

SMALL CAP DIVERSIFIED VALUE FUND

MANAGER REVIEW & ECONOMIC OUTLOOK

HWVIX
HWVAX
HWVZX

MARCH 31, 2022

MARKET COMMENTARY

The Russell 2000 Index declined -7.5% in the first quarter of 2022. The Russell 2000 Value Index declined a more modest -2.4% while the Russell 2000 Growth Index declined -12.6%. Nine of the eleven Russell 2000 GICS (Global Industry Classification Standard) sectors declined in the quarter. Utilities was one exception, returning +3%. Energy was the other, returning an impressive +42%.

The Consumer Price Index reached 7.9% year-over-year, its highest level in 40 years, raising the threat of tightening monetary policy. Russia's invasion of Ukraine fueled inflation worries further. Sanctions and trade disruption create supply shocks, putting inflationary pressures on significant Russian exports like oil, natural gas, and metals—each experienced meaningful price increases in the period. WTI crude oil increased by 33%, finishing the quarter at \$100/barrel; natural gas rose +51%, finishing the quarter at \$5.64/MMBtu. Our view has been that the lack of investment in new energy projects/production would create an imbalance once demand recovered to pre-pandemic levels; the resulting supply shortage would put upward pressure on energy prices. While this continues to be our view, Russia's invasion of Ukraine has exacerbated the situation. Russia is the world's 11th largest economy, representing just 2% of global GDP. It is the world's largest exporter of natural gas; however, and the third largest exporter of crude oil. Russia provides more than 40% of Europe's natural gas and more than 25% of its oil. The rise in energy prices has increased energy companies' cash flows significantly. Many have used the cash to pay down debt, de-risking the sector extensively. Share repurchases have been another popular use of capital, which is accretive to shareholders because valuations remain compelling. Mergers and acquisitions activity has also increased, which can also be positive for shareholders in the right situation, e.g., paying a good price, removing redundant costs. Each company is in a different situation but there are numerous opportunities for management teams to benefit shareholders. Consequently, energy remains a modest sector overweight in the portfolio notwithstanding the strong recent performance.

The number of job openings continues to hover around its highest level in at least 20 years, increasing the risk of further wage inflation. To combat these inflationary threats, the Federal Open Market Committee increased the Fed Funds rate by 0.25% and signaled more aggressive rate increases in the coming year. Higher interest rates are generally bad for equities because it increases the cost of capital and makes fixed income

investments a more appealing alternative. It is typically less bad for value than growth for two primary reasons. First, financials represent the lone sector that benefits from rising rates (higher earnings), and financials comprise significantly larger portions of value portfolios/indexes. Second, value equities are shorter duration securities than growth equities. In a discounted cash flow analysis, the terminal value estimate represents the lion's share of a conventional growth stock's value, whereas a conventional value stock will generate meaningful cash flows sooner.

Despite value's recent outperformance, the valuation spread between growth and value remains wide because the spread at the period's outset was extreme. The Russell 2000 Value trades at 14x forward P/E (consensus FY1) compared to the Russell 2000 Growth at 44x. This equates to a gap of 30x, which is much wider than the historical median of 18x. The gap has been wider than current levels only 20% of the time dating back to the mid-1990s, using monthly data. At both a forward and normal P/E of 10x, the portfolio trades at an even larger discount. We believe these large spreads and the macroeconomic backdrop should continue to benefit value relative to growth, which should be a conducive environment for our investment approach.

ATTRIBUTION – 1Q22

The Hotchkis & Wiley Small Cap Diversified Value Fund outperformed the Russell 2000 Value Index in the first quarter of 2022. The overweight position in energy, the best-performing sector by far, was a positive contributor to relative performance. The underweight position in healthcare, among the worst-performing sectors, also helped. Stock selection in financials and materials was also positive. The overweight position and stock selection in consumer discretionary detracted from performance. Stock selection in energy and industrials also hurt.

Portfolio managers' opinions and data included in this commentary are as of March 31, 2022 and are subject to change without notice. Any forecasts made cannot be guaranteed. Information obtained from independent sources is considered reliable, but H&W cannot guarantee its accuracy or completeness. Fund holdings and/or sector allocations are subject to change and are not buy/sell recommendations. Current and future portfolio holdings are subject to risk. Certain information presented based on proprietary or third-party estimates are subject to change and cannot be guaranteed. **Diversification does not assure a profit nor protect against loss in a declining market. Past performance is no guarantee of future results.**



SMALL CAP DIVERSIFIED VALUE FUND

HWVIX
HWVAX
HWVZX

MANAGER REVIEW & ECONOMIC OUTLOOK

MARCH 31, 2022

PERFORMANCE (%) as of March 31, 2022

	QTR	YTD	1 Yr	3 Yr	5 Yr	Since 6/30/14
Small Cap Diversified Value Fund – I Shares	-0.80	-0.80	7.60	13.86	10.14	9.48
Russell 2000 Value	-2.40	-2.40	3.32	12.73	8.57	8.16

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 0.87% for I Shares; 0.80% net expense ratio. The Advisor has contractually agreed to waive advisory fees and/or reimburse expenses through August 31, 2022. 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 smaller and/or newer companies involves greater risks than those associated with investing in larger companies. 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. Attribution is an analysis of the portfolio's return relative to a selected benchmark, is calculated using daily holdings 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.

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 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 with higher price-to-book ratios and higher forecasted growth values. The Consumer Price Index is a measurement of U.S. prices for household goods and services. 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.

Spread is the difference between valuations of value and growth stocks. Cash flow measures the cash generating capability of a company by adding non-cash charges (e.g., depreciation) and interest expense to pretax income. Normal Price/Earnings is the current market price per share divided by normalized earnings per share. Forward Price/Earnings (fiscal year) is the projected P/E ratios of the companies invested in the portfolio, which ratios represent current market price per share divided by a company's estimated future 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.

Mutual fund investing involves risk. Principal loss is possible.
NOT FDIC INSURED • NO BANK GUARANTEE • MAY LOSE VALUE
The Hotchkis & Wiley Funds are distributed by Quasar Distributors, LLC

WWW.HWCM.COM