

## MUTUAL FUND PROFILE

## This Value Fund Owns Anything It Wants

By Lewis Braham

Old-school value investing demands both cheapness and a margin of safety against financial distress. But the hundreds of value funds on the market today have largely suffered in the past decade. Growth stocks have outperformed since the financial crisis, but that's not the only factor that has held back value funds: Most own hundreds of stocks that either aren't so cheap or are cheap for good reason.

David Green goes beyond the traditional metrics. "Just looking at a screen gives you only a snapshot that won't tell you what a company will do in the future," says the manager of Hotchkis & Wiley Value Opportunities fund (ticker: HWAAX). "It won't tell you what a company's competitive position is, or if it has some hidden liability. So, each company's earnings profile is determined by our research team."

The extra work has paid off. Since Value Opportunities' inception in December 2002, the fund has dusted its benchmark, the Russell 3000 Value Index, with a 12% annualized return to the index's 9%.

Green's portfolio is so distinct that it is hard to categorize. It's the firm's most flexible, able to invest in stocks of any size, bonds of any credit quality, preferred stock, and even merger arbitrage. Yet it is also concentrated, typically owning 40 to 75 securities.



David Green Photograph by Sean Lemoine

The fund has already had a home in a few Morningstar categories, including mid value and large value. Last year, Morningstar moved Value Opportunities to an allocation category for funds that can own fixed income and other assets, but have at least 85% in stocks—and it's outpacing competitors there, too. The fund's 16% 10-year annualized return beats 98% of peers in Morningstar's Allocation 85%+ Equity category.

But Green's focus on value has been consistent; it's all he has done since graduating from the University of California, Berkeley with an economics

degree in 1990. He joined Hotchkis in 1997.

Although Green runs the fund's day-to-day operations, he has help from his co-manager and firm CEO George Davis and Hotchkis' experienced analytical team. The firm has 22 investment professionals, and is primarily owned by its employees. The firm is split into six different sector teams; each team peer-reviews each analyst's ideas before Green includes them in the fund.

"We go where the opportunities are at any given time," says Green. At the height of the 2008-09 crisis, for instance, Green was investing in merg-

*(over please)*

## Hotchkis & Wiley Value Opportunities

	Total Return		
	1-Yr	5-Yr	10-Yr
<b>HWAAX</b>	-1.0%	6.7%	15.6%
<b>Russell 3000 Value Index</b>	2.2	6.9	12.3
<b>Top 10 Holdings</b>	<b>% of Assets</b>		
<b>Company / Ticker</b>			
<b>General Electric / GE</b>	6.2%		
<b>Microsoft / MSFT</b>	6.0		
<b>Wells Fargo / WFC</b>	5.0		
<b>General Electric 5% Perpetual Bond</b>	5.0		
<b>American International Group / AIG</b>	4.6		
<b>Seritage Growth Properties / SRG</b>	4.6		
<b>Amerco / UHAL</b>	3.9		
<b>Goldman Sachs Group / GS</b>	3.7		
<b>Morgan Stanley / MS</b>	3.7		
<b>Bank of America / BAC</b>	3.6		
<b>Total</b>	<b>46.3</b>		

Note: Holdings as of 4/30. Returns through 6/4; five- and 10-year returns are annualized.

Sources: Morningstar; Bloomberg; Hotchkis & Wiley

er-arbitrage deals because the big investment banks that normally support such deals were crashing, so arbitrage spreads increased significantly. Today, he has nothing in merger arbitrage.

By contrast, the fund throughout its entire 17-year history hadn't owned General Electric (GE)—until the fourth quarter of 2018. “Last year, General Electric came under tremendous selling pressure, and now it's our

largest equity position,” Green says. He was willing to take such a risk because Hotchkis' sector teams analyzed GE's diverse subsidiaries separately—industrial, financial, energy, and health care.

By breaking GE into its constituent parts, Green realized that the credit risk to the company's balance sheet wasn't as great as most investors perceived during its selloff. The appearance of excessive debt was because of its financial-services subsidiary GE Capital, which Green concluded was only somewhat overleveraged, and GE “could easily get that debt down with asset sales.” Indeed, this February, DanaHER (DHR) agreed to purchase GE's biopharma division for \$21.4 billion. “That alone gets GE's balance sheet to a reasonable level,” Green says.

A company has to meet five criteria: The first three are cheapness, financial strength, and long-term business visibility. “So, if we turned off our Bloomberg terminals and came back five years from now, we'd have a pretty good idea of where that business would be,” Green says. That means avoiding companies in harder-to-predict sectors like biotech. The company should also have a history of smart capital-allocation decisions—paying dividends, for instance, instead of making overpriced acquisitions. The last requirement is promising adequate returns for liquidity risks. If a small stock is illiquid, Green requires higher expected returns to include it.

Green's strategy often involves looking across a company's capital structure to find the most attractive balance of risk and reward. In some cases, the risk to a company's stock is too great,

but its bonds remain attractive. Bonds make up 6.5% of the fund. “When we buy debt, ideally we're looking for equity-like returns,” Green says. “Usually that happens if there's some kind of distress around certain bonds.”

A recent example is J.C. Penney (JCP) bonds. The troubled retailer's stock is down 60% in the past year. But the 2023-maturity bonds Green purchased at a deep discount to their par value are secured by the company's real estate—more than 280 stores and distribution centers. “If things don't work out with J.C. Penney, we own an asset that we think is worth in excess of what we're paying for the bonds,” he says.

Of course, distressed bonds are riskier than ordinary ones, and investors should think of this fund as a pure equity one, despite its Morningstar category. In fact, the fund's standard deviation—a volatility measure—has been 18.9% over the past 15 years, versus Vanguard Total Stock Market Index's (VTSMX) 14.1%.

Though the fund's portfolio is eclectic, it has 27% in financial services—familiar turf for value managers—including warty holdings such as scandal-plagued bank Wells Fargo (WFC), insurance comeback American International Group (AIG), and Goldman Sachs Group (GS). The Russell 3000 Value Index has a 22% financial weighting.

“Any time you have a relatively concentrated portfolio, you should expect volatility,” he says. “But the goal here is to identify businesses that are creating a lot of value over long periods of time.”



BARRON'S June 6, 2019  
"This Value Fund Owns Anything It Wants"

Hotchkis & Wiley Value Opportunities Fund  
Average Annual Returns as of September 30, 2019

	1 Year	3 Year	5 Year	10 Year	Since 12/31/02
Class I	-4.22%	10.54%	7.16%	13.50%	11.90%
Class A (w/o sales charge)	-4.44	10.27	6.89	13.22	11.67
Class A	-9.45	8.31	5.74	12.61	11.32
Class C (w/o CDSC)	-5.16	9.45	6.09	12.38	10.82
Class C	-6.02	9.45	6.09	12.38	10.82
Russell 3000 Value Index	3.10	9.24	7.76	11.36	9.05
Morningstar Allocation--85%+ Equity Category Avg	0.08	8.50	6.36	9.41	n/a

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](http://www.hwcm.com).

The Fund's total annual operating expense ratio as of the most current prospectus is 0.96% for I Shares, 1.21% for A Shares and 1.92% for C Shares. Expense ratios shown are gross of any fee waivers or expense reimbursements.

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](http://www.hwcm.com). Read carefully before you invest.

Returns shown for C Shares for the periods prior to their inception are derived from the historical performance of I shares of the Fund during such periods and have been adjusted to reflect the higher total annual operating expenses of each specific Share class (Inception date: I and A Share-12/31/02, C Share-8/28/03). Returns shown for A Shares and C Shares without sales charge do not reflect the maximum sales load of 5.25% or the Contingent Deferred Sales Charge (CDSC) of 1.00% for the first year; if reflected, performance would be lower than shown. Returns for A and C shares reflect the deduction of the current maximum initial sales charges of 5.25% and 1.00% CDSC. C Shares convert automatically to A Shares approximately eight years after purchase. A Shares are subject to lower annual expenses than C Shares. Class 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.

Mutual fund investing involves risk. Principal loss is possible. Investing in non-diversified funds and/or smaller and/or medium-sized companies involves greater risks than those associated with investing in diversified funds and/or large company stocks, such as business risk, significant stock price fluctuations, sector concentration and illiquidity. The Fund is non-diversified, meaning it may concentrate its assets in fewer

individual holdings than a diversified fund. The Fund may invest in ETFs, which are subject to additional risks that do not apply to conventional mutual funds, including the risks that the market price of an ETF's shares may trade at a discount to its net asset value ("NAV"), an active secondary trading market may not develop or be maintained, or trading may be halted by the exchange in which they trade, which may impact a Fund's ability to sell its shares. The Fund may invest in foreign securities which involve greater volatility and political, economic and currency risks and differences in accounting methods. Investments in debt securities typically decrease in value when interest rates rise. This risk is usually greater for longer-term debt securities.

Investment by the Fund in lower-rated and non-rated securities presents a greater risk of loss to principal and interest than higher-rated securities. The Fund may invest in derivative securities, which derive their performance from the performance of an underlying asset, index, interest rate or currency exchange rate. Derivatives can be volatile and involve various types and degrees of risks. Depending on the characteristics of the particular derivative, it could become illiquid.

**Diversification does not assure a profit or protect against loss in a declining market.** Standard deviation measures the degree to which a fund's quarterly return varies from the fund's mean return over a specified time period. Margin of safety is a principle of investing in which an investor only purchases securities when the market price is significantly below its intrinsic value. In other words, when market price is significantly below your estimation of the intrinsic value, the difference is the margin of safety. The Russell 3000® Value Index includes stocks from the Russell 3000® Index with lower price-to-book ratios and lower expected growth rates. The index does not reflect the payment of transaction costs, fees and expenses associated with an investment in the Fund. The Fund's value disciplines may prevent or restrict investment in major stocks in the benchmark index. It is not possible to invest directly in an index. The Fund's returns may not correlate with the returns of their benchmark index.

Each Morningstar Category Average represents a universe of funds with similar investment objectives. References to other mutual funds or products should not be interpreted as an offer of these securities. Top 10 holdings as of 9/30/19 as a % of the Fund's net assets: Microsoft Corp. 6.4%, General Electric Co. 5.6%, Seritage Growth Properties 4.4%, Wells Fargo & Co. 4.4%, General Electric Co. (5% Pref.) 4.3%, Goldman Sachs Group Inc. 4.2%, Oracle Corp. 3.6%, American International Group Inc. 3.5%, Bank of America Corp. 3.5% and Morgan Stanley 3.3%. Portfolio weightings, sector allocations, and/or fund holdings are subject to change and should not be considered a recommendation to buy or sell any security. Opinions expressed are those of the author and are subject to change, are not intended to be a forecast of future events, a guarantee of future results, nor investment advice.

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