

Product Commentary

Performance Review

- US stocks surged in November and December, rebounding from three consecutive monthly declines and ending 2023's fourth quarter and full year with strong gains. Moderating inflation and a softening but resilient job market led to investor optimism that the US Federal Reserve (Fed) has concluded its rate-hiking cycle (after pausing for three consecutive meetings) and can maneuver the US economy into a soft landing. Against this backdrop, key measures of US stocks ended the quarter with double-digit percentage returns. Sector gains in a key US index were fairly broad-based, led by real estate, information technology (IT) and financials, with energy the only sector declining. By market capitalization and investment style, small-cap stocks generated the strongest returns, followed by mid- and large-cap stocks, with value stocks outpacing their growth counterparts in the small-cap tier and growth outperforming value in the mid- and large-cap tiers.

QUARTERLY KEY PERFORMANCE DRIVERS

	Stocks	Sectors
HELPED	RayzeBio Inc.	Health Care (Stock Selection)
	EyePoint Pharmaceuticals Inc.	Consumer Discretionary (Stock Selection)
	M/I Homes Inc.	Consumer Staples (Stock Selection)
HURT	Flywire Corp.	Industrials (Stock Selection)
	Lattice Semiconductor Corporation	Real Estate (Stock Selection)
	HealthEquity Inc.	—

- The composite outperformed the Russell 2000 Growth Index in the fourth quarter. In the health care sector, a leading contributor was EyePoint Pharmaceuticals, whose shares rallied following the company's release of topline Phase 2 data for a treatment for age-related blindness.
- Conversely, HealthEquity dampened health care sector results. The company, which is one of the largest health savings account custodian companies in the United States, was likely pressured by the drop in US Treasury yields, which could negatively impact future interest and investment income.
- In the consumer discretionary sector, consumer confidence and, in turn, spending helped drive profits for many companies that deal with discretionary goods and services. M/I Homes, which issued solid third-quarter financial results, was a leading contributor despite a challenging mortgage-rate backdrop. The relative affordability in many of M/I Homes' markets helped the homebuilder weather the worst of the interest-rate shocks.

Outlook & Strategy

- The year 2023 defied initial consensus expectations that stubbornly high inflation and sharply rising interest rates would impact US economic growth and lead to a recession. Instead, we were encouraged by resilient economic data, easing inflation and the possible end of the Fed's tightening cycle. In such an environment as 2023, overall US equity returns were extraordinary but driven by a narrow group of mega-cap growth stocks, although market breadth began to improve in the fourth quarter.
- We believe the scope of equity market performance will broaden further in 2024 and expect several attractive secular themes to drive returns. For example, we remain excited about compelling innovations within the medical technology space, including surgical robotics and bioprocessing systems. We see further potential in several companies that are playing leading roles in society's ongoing energy transition and digital transformation.
- In the technology space, after a period of budget cutting, we believe businesses will be more focused on digital transformation or risk falling behind the competition. Our confidence in above-market growth for the IT sector is bolstered by our assessment of strong demand for generative artificial intelligence (AI). More companies are deploying generative AI to increase the value of their product or service. In this transition, we expect to see beneficiaries further down the market-capitalization spectrum, particularly in industries like software and internet services.
- While we remain watchful of macroeconomic uncertainties, they do not drive most of our investment decisions. We believe active management is critical to moving quickly and successfully in today's dynamic markets. We look for opportunities that can potentially deliver positive long-term results, even in an environment of elevated interest rates. We have been finding opportunities in what we consider high-quality businesses levered to durable secular growth themes, have market-leading competitive positions along with strong financials and balance sheets, and possess the ability to invest and grow through a range of economic conditions.
- Our small-cap strategy invests in firms that we believe have strong growth prospects, solid balance sheets and are attractively priced. Sector positioning is a residual of bottom-up analysis. Currently, our largest sector exposures are health care, IT, industrials and consumer discretionary. This positioning reflects a more constructive view of the long-term backdrop than what we believe is reflected in stock prices. We recognize that it is challenging to have conviction in the face of economic unknowns and equity market volatility, but by focusing on the long term, we believe we can position the portfolio for a variety of potential scenarios.

Product Details¹

Inception Date	12/31/1997
Benchmark	Russell 2000 Growth Index

Performance Data^{2,3}

Average Annual Total Returns (USD %)

	3 Mths	YTD	1 Year	3 Year	5 Year	10 Year	20 Year	Since Inception (12/31/1997)
Franklin Small Cap Growth SMA - Pure GROSS	17.34	29.70	29.70	-2.67	12.08	8.86	10.68	10.49
Franklin Small Cap Growth SMA - NET	16.51	25.98	25.98	-5.52	9.19	6.72	8.82	8.59
Russell 2000 Growth Index	12.75	18.66	18.66	-3.50	9.22	7.16	8.28	6.53

Calendar Year Returns (USD %)

	2023	2022	2021	2020	2019	2018	2017	2016	2015	2014
Franklin Small Cap Growth SMA - Pure GROSS	29.70	-28.76	-0.21	43.66	33.53	0.82	22.71	8.87	-3.76	1.90
Franklin Small Cap Growth SMA - NET	25.98	-30.90	-3.12	39.57	31.84	-0.57	21.08	7.36	-5.00	0.55
Russell 2000 Growth Index	18.66	-26.36	2.83	34.63	28.48	-9.31	22.17	11.32	-1.38	5.60

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Investment Team

Michael McCarthy, CFA
Years with Firm 31
Years Experience 31

Brad Carris, CFA
Years with Firm 22
Years Experience 22

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 Separately Managed Accounts, high-net-worth individual and institutional client portfolios and with respect to any periods prior to the inception of Franklin Separately Managed Accounts, reflects the performance of any such other portfolios.

2. Performance information is based on the Franklin Small Cap Growth SMA Composite. Net of fee returns are reduced with a model of 3% for equity and balanced strategies and 1.5% for fixed income strategies. Prior to 1/1/2020, net returns were net of actual total wrap fees and non-fee paying accounts used a model fee. Accounts in the composite may have been charged trading expenses in addition to the standard bundled fee which may reduce pure gross performance. Gross of fee returns for wrap account may be pure gross before wrap fees, including brokerage fees related to trading expenses for transactions executed through the sponsor. Pure gross of fee returns do not reflect the deduction of any expenses, including transaction costs. Returns assume the reinvestment of dividends, interest, and realized and unrealized capital gains and losses.

3. 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.

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Franklin Small Cap Growth SMA Composite consists of all fully discretionary accounts with a small cap growth investment objective and for which the brokerage (including trading expenses), administrative, custodial, and investment management fees are charged together as a percentage of the portfolio's assets ("wrap fee"). All accounts in the composite have a wrap fee (also known as a bundled or "comprehensive" fee) for all time periods presented. Effective April 2, 2012, Franklin Advisers, Inc., assumed responsibility for Franklin Separately Managed Accounts' small cap strategy accounts, including those in the Franklin Small Cap Growth SMA Composite. Franklin Advisers, Inc. is a sub adviser to Franklin Separately Managed Accounts.

The primary benchmark for this composite is the Russell 2000 Growth Index, which is a float-adjusted market capitalization weighted equity index comprised of securities of small-cap U.S. companies with high price-to-book ratios and high forecasted growth values.

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. **International investments** are subject to special risks, including currency fluctuations and social, economic and political uncertainties, which could increase volatility. These risks are magnified in **emerging markets**. **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.

The composite performance results are presented in U.S. Dollars and have been calculated using time-weighted total rates of return. Returns over one year are annualized. All returns assume the reinvestment of dividends, interest, and realized and unrealized capital gains and losses. Periods greater than one year are shown as average annual total returns. Performance data is shown rounded to the nearest hundredth. **Past performance is not an indicator or a guarantee of future performance.**

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