

Franklin Small Cap Growth SMA

Commentary | as of March 31, 2026

Key Takeaways

- **Markets:** US equities endured a difficult first quarter of 2026 as investors reassessed the durability of the AI trade and geopolitical risk intensified. Technology-focused shares came under pressure as rising AI-related capital expenditure spurred a rotation away from mega-capitalization growth toward value stocks. At its two meetings during the quarter, the US Federal Reserve left its benchmark interest rate on hold. March brought further strain as the Middle East conflict disrupted energy markets, lifting oil prices and adding to inflation risk. The Nasdaq Composite Index underperformed the S&P 500 Index, while the Dow Jones Industrial Average proved more resilient. By investment style, value investing surpassed growth across market-cap tiers, with small- and mid-cap stocks performing better than their large-cap counterparts.
- **Detractors:** Stock selection in the financials sector and an overweight in the information technology (IT) sector detracted significantly from relative performance. Stock selection in the capital markets industry was a drag on the financials sector, while allocation and stock selection effects in the software industry weighed on the IT sector.
- **Contributors:** For the quarter, the combination of stock selection and an overweight in the energy sector was a top contributor to relative returns, benefiting from the effects of surging oil prices. The communication services and health care sectors also added to relative performance, helped by stock selection and allocation decisions in the media industry and biotechnology industry, respectively.
- **Outlook:** We have a constructive outlook on US small-cap stocks and believe the environment may become more supportive as earnings growth accelerates, interest-rate cuts ease financing pressures and economic activity broadens beyond mega-cap companies.

Performance Review

- The strategy's return (pure gross of fees) underperformed the Russell 2000 Growth Index. Top individual detractors were from the IT sector. Shares of software tools provider ServiceTitan fell as valuation concerns and software-as-a-service demand weakness outweighed solid fiscal fourth-quarter 2026 operating results.
- A broader market pivot away from software stocks had a negative impact on shares of software development platform GitLab despite the company's fiscal fourth-quarter earnings beat.
- Conversely, the IT sector was helped by a position in phototonics specialist Lumentum Holdings, whose shares rallied after the company reported strong fiscal second-quarter 2026 financial results and upbeat forward guidance, driven by surging demand for artificial intelligence data-center optics.

Outlook

- Our view on US equities remains positive but selective. In an environment where growth is available but not abundant, our focus is on owning high-quality franchises with durable competitive advantages, often supported by secular tailwinds. We invest in small, growing companies trading below our estimates of their intrinsic value, with the potential for growth over a three-to-five-year time horizon. We look for signs such as accelerated revenue, improved profit margins and expansion into higher-quality markets as part of our decision-making process.
- In 2026, we are focused on structural themes shaped by AI and automation, which are now producing measurable productivity gains not only in the IT sector but also in the health care, financials, industrials and energy sectors. We are also monitoring potential risks for the US economy, including inflation, regulatory pressures, geopolitical friction, infrastructure bottlenecks and unfavorable policy shifts.
- Fiscal and economic conditions appear to be supportive of growth. We expect continued innovation-led expansion underpinned by quality fundamentals in an environment where we think disciplined, active management has an advantage.

Top Equity Issuers (% of Total)

Holding	Portfolio
AAR CORP.	2.62
BWX Technologies, Inc.	2.55
Arcosa, Inc.	2.39
Granite Construction Incorporated	2.34
RBC Bearings Incorporated	2.17
New York Times Company Class A	2.05
Lumentum Holdings, Inc.	1.76
Lattice Semiconductor Corporation	1.71
Matador Resources Company	1.70
AAON, Inc.	1.69

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	-4.16	0.51	-4.16	16.21	8.77	-2.12	9.20	8.13	7.90	7.90	8.31	12/31/1997
Pure Gross of Fees	-3.44	2.01	-3.44	19.66	12.02	0.83	11.79	10.32	9.93	9.86	10.32	12/31/1997
Benchmark	-2.81	-1.63	-2.81	23.58	12.27	1.62	9.79	9.09	7.88	8.02	6.88	—

*Cumulative total returns

Benchmark(s)

Benchmark = Russell 2000 Growth Index

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

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.

Fees: Periods less than one year are not annualized. Performance results are for the composite which includes all actual, fully discretionary accounts with substantially similar investment policies and objectives managed to the composite's investment strategy. Composite returns are stated in U.S. dollars and assume reinvestment of any dividends, interest income, capital gains, or other earnings. The composite may include account(s) that are gross of fees and pure gross of fees. "Pure" gross-of-fee returns do not reflect the deduction of any expenses, including transaction costs. A traditional (or "true") gross-of-fee return reflects performance after the reduction of transaction costs but before the reduction of the investment advisory fee. The gross-of-fee return may include a blend of "true" gross-of-fee returns for non-wrap accounts and "pure" gross-of-fee returns for wrap accounts. Net-of-fee returns is reduced by a model "wrap fee" (3.0% is the maximum anticipated wrap fee for equity and balanced portfolios) which includes trading expenses as well as investment management, administrative and custodial fees. The model wrap fee used represents the highest anticipated wrap fee applicable to the strategy. Actual fees and account minimums may vary.

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What are the Risks?

All investments involve risks, including possible loss of principal. To the extent the portfolio invests in a **concentration of certain securities, regions or industries**, it is subject to increased volatility. **Equity securities** are subject to price fluctuation and possible loss of principal. The **investment style** may become out of favor, which may have a negative impact on performance. **Active management** does not ensure gains or protect against market declines. **Small- and mid-cap stocks** involve greater risks and volatility than large-cap stocks. The manager may consider **environmental, social and governance (ESG) criteria** in the research or investment process; however, ESG considerations may not be a determinative factor in security selection. In addition, the manager may not assess every investment for ESG criteria, and not every ESG factor may be identified or evaluated.

Glossary

Capital Expenditure (capex) are funds used by a company to acquire or upgrade physical assets such as property, industrial buildings or equipment.

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.

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Source: FTSE.

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