

# SMALL CAP DIVERSIFIED VALUE FUND

## Commentary

Calendar Year 2018



### Manager Review and Economic Outlook

#### Market Commentary

The Russell 2000 Index was up more than +11% through the first nine months of the year before posting its worst calendar quarter in 7 years, falling -20.2% in Q4. The end result was a -11.0% return for calendar year 2018. Until the most recent quarter, robust corporate earnings growth had overcome political unrest across the globe. In the fourth quarter, however, ongoing trade tensions came to the forefront. While small caps are more domestic-focused than large caps, and should be insulated from global disruptions relative to large caps, this suppressed investor risk appetite and small caps sold off disproportionately. Markets began pricing in slowing economic growth in several major economies that are important trading partners with the US. In contrast to this however, real GDP growth in the US was a healthy +3.4% in the most recent quarter and the unemployment rate remains below 4%. Both the Federal Reserve and the European Central Bank implemented and spoke of future restrictive monetary policy. This appears to have added to equity investor apprehension. The forward P/E ratio for the Russell 2000 Index declined from 20.6x at the beginning of the year to 14.3x at the end of the year. The index's median P/E since 1995 is 16.7x, so it went from well above average to comfortably below average over the course of the year.

Fears that slowing economic growth would weaken demand weighed heavily on oil prices. WTI crude closed the year at \$45/barrel, down 25% from the beginning of the year (\$60) and more than 40% from its early October high (\$76). Commodity securities were among the worst-performers of the year, with the small cap energy (-37%) and materials sectors (-26%) leading the decline. Non-cyclical utilities performed best, returning +4% during the year—the only sector in the Russell 2000 Value with a positive return. The performance dispersion and resulting valuation differentials among stocks that are economically sensitive compared to those that are not suggests the market has begun to price in a recession scenario. Economic metrics do not yet verify a meaningful change from positive economic growth. At present, while acknowledging the uncertain economic outlook, we view the valuation support of cyclical stocks as vastly superior to non-cyclicals. We believe this valuation discrepancy provides a “margin of safety” in the long run almost irrespective of near term economic growth.

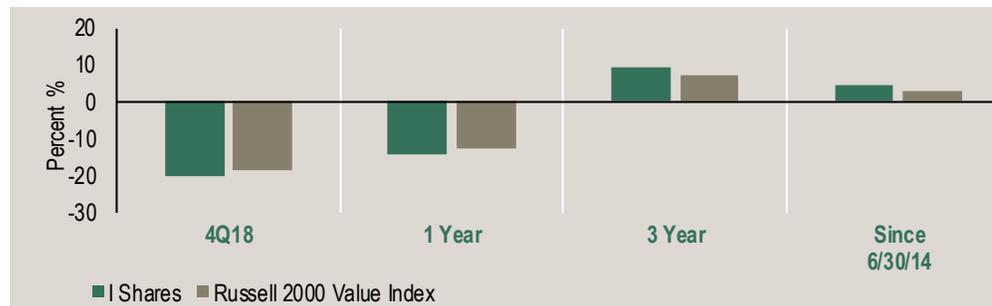
The portfolio trades at a substantial valuation discount to the index, which makes us optimistic about its prospects irrespective of market direction or temperament. The portfolio trades at 7.2x normal earnings compared to 12.5x for the Russell 2000 Value and 14.4x for the Russell 2000. The portfolio's price-to-book ratio is 1.1x compared to 1.2x and 1.8x for the Russell 2000 Value and the Russell 2000, respectively.

#### Attribution: 2018

The Hotchkis & Wiley Small Cap Diversified Value Fund underperformed the Russell 2000 Value Index in 2018. The portfolio's average energy weight was slightly more than 9% for the year compared to just 7% for the index, which detracted from performance. Energy was the worst-performing sector in the Russell 2000 Value during the year by a large margin, as crude oil prices fell 25% in the year. The portfolio's energy stocks held up considerably better than the index's energy stocks which more than made up for the modest overweight position. The underweight position in real estate, healthcare, and utilities were modest detractors, along with stock selection in healthcare, industrials, and consumer discretionary. This was partially offset by positive stock selection in financials and materials.

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## Performance as of December 31, 2018



	4Q18	1 Year	3 Year	Since 6/30/14
I Shares	-20.11%	-14.33%	9.31%	4.52%
A Shares without sales charge	-20.12	-14.59	9.00	4.24
A Shares	-24.33	-19.06	7.04	3.01
Russell 2000 Value Index	-18.67	-12.86	7.37	3.07

The Fund's total annual operating gross expense ratio as of the most current prospectus is 1.45% for I Shares and 1.70% for A Shares. The net expense ratio is 0.90% for I Shares and 1.15% for A Shares. The Advisor has contractually agreed to waive advisory fees and/or reimburse expenses through August 29, 2019.

The performance shown represents past performance. Past performance is no guarantee of future results and current performance may be higher or lower than the performance shown. Short-term performance, in particular, is not a good indication of the fund's future performance, and an investment should not be made based solely on returns. Investment results and principal value will fluctuate so that shares, when redeemed, may be worth more or less than their original cost. To obtain performance data current to the most recent month-end, access our website at [www.hwcm.com](http://www.hwcm.com).

**You should consider the Fund's investment objectives, risks, and charges and expenses carefully before you invest. This and other important information is contained in the Fund's summary prospectus and prospectus, which can be obtained by calling 1-800-796-5606 or visiting our website at [www.hwcm.com](http://www.hwcm.com). Read carefully before you invest.**

(Inception date: I and A Shares-6/30/14). Returns shown for A Shares without sales charge do not reflect the maximum sales load of 5.25%; if reflected, performance would be lower than shown. Returns for A shares reflect the deduction of the current maximum initial sales charges of 5.25%. Class I shares sold to a limited group of investors. Periods over one year are average annual total return. Average annual total returns include reinvestment of dividends and capital gains. Expense limitations may have increased the Fund's total return.

The Russell 2000® Index measures the performance of the 2,000 smallest companies in the Russell 3000® Index. The Russell 2000® Value Index measures the performance of those Russell 2000® companies with lower price-to-book ratios and lower forecasted growth values. The indices do not reflect the payment of transaction costs, fees and expenses associated with an investment in the Fund. The Fund's value disciplines may prevent or restrict investment in major stocks in the benchmark indices. It is not possible to invest directly in an index. The Fund's returns may not correlate with the returns of their benchmark indices. Margin of safety is a principle of investing in which an investor only purchases securities when the market price is significantly below its intrinsic value; when market price is significantly below your estimation of the intrinsic value, the difference is the margin of safety. Forward P/E (Price/Earnings) ratio is a stock's price over its predicted earnings per share. Price-to-book value is the price of a stock divided by its book value.

*Mutual fund investing involves risk. Principal loss is possible. Investing in smaller and/or newer companies involves greater risks than those associated with investing in larger companies, such as business risk, significant stock price fluctuations and illiquidity. The Fund may invest in foreign securities which involve greater volatility and political, economic and currency risks and differences in accounting methods.*

### Contributors to Performance

Top Five	% of Total Portfolio <sup>1</sup>
Fossil Group Inc.	0.0%
Renewable Energy Group Inc.	0.4
Delek US Holdings	0.0
Syntel Inc.	0.0
Whiting Petroleum Corp.	0.4

Bottom Five	% of Total Portfolio <sup>1</sup>
Aceto Corp.	0.0%
United Natural Foods Inc.	0.3
MDC Partners Inc.	0.4
Smart Sand Inc.	0.4
Francesca's Holdings Corp.	0.4

### Classes & Tickers

I Shares	HWVIX
A Shares	HWVAX

<sup>1</sup>% of total portfolio includes total investments, cash and cash equivalents, and accrued investment income on a trade date basis.

Investing in value stocks presents the risk that value stocks may fall out of favor with investors and underperform other asset types during a given period. Equities, bonds, and other asset classes have different risk profiles, which should be considered when investing. All investments contain risk and may lose value. Attribution is an analysis of the portfolio's return relative to a selected benchmark, is calculated using daily holding information and does not reflect the payment of transaction costs, fees and expenses of the Fund.

**NOT FDIC INSURED  
NO BANK GUARANTEE  
MAY LOSE VALUE**

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