

Franklin Small Cap Growth SMA

Commentary | as of June 30, 2025

Key Takeaways

- **Markets:** US stocks advanced during the second quarter of 2025. After rebounding from April's lows, equity markets continued to rally through June despite bouts of volatility. The S&P 500 Index and Nasdaq Composite Index closed the period with solid gains after hitting new record highs at the end of June, while the Dow Jones Industrial Average hovered near its all-time high. Temporary delays in tariff hikes, reduced fears of a recession, growing expectations of interest-rate cuts later in the year and easing geopolitical tensions helped drive US stocks higher. Large-capitalization equities gained the most, followed by mid- and small-cap stocks, and growth stocks outperformed value by a wide margin in all three market-cap tiers.
- **Detractors:** Stock selection in the information technology (IT) sector was a leading detractor from performance relative to the Russell 2000 Growth Index. Stock selection and an overweight in the consumer staples sector and stock selection in the energy sector also hindered relative performance.
- **Contributors:** Stock selection and an underweight in the health care sector contributed significantly to relative performance. To a lesser degree, the fund benefited from stock selection in the financials, industrials and consumer discretionary sectors.
- **Outlook:** We are hopeful as we enter the second half of the year that financial markets can focus on the potential long-term structural benefits of a Trump 2.0 policy agenda that might include initiatives to rebalance global trade and stimulate growth through tax reform and deregulation.

Performance Review

- The portfolio's return was positive but lagged that of the Russell 2000 Growth Index. Relative returns in the IT sector were negatively impacted by stock selection in the semiconductors and semiconductor equipment industry, where Onto Innovation was a leading detractor. The process control solutions company issued disappointing second-quarter earnings guidance that weighed on its shares. We believe Onto operates in an attractive space (process control, metrology, inspection, lithography) during a time when semiconductor packaging complexity is increasing dramatically.
- Nutrition products company BellRing Brands was a top detractor in the consumer staples sector. While the company reported strong performance across its protein-focused portfolio, it raised concerns about inventory reductions and profit-margin pressures in the second half of the year. We believe BellRing continues to benefit from various tailwinds, including new capacity, improved inventory tracking and ramped up promotions and marketing.
- In contrast, in the industrials sector, BWX Technologies was a leading individual contributor to relative returns. The company is a supplier of nuclear components and fuel to the US Navy and the commercial nuclear power industry. We believe BWX can profit from the government's focus on bolstering defense spending.

Outlook

- Our outlook for financial markets remains cautious, reflecting the magnitude and complexity of the current political and economic climate. While challenging, active management allows us to pursue alpha by taking advantage of market volatility as a chance to initiate or build up positions in what we believe are high-quality businesses. These businesses have strong balance sheets and market-leading competitive positions, and they are levered to durable secular growth themes.
- One theme is technology, which continues to be a large area of opportunity as more companies adopt artificial intelligence in their efforts to lower costs and increase productivity. We see significant growth potential for the industrials sector, fueled by trends that include the reshoring of US manufacturing, electrification and meaningful infrastructure investment. Our outlook for health care is also bullish. Wide-ranging innovations (genomics, robotics, personalized medicine) and meaningful demographic shifts support our convictions.
- Deregulation could positively impact the energy sector by increasing fossil fuel production and streamlining the permitting process. Deregulation and lower taxes could serve many companies in the financials sector as they could help boost profits. With a stronger economy and lower regulatory burden, we think banks may see an increase in lending activity, and fintech innovation could surge.
- Our strategy is designed to address both upward and downward market cycles, and a diversified approach helps us participate in both ongoing market strength and anticipated rotation in market leadership. We invest in what we regard as great businesses positioned to potentially benefit from secular growth over a long-term horizon.

Top Equity Issuers (% of Total)

Holding	Portfolio
BWX Technologies, Inc.	3.56
Kratos Defense & Security Solutions, Inc.	2.22
Arcosa, Inc.	2.19
AAR CORP.	2.11
SiTime Corporation	2.06
Integer Holdings Corporation	1.98
Granite Construction Incorporated	1.96
BellRing Brands, Inc.	1.93
Couchbase, Inc.	1.85
New York Times Company Class A	1.84

Sector Allocation (% of Total)

Sector	Portfolio
Information Technology	25.42
Industrials	17.93
Health Care	16.61
Consumer Discretionary	11.09
Financials	9.10
Consumer Staples	5.55
Energy	2.67
Other	3.05
Cash & Other Net Assets	8.58

Average annual total returns (%) - as of June 30, 2025-PRELIMINARY

Product	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	9.77	-3.87	-3.87	4.00	10.46	3.38	6.51	10.04	8.31	6.39	8.32	12/31/1997
Pure Gross of Fees	10.56	-2.42	-2.42	7.12	13.75	6.48	8.91	12.18	10.28	8.30	10.29	12/31/1997
Benchmark	11.97	-0.48	-0.48	9.73	12.38	7.42	7.14	11.06	8.49	5.76	6.69	—

*Cumulative total returns

Benchmark(s)

Benchmark =Russell 2000 Growth Index

Past performance is not a guarantee of future results. An investment in this strategy can lose value. Please visit www.franklintempleton.com for the latest performance figures. Investors cannot invest directly in an index, and unmanaged index returns do not reflect any fees, expenses or sales charges.

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Glossary

Dow Jones Industrial Average (DJIA) is an unmanaged index composed of 30 blue-chip stocks, each with annual sales exceeding \$7 billion. The DJIA is price-weighted, reflects large-cap companies representative of U.S. industry, and historically has moved in tandem with other major market indexes such as the S&P 500. Source: © S&P Dow Jones Indices LLC.

Nasdaq Composite Index is a market-capitalization-weighted index that is designed to represent the performance of NASDAQ securities and includes over 3,000 stocks. Source: Nasdaq OMX.

The **S&P 500 Index** features 500 leading U.S. publicly traded companies, with a primary emphasis on market capitalization. Source: © S&P Dow Jones Indices LLC. All rights reserved.

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The **Russell 2000 Growth Index** measures the performance of the small-cap growth segment of the U.S. equity universe. Source: FTSE.

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