Webcast Q&A

LEGG MASON CLEARBRIDGE US AGGRESSIVE GROWTH FUND

Evan Bauman believes that certain areas of the market offer strong prospects for growth investors. This Q&A is based on a webcast that took place on 3 December 2014, in which Evan reflected on the Legg Mason ClearBridge US Aggressive Growth Fund's positioning.

KEY POINTS

- **Healthcare and media companies make up approximately 50% of the portfolio. The manager believes they can generate strong growth, even during periods of slow economic activity.**
- **The fund's exposure to technology is selective, and it remains underweight consumer-related stocks.**
- **The manager had taken advantage of the recent weakness in energy companies to add to the fund's holdings in this sector.**

Q: What distinguishes this fund?

EB: The way that we define growth is very different from many other managers. We are focused on sustainable growth and sustainably innovative businesses; companies which are in non-competitive industries and can grow through the advent of innovative technologies, disruptive technologies and true pricing power, even during periods of economic softness. This can give us an advantage since we are not trying to predict global economies or GDP growth on a short-term basis.

Another differentiating characteristic is turnover, which is in the mid-single digits, reflecting our very long-term investment horizon. We have owned our top 10 holdings, which make up around 50% of the portfolio, for an average of 18 years. The remainder of the fund is in a tail of incubator positions. Importantly, while turnover is low, there is also a high activity level when there are good valuations points in the market and disruptive points in the market.

Q: Were you able to take advantage of the recent market setback?

EB: October saw the single greatest period of volatility this year, with close to a 10% correction in the S&P 500 index. Since then, markets have snapped back, with the S&P recording new highs. However, there are sectors of the market, particularly cyclical ones and especially energy, which are still down significantly over the last two months.

We used this weakness to reduce our cash position, which, by July, had built to around 15% of the portfolio. Today, cash represents more like 9% of the fund. A significant part of this cash was used to add to our holdings in the energy sector. We didn't add any new positions or new names, but increased the weightings in existing holdings of Weatherford International, Anadarko Petroleum, National Oilwell Varco and Core Laboratories, along with Newfield Exploration. This reflects our high conviction in an area which we believed to have significantly overshot on the downside.

Q: Can you elaborate more on your exposure to energy?

EB: We are very conservative in terms of our positioning, looking for companies that are financially strong and can continue to generate cash even in the current commodity price environment. Energy prices, particularly oil prices, tend to be self-correcting as price falls lead to a downtick in production and, ultimately, a big uptick in demand. Moreover, the market sell-off was not fundamentally-driven; rather it reflected selling by hedge funds, short selling and margin call selling by large owners of commodities or commodity-related equities.

I believe that the pullback in equity prices and the dislocation in equity prices versus fundamentals will lead to a sharp uptick in consolidation, both on the exploration and production side and the service side. Just yesterday, Weatherford International announced that they had sold over US$800 million of assets to a Berkshire Hathaway company, and Halliburton has already made a bid for Baker Hughes. Longer term, I think the opportunities in the energy sector are significant and the upside strong, given where equity prices are today.

Q: Which areas have been the strong contributors in 2014?

EB: The clear winner for this portfolio has been healthcare for a number of reasons. One has been consolidation within the healthcare space, with two major takeovers this year. The single biggest in terms of attribution was Forest Laboratories, a company we have held for over 30 years. Forest was acquired earlier this year by Actavis Pharmaceuticals, which has also subsequently announced it is to buy Allergan Pharmaceuticals.

Aside from consolidation, there have been extremely strong fundamental results from some of the biotech companies that we own, such as Amgen and Biogen Idec, the single biggest position within the portfolio. Biogen Idec, which we've owned for 23 years, is growing faster today than it has been at any point over the last 15 years. Yesterday the company announced very encouraging, albeit early stage, results for its Alzheimer’s disease drug.

Q: Where do you see the prospects for the market in 2015?

EB: I am agnostic on the stock market. The market is at all-time highs; some sectors are fully valued while others, such as healthcare, technology and media, still offer significant opportunity. These are the areas we favour overall. In addition, the dislocations in the energy space could lead to a significant rally, even with little change to fundamentals. I would expect the market to remain volatile, with M&A activity the biggest driver of equity prices going forward. I think we’re heading into a period where stock picking and finding growth in a difficult economic backdrop remains at a premium.

IMPORTANT INFORMATION

The Fund may invest in certain types of derivative instruments for efficient portfolio management purposes. Please refer to the prospectus for more information.

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