

INTERNATIONAL VALUE

MARKET COMMENTARY

The MSCI World ex-USA Index returned +16.2% in the fourth quarter of 2022. The MSCI World ex-USA Value Index increased +18.1%, while the MSCI World ex-USA Growth Index increased +14.3%.

In calendar year 2022, the global economy and capital markets experienced numerous milestones that had not been observed for quite some time. The MSCI World ex-USA declined -14.3%, its worst annual performance since the Great Financial Crisis. Value stocks declined but held up much better than growth stocks. The MSCI World ex-USA Value declined -5.6% compared to the MSCI World ex-USA Growth's -22.7% decline. Considering value's significant outperformance in periods of elevated/rising inflation and interest rates, and its outperformance coming out of economic slowdowns, we are optimistic that value's outperformance can persist.

Inflationary pressures across most of the globe appear to have peaked in recent months, although it may be too soon to take a victory lap. Much of the decline in eurozone inflation can be attributed to softer energy prices as the winter has been much milder than expected. A prolonged cold spell across the eurozone could be counterproductive in the inflation fight, particularly if fears of a looming recession recede. As such, the European Central Bank has signaled a willingness to do more after setting its benchmark rate at 2.0%, the highest since 2008.

Forecasting economic growth and/or predicting recessions is not our expertise. We do, however, fully acknowledge current warnings signs. Two things providing solace in the event of an economic slowdown are modest financial leverage and attractive valuations. There are fewer excesses in the system compared to prior recessionary periods like 2008. Unlike then, balance sheets of both consumers and financial institutions are quite strong today. Further, equity valuations are reasonable, and in select market segments, unusually attractive. A strong argument could be made that a recession is already priced into equity markets, at least in certain market segments, which is different compared to recessionary periods like 2002. While several signs point to an economic slowdown, several others suggest that the severity would be manageable and/or much of the pain has already been felt.

The MSCI World ex-USA Energy sector returned +26% in 2022, the best-performing sector by substantial margin. All other MSCI World ex-USA sectors were negative for the year. Crude oil is a depleting resource/commodity. Put simply, when oil is extracted from a well, that well now contains less oil, and what remains is increasingly difficult to extract. As a result, wells produce less oil as they age, the pace of which is called its *decline rate*. To maintain flat production, therefore, companies must invest considerable sums in new projects to replace these wells'

declining production. To *increase* production, these investments need to be substantial. In recent years, however, energy companies have spent unusually little on new production, instead using cash flows to pay down debt and/or return to shareholders. Our view has been, and continues to be, that this lack of investment will create a situation where supply, i.e., production, is unable to keep pace with global demand. This imbalance keeps the price of oil elevated and facilitates strong free cash flows for energy companies. Much of the cash flow is earmarked for share repurchases, which is accretive to earnings per share. Capital expenditures, i.e., new investments, have increased recently, but it takes a long time for such investments to result in actual production. Thus, this imbalance could persist for some time. Meanwhile, energy stocks' valuations remain compelling even after the impressive performance because they are coming from such a low base. Free cash flow yields are well into the teens, hence our continued overweight.

Financials represents the portfolio's largest weight. Our thesis on Financials is straightforward—it is the most attractively valued sector in the portfolio. The sector trades at notable discounts to other parts of the market and relative to its own history, despite balance sheets that are well positioned to withstand a potential economic slowdown. Our positions are focused on companies with difficult-to-replicate franchises that should earn returns well above their cost of capital.

ATTRIBUTION – 4Q22 & 2022

The Hotchkis & Wiley International Value portfolio (gross and net of management fees) outperformed the MSCI World ex-USA Index in the fourth quarter of 2022. Stock selection in Energy, Industrials, and Financials resulted in the bulk of the performance advantage. Conversely, stock selection in Information Technology and Health Care detracted from relative performance. The underweight in Materials also detracted modestly. The largest positive contributors to relative performance in the quarter were CNH Industrial, ING Groep, UniCredit SpA, BNP Paribas, and Airbus; the largest detractors were Ericsson, Vodafone, Koninklijke Philips, Hudson Global, and Credit Suisse.

The portfolio outperformed the benchmark over calendar year 2022 (gross and net of management fees). The overweight and stock selection in Energy contributed significantly to outperformance. Stock selection in Consumer Discretionary and Industrials also worked well. Conversely, stock selection in Health Care, Financials, and Information Technology detracted from relative performance in 2022.

LARGEST NEW PURCHASES – 4Q22

No new purchases.

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Composite performance is available at www.hwcm.com, located on the strategy's Performance tab. Returns discussed can differ from actual portfolio returns due to data differences, cash flows, trading, and other activity. Index returns include reinvestment of dividends, net foreign withholding taxes. Portfolio characteristics and attribution based on representative International Value portfolio. Certain client portfolio(s) may or may not hold the securities discussed due to each account's guideline restrictions, cash flow, tax and other relevant considerations. Performance 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. Specific securities identified are the largest contributors (or detractors) to the portfolio's performance relative to the index. Other securities may have been the best and worst performers on an absolute basis.

The value discipline used in managing accounts in the International Value strategy may prevent or limit investment in major stocks in the MSCI World ex-USA, MSCI World ex-USA Value and MSCI World ex-USA Growth and returns may not be correlated to the indexes. Quarterly characteristics and portfolio holdings are available at www.hwcm.com, located on the strategy's 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, please contact H&W at hotchkisandwiley@hwcm.com. Portfolio information is subject to the firm's portfolio holdings disclosure policy.

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. The strategy invests in foreign securities which involve greater volatility and political, economic and currency risks and differences in accounting methods.

The securities reflected herein are intended for illustrative purposes only and not a recommendation to buy or sell specific securities. There is no assurance that the securities discussed will remain in the portfolio or that securities sold have not been repurchased. The securities discussed do not represent the entire portfolio, may only represent a small portion of the portfolio and should not assume the securities discussed were or will be profitable or that recommendations made in the future will be profitable or will equal the performance of the securities discussed. H&W's opinions regarding these securities are subject to change at any time, for any reason, without notice.

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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.

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Past performance is no guarantee of future results.