

# Franklin Small Cap Growth Fund

Advisor Class: FSSAX Class A: FSGRX

Commentary | as of March 31, 2025

## Key Takeaways

- Markets:** US equities experienced heightened volatility during the first quarter of 2025 amid concerns about President Donald Trump's tariff policies and their impact on economic growth, inflation and the US Federal Reserve's interest-rate path, with some investors fearing a potential recession or stagflation (economic stagnation and high inflation). Underwhelming earnings reports and guidance from some companies and significantly lower consumer confidence also hindered sentiment. US stocks collectively declined in the first quarter, with the S&P 500 Index, Dow Jones Industrial Average and NASDAQ Composite Index ending with losses. Small-capitalization stocks struggled over the quarter, followed by large- and mid-cap equities. In all three market-cap tiers, value stocks performed better than growth, with large-cap value stocks ending modestly positive.
- Contributors:** The biggest contributor to the fund's performance relative to its Russell 2000 Growth Index benchmark was stock selection in the information technology (IT) sector. To a lesser extent, stock selection in the consumer discretionary, industrials and communication services sectors also supported relative results.
- Detractors:** Overall stock selection and allocation decisions worked against us, resulting in the fund's underperformance versus the benchmark. Stock selection in the financials and consumer staples sectors and stock selection and an underweight in the health care sector weakened relative returns.
- Outlook:** We expect the equity market to remain volatile as tariffs and policy information unfold. For longer-term, patient investors, we think there are reasons for optimism. We believe that no matter what comes, innovators can find new ways to create value in a changing world. We are finding what we consider to be high-quality companies on sale today that we believe are resilient in tariff and recessionary environments and have excellent long-term prospects.

## Performance Review

- The fund underperformed its Russell 2000 Growth Index benchmark in the first quarter of 2025. In the financials sector, relative performance was hurt by a position in Flywire. The company reported a fourth-quarter 2024 revenue decline and dramatically reduced its 2025 outlook, sending the shares of the payments processor lower. Flywire provides services designed to help international students manage their education payments. This is a core business for the company and changes in student visa policies have impacted the number of international students it services.
- The leading individual detractor from relative performance was an off-benchmark position in Freshpet in the consumer staples sector. The pet food company issued fourth-quarter 2024 financial results that missed consensus analyst estimates, causing its stock to decline. While the company reported modest top-line growth deceleration, the quarter included strong volume trends and significant profit-margin upside following operational and cost-management improvements.
- While health care was a relative detractor at the sector level, the fund's off-benchmark investment in Intra-Cellular Therapies (not held at quarter-end) was a top relative contributor. The shares of the biopharmaceutical company soared following news of its acquisition by Johnson & Johnson (not a fund holding).

## Outlook

- Recent equity market volatility is not surprising given the uncertainty about tariffs and their potential impact on the economy. As clarity emerges, we are likely to learn more about the new presidential administration's investor-friendly policies, such as deregulation and tax cuts, which should help improve investor sentiment, in our view.
- In broad terms, consumers continue to spend, employment is still stable, corporate earnings remain fairly steady, and we are on the cusp of an innovation-led business cycle driven by artificial intelligence (AI) and factory reshoring (i.e., moving production back to the company's home country). While the Magnificent Seven group of US mega-capitalization technology-related stocks played a key role in 2024's equity market rally, we see growing opportunities beyond these market leaders.
- As bottom-up fundamental investors, our focus is on analyzing individual companies rather than broader market trends or economic cycles. We invest in sectors that, in our analysis, deliver consistent, sustainable earnings growth and are backed by potentially sustainable secular growth tailwinds, such as IT with its advancements in AI. We believe the health care sector can be one of the biggest beneficiaries of innovation, whether it is AI applications or new drug discoveries. We are also paying attention to the industrials sector as the United States undergoes an industrial renaissance with companies reshoring their production and new technology making factories more competitive on a world-class basis.
- Our strategy is designed to address both upward and downward market cycles, which are historically not unusual in equity markets. 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	Fund
BWX TECHNOLOGIES INC	2.59
BELLRING BRANDS INC	2.55
ARCOSA INC	2.26
KRATOS DEFENSE & SECURITY SOLUTIONS INC	1.92
INTEGER HOLDINGS CORP	1.91
BEACON ROOFING SUPPLY INC	1.91
VONTIER CORP	1.84
LATTICE SEMICONDUCTOR CORP	1.80
AAR CORP	1.79
GRANITE CONSTRUCTION INC	1.73

## Sector Allocation (% of Total)

Sector	Fund
Information Technology	24.79
Industrials	19.58
Health Care	18.62
Consumer Discretionary	12.09
Financials	10.49
Consumer Staples	6.25
Energy	3.36
Communication Services	2.44
Real Estate	1.32
Cash & Cash Equivalents	1.05

## Average annual total returns and fund expenses (%)

Class	CUSIP	Ticker	Without Sales Charge							With Maximum Sales Charge							Expenses		Sales Charges		Inception Date
			3-Mo	YTD	1-Yr	3-Yr	5-Yr	10-Yr	Inception	3-Mo	YTD	1-Yr	3-Yr	5-Yr	10-Yr	Inception	Gross	Net	Initial Charge	CDSC	
Advisor Class	354713653	FSSAX	-12.80	-12.80	-8.09	1.07	11.40	7.02	7.53	-12.80	-12.80	-8.09	1.07	11.40	7.02	7.53	0.84	0.83	—	—	5/1/2000
Class A	354713620	FSGRX	-12.83	-12.83	-8.29	0.84	11.12	6.76	7.24	-17.62	-17.62	-13.32	-1.05	9.87	6.16	6.99	1.09	1.08	5.50	—	5/1/2000
Benchmark 1	—	—	-11.12	-11.12	-4.86	0.78	10.78	6.14	—	-11.12	-11.12	-4.86	0.78	10.78	6.14	—	—	—	—	—	
Benchmark 2	—	—	-4.27	-4.27	8.25	9.06	18.59	12.50	—	-4.27	-4.27	8.25	9.06	18.59	12.50	—	—	—	—	—	

## Benchmark(s)

Benchmark 1=Russell 2000 Growth Index

Benchmark 2=S&amp;P 500 Index

**Performance data quoted represents past performance, which does not guarantee future results.** Current performance may be lower or higher than the figures shown. Principal value and investment returns will fluctuate, and investors' shares, when redeemed, may be worth more or less than the original cost. Performance would have been lower if fees had not been waived in various periods. Total returns assume the reinvestment of all distributions and the deduction of all fund expenses. Returns with sales charge reflect a deduction of the stated maximum sales charge. An investor cannot invest directly in an index, and unmanaged index returns do not reflect any fees, expenses or sales charges. Returns for periods of less than one year are not annualized. All classes of shares may not be available to all investors or through all distribution channels. For current month-end performance, please visit [franklintempleton.com](http://franklintempleton.com).

The fund began offering Advisor Class shares on 5/1/2000. Performance quotations have been calculated as follows: (a) for Advisor Class periods prior to 5/1/2000, a restated figure is used based on the fund's Class A performance. The performance was adjusted to take into account differences in class-specific operating expenses and maximum sales charges. (b) For periods after share class offering, performance for the specific share class is used, reflecting the expenses and maximum sales charges applicable to that class.

Gross expenses are the fund's total annual operating expenses as of the fund's prospectus available at the time of publication. Actual expenses may be higher and may impact portfolio returns. Net expenses reflect contractual fee waivers, expense caps and/or reimbursements, which cannot be terminated prior to 08/31/2025 without Board consent. Additional amounts may be voluntarily waived and/or reimbursed and may be modified or discontinued at any time without notice.

## What are the Risks?

**All investments involve risks, including possible loss of principal. Small- and mid-cap stocks** involve greater risks and volatility than large-cap stocks. The **investment style** may become out of favor, which may have a negative impact on performance. To the extent the portfolio invests in a **concentration of certain securities, regions or industries**, it is subject to increased volatility. **Liquidity risk** exists when securities or other investments become more difficult to sell, or are unable to be sold, at the price at which they have been valued. 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. These and other risks are discussed in the fund's prospectus.

## 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.

**Stagflation** is a seemingly contradictory condition described by slow economic growth and relatively high unemployment, or economic stagnation, which is at the same time accompanied by rising prices (i.e. inflation).

**Stagnation** is a prolonged period of little or no growth in an economy.

## Important Information

The information provided is not a complete analysis of every material fact regarding any country, market, industry, security or fund. Because market and economic conditions are subject to change, comments, opinions and analyses are rendered as of the date of this material and may change without notice. A portfolio manager's assessment of a particular security, investment or strategy is not intended as individual investment advice or a recommendation or solicitation to buy, sell or hold any security or to adopt any investment strategy; it is intended only to provide insight into the fund's portfolio selection process. Holdings are subject to change.

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

Important data provider notices and terms available at [www.franklintempletondatasources.com](http://www.franklintempletondatasources.com). All data is subject to change.

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**Before investing, carefully consider a fund's investment objectives, risks, charges and expenses. You can find this and other information in each prospectus, or summary prospectus, if available, at [www.franklintempleton.com](http://www.franklintempleton.com). Please read it carefully.**