

SMALL CAP DIVERSIFIED VALUE FUND

Commentary

Third Quarter 2018



Manager Review and Economic Outlook

Market Commentary

The Russell 2000 Index returned +3.6% in the third quarter and is now up +11.5% since the beginning of the year. Failed Brexit negotiations and the threat of a global trade war have triggered short-lived bouts of equity market volatility, but positive economic data and strong corporate earnings growth has overwhelmed those concerns. Despite Wall Street having revised estimates upward rather persistently, nearly two-thirds of Russell 2000 companies beat consensus earnings estimates in the most recent quarter; the median positive surprise was 16% above consensus estimates.

Small cap growth outperformed small cap value in the quarter, extending its considerable lead in recent years. Some of the disparity was due to differences in sector exposures: the growth index has more exposure to healthcare which outperformed and less exposure to energy which underperformed. Sector weights aside, however, stocks with high valuations outperformed stocks with low valuations. The Russell 2000 Growth has outperformed the Russell 2000 Value by more than 8 percentage points since the beginning of the year, after outperforming by more than 14 percentage points in 2017. As a result, the valuation gap between growth stocks and value stocks has widened. Three years ago, the forward P/E for the Russell 2000 Growth was 36.1x compared to 19.7x for the Russell 2000 Value, for a difference of 16.4x (“growth premium”). Since the year 2000, the median growth premium has been 11.6x, so three years ago spreads were wider than average. Today, however, the forward P/E ratio for the Russell 2000 Growth has expanded to 47.8x while the Russell 2000 Value has declined to 18.8x. The current growth premium, therefore, is 29.0x (47.8x – 18.8x), or more than double the long term average. Earnings growth between the two indices has been comparable, thus the primary cause of the outperformance has been the repricing of growth stocks, i.e. multiple expansion. We do not believe that this valuation gap can widen indefinitely, and consequently we are optimistic about the prospects of value relative to growth as we look forward.

We remain overweight industrials and energy compared to the Russell 2000 Value, though we have taken capital out of energy since the beginning of the year. Our portfolio holdings in energy have outperformed and so we have shifted capital to more compelling valuation opportunities. The portfolio’s valuation discount relative to the market has moved from wide to wider, which gets us excited about the portfolio going forward. The portfolio trades at 9.7x normal earnings compared to 15.2x for the Russell 2000 Value and 17.3x for the Russell 2000.

Attribution: 3Q 2018

The Hotchkis & Wiley Small Cap Diversified Value Fund underperformed the Russell 2000 Value Index in the third quarter of 2018. Relative to the benchmark the portfolio has nearly twice the exposure to stocks with a market cap of less than \$1 billion, which lagged the rest of the small cap market in the quarter considerably. Stock selection in consumer discretionary, healthcare, and consumer staples also detracted from performance. Positive stock selection in energy, real estate, and materials helped relative performance. The overweight position in industrials also helped as the sector outperformed the market.

SMALL CAP DIVERSIFIED VALUE FUND

Performance as of September 30, 2018



	3Q18	1 Year	3 Year	Since 6/30/14
I Shares	0.66%	11.50%	19.21%	10.48%
A Shares without sales charge	0.58	11.19	18.87	10.17
A Shares	-4.68	5.31	16.77	8.79
Russell 2000 Value Index	1.60	9.33	16.12	8.39

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.

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. 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 Russell 2000® Growth Index measures the performance of those Russell 2000® Index companies higher price-to-book ratios and higher 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. Forward P/E (Price/Earnings) ratio is a stock's price over its predicted earnings per share.

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 ¹
Renewable Energy Group Inc.	0.5%
Steelcase Inc.	0.5
World Fuel Service	0.4
LifePoint Health Inc.	0.4
Armstrong Flooring Inc.	0.5

Bottom Five	% of Total Portfolio ¹
Bed Bath & Beyond Inc.	0.3%
LSC Communications Inc.	0.4
William Lyon Homes	0.3
Francesca's Holdings Corp.	0.2
Ultra Petroleum Corp.	0.4

Classes & Tickers

I Shares	HWVIX
A Shares	HWVAX

¹% 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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