
Franklin U.S. Focused Growth SMA - Pure GROSS	38.15	49.15	-38.63	16.47
Franklin U.S. Focused Growth SMA - NET	34.22	44.93	-40.50	13.11
Russell 1000 Growth Index	33.36	42.68	-29.14	27.60

The strategy returns shown are preliminary composite returns, subject to future revision (downward or upward). Please visit www.franklintempleton.com for the latest performance figures. Past performance is not a guarantee of future results. An investment in this strategy can lose value.

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Investment Team

Matthew Moberg
 Years with Firm 25
 Years Experience 27

2. 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.

3. Performance shown is past performance and includes periods with unusually favorable conditions in some markets. No assurances can be given that such performance or market conditions will be repeated in the future. Ongoing market volatility can dramatically impact short-term returns. Current performance may differ from figures shown.

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