SMALL CAP DIVERSIFIED VALUE

MARKET COMMENTARY

The Russell 2000 Index increased 5.2% in the first quarter of 2024. Small value stocks underperformed small growth stocks in the quarter (+2.9% vs. +7.6%). Performance was mixed across the Russell 2000 GICs sectors in the quarter, with the information technology, energy, industrials, and consumer discretionary sectors performing best. Communication services, utilities, real estate, and financials declined slightly in the quarter.

Despite a positive return in the first quarter, small cap stocks underperformed large cap stocks by a wide margin. The Russell 1000 Index returned +10.3%, nearly doubling the Russell 2000 Index return of +5.2%, largely due to strong performance from a few mega cap, tech-oriented companies. The recent performance disparity has helped form a compelling opportunity for small-cap investors. Since 2005, the average forward P/E ratio (using FY2 consensus earnings) of the large cap index has been 15.0x compared to the small cap index average at 14.6x. At the end of the first quarter, however, the large cap index traded at 19.0x, or 27% above its historical average. The small cap index traded at 13.8x, or 6% below its historical average. We believe a reversion toward more normal valuation relationships is more likely than not, which would be conducive for small caps. The only other period when small caps traded at such a significant discount to large caps was during the tech bubble, after which small caps outperformed considerably. Further, the small growth index trades at a slight premium to its historical average, while the small value index trades at a meaningful discount. Putting it all together, small cap value appears to be an attractively valued asset class, both in absolute and relative terms.

Much of the market movement in Q1 hinged on expectations for interest rate cuts by the Federal Reserve. Economic data in the U.S. has been resilient, leading to speculation that interest rate cuts would be fewer/smaller and/or pushed further into 2024. This weighed disproportionately on smaller companies, which use more variable rate debt and on average, have more financial leverage. There are, however, a large number of small cap companies with good balance sheets, including many that have more cash than debt. We have several mechanisms embedded within our investment process that steer us away from highly leveraged companies, most notably our fundamental risk ratings. The market appears to have shunned small caps indiscriminately, leading to attractive risk-adjusted valuation opportunities for discerning active investors.

Financials remain our portfolio's largest holding, both in absolute and relative terms. We are well diversified across the banks, capital markets, and insurance companies. Banks are currently trading at especially large discounts to the broad market, despite solid current earnings and strong capital ratios. While economic and regulatory risks persist, we believe the high single-digit price-to-earnings ratios and discounts to book value present attractive upside potential. Conversely, we continue to see fewer compelling valuation opportunities in small-cap real estate and healthcare companies.

Overall, we continue to view the valuations for quality small cap companies as compelling. Passive small cap investing exposes an investor to many companies that are unprofitable and/or exhibit a high degree of financial leverage. We generally avoid such exposures, and believe the current portfolio exhibits an appropriate balance of attractive valuation/upside potential with acceptable risks.

ATTRIBUTION ANALYSIS – 1Q24

The Hotchkis & Wiley Small Cap Diversified Value portfolio underperformed the Russell 2000 Value Index in the first quarter of 2024 (gross and net of management fees). The weighted average return for Russell 2000 Value stocks that began the quarter with a market cap of more than $1 billion was +3.6%, but stocks that began the quarter with a market cap of less than $1 billion declined slightly. This was a major performance headwind in the quarter, as the portfolio’s average exposure to the smaller cohort was 30% compared to 19% for the index. The lack of exposure to biotech, which is more than 5% of the index and returned more than +16% in the quarter, also hurt. Stock selection in the consumer discretionary sector was also a detractor. Conversely, the underweight in real estate contributed positively during the quarter, as did stock selection in financials, information technology, and utilities.

Net of fee composite performance as of 3/31/24: 17.59%, 10.47% and 8.93% for 1-, 5-, and 10-year, respectively. Net performance results are presented after management fees and all trading expenses but before custodial fees. **Past performance is no guarantee of future results.**

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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 Small Cap Diversified 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.

The value discipline used in managing accounts in the Small Cap Diversified Value strategy may prevent or limit investment in major stocks in the Russell 2000, Russell 2000 Value, and Russell 2000 Growth and returns may not be correlated to the indexes. 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 2000® Index measures the performance of the 2,000 smallest companies in the Russell 3000® Index. The Russell 1000® Index, an unmanaged index, measures the performance of the 1,000 largest 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 with higher price-to-book ratios and higher forecasted growth values.

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 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.

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.

Information contained in this material may represent or be based on forward-looking statements. Due to various risks and uncertainties, actual events/results or performance of the strategy may differ materially from those reflected or contemplated in such forward-looking statements. Information based on forecasts, proprietary or third-party estimates cannot be guaranteed and are subject to change. Information obtained from independent sources is considered reliable, but H&W cannot guarantee its accuracy or completeness.

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Past performance is no guarantee of future results