SEPTEMBER 30, 2024

LARGE CAP FUNDAMENTAL VALUE

MARKET COMMENTARY

The S&P 500 Index returned +5.9% in the third quarter and is now up +22.1% since the beginning of the year. The most recent Consumer Price Index report provided further evidence that inflation is decreasing on a sustainable path. Moderate inflation combined with signs of labor market softness prompted the FOMC to cut the Fed Funds rate by 50 basis points to 5.0% (upper bound). While the cut was mostly anticipated, the Fed's outlook and comments reinforced the view of further rate cuts, and equity markets reacted positively. Large value outperformed large growth in the quarter (+9.4% vs. +3.2%), though growth maintains a considerable edge year-to-date (+24.6% vs. +16.7%). The energy sector declined amid the drop in crude oil prices, while all other sectors were positive. Utilities, real estate, industrials, and financials all returned more than +10%. Technology and communication services, which combined represent more than 40% of the index, were notable laggards as both increased a modest +2%.

The S&P 500 closed the quarter at a record high, its 43rd such achievement this year. The broad market's price level appears better supported by earnings and cash flows today than it was in the dot.com bubble, but outside that extreme era it trades at near-record valuation multiples. At 24x, the S&P 500's forward P/E multiple ranks in the 91st percentile dating back to 1990. The only observations that exceeded today's multiple occurred between 1998 and 2000[1]. Like that period, the S&P 500 is highly concentrated in its largest stocks, which is the primary source of its elevated valuation. Excluding the top 10 stocks, its P/E ratio would rank in the 73rd percentile, still elevated but less alarming. We believe the high concentration in expensive stocks poses considerable risk to passive equity investors.

The portfolio is positioned much differently than the index. Its active share relative to the Russell 1000 Value and S&P 500 is 90 and 93, respectively, meaning that overlapping positions/weights comprise less than 10% of the portfolio. Among market segments where we have become increasingly interested are defensive, or non-cyclical sectors like healthcare, consumer staples, and utilities. Over the past two years, the S&P 500 is up +66% cumulatively, but those three sectors are up about half that. Going back to 1990, the healthcare and consumer staples sectors typically trade at modest valuation premiums to the market, with average premiums of 105% and 108%, respectively. Today, however, both sectors trade at a valuation discount to the market, at 91% and 89%, respectively. Utilities have typically traded at a discount to the market, and today's discount is slightly greater than average. We are also attracted to these sectors' defensive attributes and potential diversification benefits. Accordingly, we have increased the weight in this group by about 10 percentage points over the past 2 years while the index weight has declined slightly. We went from underweight the group by about 16 percentage points two years ago to just 3 percentage points today. Of the three sectors, healthcare represents the largest weight and largest increase, both by far. It is the portfolio's second largest exposure after financials. As a group, the portfolio's healthcare positions trade at 12x normal earnings, which represents an attractive valuation considering the group's balance sheet strength, business quality, and governance—the three pillars of our Fundamental Risk Ratings framework.

At 27%, financials represent the portfolio's largest sector weight. We have positions diversified across financial services, capital markets, and insurance, but nearly half the financials exposure is banks. Our thesis remains largely unchanged. Bank valuations are at a larger-than-normal discount to the rest of the market. In fact, the discount is roughly 2 standard deviations wider than the 30-year average. We view this as attractive for the risks at hand, which we believe have merit but should be manageable.

While we view the broad market as richly valued, value stocks appear more reasonable and the portfolio itself appears attractive—without assuming unnecessary risks. We are optimistic about the portfolio's prospects in the foreseeable future, particularly compared to passive alternatives.

(continued)

[1]Technically price multiples exceeded this in 2020 due to a massive decline in earnings projections from COVID, though this was short-lived.

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ATTRIBUTION ANALYSIS – 3Q24

The Hotchkis & Wiley Large Cap Fundamental Value portfolio underperformed the Russell 1000 Value index in the third quarter of 2024 (gross and net of management fees). Energy was the largest source of underperformance as both the overweight position and stock selection hurt. WTI crude prices declined from $82/barrel to $68/barrel over the course of the quarter. The portfolio's consumer discretionary exposure, which is all auto-related, also detracted from performance over the quarter. Stock selection in financials and the lack of exposure to real estate were modest detractors. Positive stock selection in technology and consumer staples helped relative performance.

LARGEST INDIVIDUAL CONTRIBUTORS – 3Q24

F5 (FFIV) sells application networking and security software, as well as data center appliances. The company's stock price rebounded sharply in Q3 after reporting a growing pipeline and better close rates in subscription software sales. F5 has no debt, trades at an attractive valuation, and is benefiting from an improving gross margin and lower operating expenses.

Ericsson (ERIC) is the largest vendor of hardware and software for operating wireless networks outside of China. The company built on the prior quarter's outperformance, with signs of revenue stabilization and margin improvement continuing, and management seeing signs of recovery in the North American market.

Unilever (UL) is one of the world's leading suppliers of consumer goods in the food, home care, and personal care categories, maintaining #1 or #2 market share over 75% of its business. With a new CEO and the involvement of an activist investor (Trian), Unilever is focused on execution and consistency, expecting low to mid-single digit volume-driven top line growth over the medium term, profit growth ahead of sales growth due to operating leverage and mix, and consistent return of cash to shareholders. Additionally, the company has announced plans to separate the Ice Cream business (13% of 2023 sales), which is expected to be completed by the end of 2025 and increase organic sales growth to 4-6% annually. Over the last quarter, the stock price reached a five-year high, as the company has continued to execute the plans laid out above. Unilever has not yet released their official third quarter results but has reiterated their confidence in achieving 3-5% organic sales growth for the full year, with the majority of this growth being driven by volume.

LARGEST INDIVIDUAL DETRACTORS – 3Q24

APA Corp. (APA) is an independent E&P company operating offshore in the North Sea, onshore in Egypt, and in the Midland and Delaware basins in the Permian. Recent exploration success in Suriname and Egypt has allowed APA to de-emphasize spending on lower-returning assets in the North Sea. APA's performance continued to be pressured over the quarter due to the downturn in energy prices. In addition, free cash flow was impacted by spending related to the recent acquisition of Callon Petroleum. We expect free cash flow to improve as capital expenditures normalize following the integration of Callon Petroleum.

NOV, Inc. (NOV) is a leading provider of oilfield capital equipment, consumables, and services. Like APA, the downturn in energy prices has reduced oilfield activity below sustainable levels, impacting NOV's sales and profitability. As activity rebounds, most of NOV's product lines should experience significant increases in volume and pricing. In the longer term, the earnings power of its Rig Aftermarket business should improve, given its large installed base.

General Motors Company (GM) is one of the world's largest manufacturers of passenger vehicles. GM reported a strong Q2; however, management provided a cautious outlook for the second half of 2024. Comments from GM mirrored those of other OEMs and auto suppliers, leading investors to believe the automotive cycle has peaked. We believe this is an overreaction, and we continue to view GM as an attractive investment. We like GM for many reasons. First, we believe GM has leading market positions in its main business segments. Second, the valuation is extremely attractive. Finally, it is a strong free cash flow generator, and the management team is committed to repurchasing their undervalued shares.

Net of fee composite performance as of 9/30/24: 26.64%, 12.91%, and 10.20% for 1-, 5-, and 10-year, respectively. Net performance results are presented after management fees and all trading expenses but before custodial fees.

For informational purposes only, the specific investments shown represent only the top contributors and detractors for the relevant performance time period. The selection criteria used to determine the top contributors and detractors remains the same across performance measurement periods; additional disclosures provided in Endnotes. **Past performance is no guarantee of future results.**

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Endnotes:

All investments contain risk and may lose value. This commentary is for general information only and should not be relied on for investment advice or recommendation of any particular security, strategy, or investment product.

Portfolio characteristics and attribution are based on a representative Large Cap Fundamental Value portfolio. Attribution is an analysis of the portfolio's return relative to the index, is calculated using daily holdings information and does not reflect management fees and other transaction costs and expenses; interaction effect is combined with stock selection. Returns can differ from certain client portfolio(s) due to data differences, cash flows, trading, and other activity (data source: Bloomberg, Russell).

Specific securities identified are the three largest contributors (or detractors) to the portfolio's performance, relative to the index. Other securities may have been the best and worst performers on an absolute basis. There is no assurance that the securities discussed will remain in the portfolio or that securities sold have not been repurchased. The securities discussed do not represent the entire portfolio, may only represent a small portion of the portfolio and should not assume the securities discussed were or will be profitable or that recommendations made in the future will be profitable or will equal the performance of the securities discussed. H&W's opinions regarding these securities are subject to change at any time, for any reason, without notice. Certain client portfolio(s) may or may not hold the securities discussed due to each account's guideline restrictions and other relevant considerations.

The value discipline used in managing accounts in the Large Cap Fundamental Value strategy may prevent or limit investment in major stocks in the Russell 1000 Value and returns may not be correlated to the index. Composite performance is available at www.hwcm.com, located on the strategy's Performance tab along with important disclosures included in the strategy's GIPS Report; quarterly characteristics and portfolio holdings are located on the Portfolio and Literature tabs. For a list showing every holding's contribution to the overall account's performance and portfolio activity for a given time period, contact H&W at Hotchkisandwiley@hwcm.com. Portfolio information is subject to the firm's portfolio holdings disclosure policy.

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The Russell 1000® Value Index measures the performance of those Russell 1000® companies with lower price-to-book ratios and lower forecasted growth values. The Russell 1000® Growth Index measures the performance of those Russell 1000® Index companies with higher price-to-book ratios and higher forecasted growth values. The S&P 500® Index is a broad-based unmanaged index of 500 stocks, which is widely recognized as representative of the equity market in general.

Equity securities may have greater risks and price volatility than U.S. Treasuries and bonds, where the price of these securities may decline due to various company, industry and market factors. Investing in foreign as well as emerging markets involves additional risk such as greater volatility, political, economic, and currency risks and differences in accounting methods.

A value-oriented investment approach involves the risk that value stocks may remain undervalued or may not appreciate in value as anticipated. Value stocks can perform differently from the market as a whole or from other types of stocks and may be out of favor with investors and underperform growth stocks for varying periods of time. Investment risk disclosures for the firm's strategies are described in Part 2A of Form ADV of H&W.

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Portfolio managers' opinions and data included in this commentary are as of September 30, 2024. Any discussion or view of a security, an asset class/segment, industry/sector and/or investment type are not investment recommendations, should not be assumed to be profitable, and are subject to change without notice.

Past performance is no guarantee of future results.