# MID-CAP VALUE FUND

HWMIX
HWMAX
HWMCX
HWMZX

**MANAGER REVIEW & ECONOMIC OUTLOOK**

SEPTEMBER 30, 2022

## MARKET COMMENTARY

The Russell Midcap Index declined -3.4% in the third quarter of 2022. The Russell Midcap Value Index declined -4.9% while the Russell Midcap Growth Index declined -0.7%. Ten of the eleven Russell Midcap GICS sectors declined in the quarter.

Investors continued to grapple with elevated inflation and the Fed's hawkish action and sentiment. The latest Consumer Price Index (CPI) reading was 8.3% year-over-year, which was slightly above consensus forecasts but below the 40-year high reached in June (9.1%). Energy prices declined, with WTI crude oil falling from $106/barrel to $79/barrel over the course of the quarter. The most recent Core CPI reading, which excludes food and energy, increased slightly from the beginning of the quarter (6.3% from 5.9%). To combat inflation, the Federal Open Market Committee continued to raise interest rates. It increased the Fed Funds Target Rate by 150 basis points via two hikes in the quarter. The target rate now stands at 3.25% (upper bound), a full 3 percentage points higher than where the year began (0.25%). Market implied expectations are for the rate to exceed 4% by year-end.

The economy demonstrated mixed signals. Second quarter real gross domestic product (reported in the third quarter) contracted -0.6% quarter-over-quarter. The ISM Manufacturing PMI declined to 50.9 from over 60 in late 2021 (a reading above 50 indicates expansion, below 50 contraction). The ISM Services PMI was 56.7, slightly higher than at the beginning of the quarter. Unemployment and initial jobless claims remain low. Reported corporate earnings were strong, with 78% of S&P 500 companies exceeding analyst expectations. Lower forward guidance was a common theme, however. Many management teams have been pointing to inflation, continued supply constraints, and the stronger dollar as near-term profitability headwinds.

At a price-to-earnings ratio[1] of 11.9x at the end of September, the Russell Midcap Value Index continues to trade at an attractive valuation relative to its own history, as well as to the Russell 1000 Index price-to-earnings ratio of 15.5x. While the broad market trades at a discount to its average historical valuation, it is not average across all sectors uniformly. We find few attractive opportunities in non-cyclical sectors like Consumer Staples and Utilities. Both trade at valuations considerably richer than is typical. While we are attracted to the relative stability of the underlying businesses, we are unwilling to invest at current valuations for sectors that are perpetually slow growing. We are attracted to select technology companies that trade at better valuations and grow faster. Many of these businesses also have great balance sheets and are less economically sensitive than generally believed.

We continue to find attractive opportunities in Energy. There has been massive underinvestment in new energy projects. These projects take a long time, i.e., years, to produce oil and gas, so even if investment ramps up, we appear poised for a supply shortage for some time. This should keep upward pressure on commodity prices and benefit energy companies' earnings and cash flow. Eventually this is likely to balance but this could be well into the future. In the meantime, the overearning and above normal cash flow puts energy companies in a position to return a lot of capital to shareholders. Retiring shares at attractive valuations is accretive to earnings per share and makes these companies even more attractively valued. We also remain partial to banks, which trade at significant discounts to the market and to their own history. Banks are also returning a lot of capital to shareholders and are one of very few industries than can benefit from rising interest rates. The substantial excess capital on their balance sheets should enable banks to withstand an economic downturn without requiring dilutive capital raises.

## ATTRIBUTION – 3Q22

The Hotchkis & Wiley Mid-Cap Value Fund underperformed the Russell Midcap Value Index in the third quarter of 2022. On a sector basis, the largest detractor from relative performance came from stock selection in Industrials. International Distributions Services (formerly Royal Mail) and Brink's were notable detractors. Stock selection in Information Technology, Energy, and Financials also weighed on relative performance during the quarter. Conversely, the overweight positions in Energy and Financials contributed positively, as did the underweight in Real Estate. The largest positive contributors to relative performance in the quarter were First Citizens BancShares, Chord Energy, Murphy Oil, The ODP Corp., and Fluor Corp.; the largest detractors were International Distributions Services, Kosmos Energy, Credit Suisse, Ericsson, and Enstar Group.

## LARGEST NEW PURCHASES – 3Q22

FedEx faces multiple earnings headwinds. A mix shift toward less profitable B2C packages is pressuring the Ground margin, a challenging integration of TNT is pressuring the Express margin, and a deteriorating global macro environment is leading to volume declines and negative operating leverage in both segments. These headwinds are meaningful but should be mostly temporary. New management and shareholder-friendly board members at FedEx are now focused on profit improvement rather than market share maximization which should lead to improving ROIC, FCF, and shareholder returns over time. Valuation is attractive on depressed current earnings, and very attractive if margins approach our estimate of normal.

*(continued)*

[1]Based on FY1 consensus earnings



Hotchkis & Wiley

TechnipFMC is the largest provider of offshore oil and gas production solutions, offering a full range of subsea equipment as well as integrated subsea engineering and construction services. They also have surface business providing a variety of product lines including wellheads, valves, and frack fleet assembly. As activity rebounds, most the business's product lines should experience significant increases in volumes and pricing. Further, the company operates in an improved industry structure compared to pre-pandemic - it is now effectively in a duopoly in several key product service lines.

Twitter Inc. The market is increasingly concerned that the deal to sell the company to Elon Musk will fail. While we recognize there is risk to the deal, we believe that the current price provides an attractive expected return when probability weighting the different potential outcomes.

## PERFORMANCE (%) as of September 30, 2022

| | QTR | YTD | 1 Yr | 3 Yr | 5 Yr | 10 Yr | Since 1/2/97 |
|---|---|---|---|---|---|---|---|
| Mid-Cap Value Fund – I Shares | -5.77 | -13.35 | -5.49 | 9.62 | 2.93 | 7.82 | 10.35 |
| Russell Midcap Value | -4.93 | -20.36 | -13.56 | 4.50 | 4.76 | 9.44 | 9.45 |

*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. 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.*

The Fund's total annual operating gross expense ratio as of the most current prospectus is 1.01% for I Shares. Expense ratio shown is gross of any fee waivers or expense reimbursements. 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.

*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.*

*Investing in small and medium-sized companies involves greater risks than those associated with investing in large company stocks. Please read the fund prospectus for a full list of fund risks.* Equities, bonds, and other asset classes have different risk profiles, which should be considered when investing. All investments contain risk and may lose value. Specific securities identified are the largest contributors (or detractors) on a relative basis to the Russell Midcap Value Index. Securities' absolute performance may reflect different results. The Fund may not continue to hold the securities mentioned and the Advisor has no obligation to disclose purchases or sales of these securities. 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.

Russell Investment Group is the source and owner of the Russell Index data contained herein (and all trademarks related thereto), which may not be redistributed. The information herein is not approved by Russell. H&W and Russell sectors are based on the Global Industry Classification Standard by MSCI and S&P.

The "Largest New Purchases" section includes the three largest new security positions during the quarter/year based on the security's quarter/year-end weight adjusted for its relative return contribution; does not include any security received as a result of a corporate action; if fewer than three new security positions during the quarter/year, all new security positions are included.

Style Risk: 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.

Market Disruption: The global coronavirus pandemic has caused disruption in the global economy and extreme fluctuations in global capital and financial markets. H&W is unable to predict the impact caused by coronavirus pandemic, which has the potential to negatively impact the firm's investment strategies and investment opportunities.

The Russell Midcap® Index, an unmanaged index, measures the performance of the 800 smallest companies in the Russell 1000® Index. The Russell Midcap® Value Index measures the performance of those Russell Midcap® companies with lower price-to-book value ratios and lower forecasted growth values. The Russell Midcap® Growth Index measures the performance of those Russell Midcap® Index companies with 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. It is not possible to invest directly in an index. Top ten holdings as of 9/30/22 as a % of the Fund's net assets: Kosmos Energy Ltd. 5.1%, Popular Inc. 4.8%, Fluor Corp. 4.7%, Citizens Fin'l Group Inc. 4.0%, First Citizens Bancshares 3.5%, APA Corp. 3.4%, American Int'l Group Inc. 3.1%, Adient PLC 3.0%, F5 Inc. 2.7%, and State Street Corp. 2.6%.

Real gross domestic product (GDP) is the inflation adjusted value of the goods and services produced by labor and property located in the US. The Consumer Price Index is a measurement of US prices for household goods and services. Basis point is a unit equal to 1/100th of 1% and is used to denote the change in a financial instrument. Cash flow measures the cash generating capability of a company by adding non-cash charges (e.g., depreciation) and interest expense to pretax income. Price-to-Earnings is the current market price per share divided by normalized earnings per share. Projected earnings are consensus analyst forecasts; actual P/E ratios may differ from projected P/E ratios. **A company's forecasted, or estimated, earnings made by analysts or by the company itself. Forward earnings differ from trailing earnings (which is the figure that is quoted more often) in that they are a projection and not a fact.**