

Franklin Small Cap Growth SMA

Commentary | as of December 31, 2025

Key Takeaways

- **Markets:** US equities delivered solid gains over the fourth quarter of 2025, maintaining their upward trajectory against a backdrop of generally robust corporate earnings, despite some mixed economic signals and investor concerns about stretched valuations in technology-related stocks. Continued monetary easing by the US Federal Reserve (Fed), along with a constructive shift in US-China relations, also underpinned investor sentiment. The outperformance of the Magnificent Seven mega-capitalization technology stocks during the quarter boosted returns for the S&P 500 Index and the Nasdaq Composite Index, while the relatively strong performance of the Dow Jones Industrial Average reflected the enduring strength of blue-chip companies. By investment style, value investing surpassed growth in the large-, mid- and small-capitalization tiers, with large-cap stocks performing better than their mid- and small-cap counterparts.
- **Contributors:** For the quarter, stock selection decisions factored into the strategy's relative outperformance. Strong stock selection bolstered relative results in the information technology (IT) sector. Stock selection and an underweight in the industrials sector and stock selection in the energy sector also contributed to a lesser extent.
- **Detractors:** In contrast, stock selection and an underweight in the health care sector, stock selection and an overweight in the consumer staples sector and stock selection and an underweight in the real estate sector also proved adverse for relative returns.
- **Outlook:** The performance of small-cap stocks in general was positive for the fourth quarter and for 2025, supported by broadly favorable valuations, earnings growth and monetary policy. Future performance is likely to depend on the health of the US economy, Fed decisions and overall investor confidence. We believe small-cap growth stocks are attractively valued, both relative to large caps and in light of their own underlying growth potential.

Performance Review

- The strategy's return (pure gross of fees) was positive and meaningfully outperformed that of the Russell 2000 Growth Index. In the IT sector, Lumentum Holdings was a top contributor to returns. The photonics specialist reported solid fiscal first-quarter 2026 financial results, but it was the company's second-quarter guidance of more than 20% sequential growth that rallied the stock. Increased artificial intelligence (AI) demand benefited its core business, including transceiver components and data center interconnects.
- Haemonetics was a leading contributor in the health care sector. Shares of the hematology products company climbed due to a rebound in its hospital business. The company has also seen ongoing growth in hospital-related technologies and blood-management products.
- In contrast, the health care sector was hindered by a position in uniQure (not held by period-end), whose shares fell sharply after the US Food & Drug Administration withdrew its support for the firm's Huntington's disease trial data, raising regulatory uncertainty for the biotechnology company.
- Elsewhere, shares of nutrition products company BellRing Brands in the consumer staples sector struggled under the weight of profit-margin pressures, inventory destocking and a narrowed full-year outlook.

Outlook

- As we enter 2026, 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.
- In recent years, a small group of mega-capitalization innovators—dominated by the Magnificent Seven—has driven the majority of index returns, benefiting from scale and AI leadership. Looking toward 2026, we believe conditions should favor a broadening of equity market leadership, with opportunities emerging across sectors beyond IT and companies below the mega-cap threshold, which can offer an advantage for small- and mid-cap companies.
- 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 aligning to support 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
BWX Technologies, Inc.	2.83
Arcosa, Inc.	2.66
AAR CORP.	2.27
Granite Construction Incorporated	2.16
Onto Innovation, Inc.	2.13
SiTime Corporation	2.04
New York Times Company Class A	2.04
Lattice Semiconductor Corporation	1.98
Lumentum Holdings, Inc.	1.95
ServiceTitan, Inc. Class A	1.90

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	4.88	10.47	6.20	6.20	13.74	-0.30	8.89	8.75	8.59	7.30	8.55	12/31/1997
Pure Gross of Fees	5.64	12.09	9.37	9.37	17.13	2.70	11.43	10.92	10.61	9.24	10.55	12/31/1997
Benchmark	1.22	13.56	13.01	13.01	15.59	3.18	9.57	9.94	8.76	7.43	7.05	—

*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

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.

The **Magnificent Seven** stocks are Apple, Amazon, Alphabet, Meta Platforms, Microsoft, Nvidia, and Tesla.

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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