SMALL CAP DIVERSIFIED VALUE FUND

HWVIX
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HWVZX

MANAGER REVIEW & ECONOMIC OUTLOOK

SEPTEMBER 30, 2020

MARKET COMMENTARY

The Russell 2000 Index returned +4.9% in the third quarter of 2020 and is now down -8.7% year-to-date. Two-thirds of Russell 2000 companies beat consensus revenue expectations and 70% exceeded earnings expectations. Corporate America's strong showing trumped continued worries about the prevalence of COVID-19 and Congress' stalemate over a new stimulus package. Meanwhile, the Fed continues to signal easy monetary policy for the foreseeable future, maintaining a subdued economic outlook. COVID-19 cases reaccelerated for the first time in months, but hospitalizations and deaths remained downward trending—there was a large jump in tests administered which could explain the mixed developments.

Growth outperformed value across geographies and across market capitalizations. Based on information from the Kenneth French/Dartmouth data library, small value has underperformed growth over the last 10 years by the largest magnitude on record. This has led to a colossal divergence in valuations. The Russell 2000 Value Index trades at 11x normal earnings, which is below its historical average of 13x. The Russell 2000 Growth Index, however, trades at 24x normal earnings, above its historical average of 21x.

Perhaps more important to our clients than the value-growth dichotomy is the equally noteworthy divergence within value, both in terms of trailing performance and future opportunity. The portfolio, for example, trades at 7.9x normal earnings, a considerable discount to the value benchmark. The strongest performers within small cap value have been concentrated in market segments with low correlations to economic growth, like healthcare and consumer staples. The weakest performers within value have been concentrated in market segments where near-term forward earnings estimates have declined meaningfully, in some cases by 30% or more. Financials and energy comprise a disproportionate share of these examples. The positions we have in these areas have underperformed, though we view the forthcoming earnings declines as temporary. While a year or two of depressed earnings modestly reduces our estimate of intrinsic value, the market reaction has been much greater. Companies with good liquidity and strong balance sheets are in position to weather the next year or two of depressed earnings which makes their stocks attractive return opportunities for the long-term investor. We remain selective, however, and recognize that certain market segments and/or individual companies may not recover—we look to avoid businesses with uncertain long-term outlooks or insurmountable secular pressures.

Financials represent the portfolio's largest weight, and banks represent the portfolio's largest exposure within financials. Earnings estimates have declined due to the combination of increased loan loss provisions, a ban on share repurchases, slower asset growth, and lower interest rates. Accounting rules require banks to estimate loan losses upfront based on prevailing economic conditions. The substantial provisions taken during the first half of 2020 could end up being too high as the actual impact of COVID appears to be less economically damaging than what was assumed at the beginning of the crisis. Banks' balance sheets were quite healthy entering 2020, as substantial capital had been built in the previous decade. The provisions already taken combined with the excess capital—not to mention the pre-provision income being generated—provides a meaningful cushion to absorb elevated credit losses. Further, banks' business models are less interest rate sensitive than generally believed. Banks' net interest margin is more closely tied to the yield spread earned on loans than it is from the rate sensitive benefit they get from funding a portion of their earning assets with non-interest bearing liabilities. The banks' benefit of free funding dissipates as rates decline, but the yield spread on loans exhibits countercyclical traits (i.e. the yield spread often widens when rates decline as banks tighten lending standards). This has resulted in relatively stable net interest margins over the past decade despite persistently falling interest rates over that period.

The dichotomy between growth and value is significant and pervasive, but so too are the opportunities within value. The portfolio's valuation discount to the value benchmark is considerably wider than normal. This reflects our conviction that select opportunities are exceptionally attractive. The recent environment has not been conducive to our approach, but we are confident that patient investors could be rewarded by the rarely observed risk-adjusted potential of the current portfolio.

ATTRIBUTION – 3Q20

The Hotchkis & Wiley Small Cap Diversified Value Fund underperformed the Russell 2000 Value Index in the third quarter of 2020. The portfolio's value-focused approach hurt relative performance as the most deeply discounted stocks underperformed. For example, index stocks trading at a discount to book value lagged the overall index by about 10 percentage points in the quarter; the portfolio had 44% of the portfolio invested in such stocks compared to 32% percent for the Russell 2000 Value. The overweight position and stock selection in financials, along with stock selection in industrials detracted from performance. The underweight in real estate and the overweight in consumer discretionary helped.

Hotchkis & Wiley

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PERFORMANCE (%) as of September 30, 2020

	QTR	YTD	1 Yr	3 Yr	5 Yr	Since 6/30/14
Small Cap Diversified Value Fund – I Shares	0.63	-26.37	-20.16	-7.25	3.93	1.44
Russell 2000 Value	2.56	-21.54	-14.88	-5.13	4.11	1.54

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 0.92% for I Shares; 0.80% net expense ratio. The Advisor has contractually agreed to waive advisory fees and/or reimburse expenses through August 31, 2021. Expense ratios shown are 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.

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. Growth investing tends to work well during speculative, momentum-driven markets, while value investing tends to work well following recessionary periods. Value stocks following a recession may start from a lower market value than growth stocks which can contribute to their outperformance. Past recessions and recoveries cannot predict future performance due to different factors and circumstances.

Market Disruption: The recent global coronavirus pandemic has caused and continues to cause disruption in the global economy, unprecedented business and travel disruption and extreme fluctuations in global capital and financial markets. H&W is unable to predict the consequences of the upheaval caused by coronavirus pandemic, which, depending on the severity and the length of the outbreak, has the potential to negatively impact the firm's investment strategies and reduce available investment opportunities.

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.

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 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. Book value is the net asset value of a company, calculated by subtracting total liabilities from total assets. **Forward earnings is not representative of the Fund's future performance.**

Mutual fund investing involves risk. Principal loss is possible.
NOT FDIC INSURED • NO BANK GUARANTEE • MAY LOSE VALUE
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