LARGE CAP DIVERSIFIED VALUE

MARKET COMMENTARY

The S&P 500 Index declined -4.6% in the first quarter of 2022. 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 created supply shocks, putting inflationary pressures on significant Russian exports like oil, natural gas, and metals—each experienced meaningful price increases in the period. 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 FOMC 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. In the quarter, the Russell 1000 Value declined -0.7% compared to the Russell 1000 Growth's decline of -9.0%.

Nine of the eleven S&P 500 GICS sectors declined in the quarter. Utilities was one exception, returning +5%. Energy was the other, returning an impressive +39%. 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. M&A activity has also increased, which can also be positive for shareholders in the right situation, e.g., paying a good price, redundant costs, etc. Each company is in a different situation but there are numerous opportunities for management teams to benefit shareholders. Consequently, it remains the portfolio's largest sector overweight notwithstanding the strong recent performance.

Despite value's outperformance, the valuation spread between growth and value remains wide because the spread at the period's outset was extreme. The Russell 1000 Value trades at 16x forward P/E (consensus FY1) compared to the Russell 1000 Growth at 28x. This equates to a gap of 12x, which is much wider than the historical median of 5x. The gap has been wider than current levels only 11% of the time dating back to the mid-1990s. At 12x forward P/E and less than 11x normal P/E, 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 Large Cap Diversified Value portfolio (gross and net of management fees) outperformed the Russell 1000 Value Index in the first quarter of 2022 by a considerable margin. The overweight and stock selection in energy was the largest positive contributor, by far. The portfolio's energy positions returned +48% as a group compared to the Russell 1000 Value's energy return of +39%. Positive stock selection in healthcare, communication services, and technology also helped. The overweight and stock selection in consumer discretionary detracted from relative performance. Stock selection in consumer staples was also a modest detractor. The largest positive contributors to relative performance in the quarter were Marathon Oil, APA Corp., Hess Corp., Halliburton Co., and AIG; the largest detractors were General Motors, Citigroup, Magna International, F5 Inc., and Berkshire Hathaway.

LARGEST NEW PURCHASES – 1Q22

Aptiv is an auto supplier that essentially provides the "brain" and the "nervous system" of increasingly complex vehicles demanded worldwide. It designs, manufactures, and assembles components, systems, and software that address safety, security, and entertainment. Another business segment designs, manufactures, and assembles systems that facilitate high speed data transfer and high-power electrical distribution. Aptiv appears to have a healthy lead in these technologies, which have clear secular tailwinds and impressive growth prospects. It has a conservative balance sheet and trades at an attractive multiple of normal earnings.

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Paramount Global was formed through the December 2019 merger of CBS and Viacom. The company is going through an industry-wide transition from the traditional TV model to a model where traditional TV coexists with streaming. We bought the position when the price fell following Paramount's announcement of strong streaming subscribers but higher than expected near-term streaming losses. With growing evidence that Paramount's streaming service appears to be achieving strong subscriber results, we expect the company's margins to improve as the streaming business drives revenue growth that scales into its cost base.

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. Portfolio characteristics and attribution based on representative Large Cap Diversified 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 Large Cap Diversified Value strategy may prevent or limit investment in major stocks in the S&P 500, Russell 1000 Value and Russell 1000 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, 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 "Largest New Purchases" section includes the three largest new security positions during the quarter/year based on the security's quarter/year-end weight adjusted for its relative return contribution; does not include any security received as a result of a corporate action. If fewer than three new security positions during the quarter/year, all new security positions are included. Securities identified do not represent all of the securities purchased or sold for advisory clients and are not indicative of current or future holdings or trading activity. H&W has no obligation to disclose purchases or sales of the securities. The largest new purchases are as of the publication date but may be sold and no longer held in the Large Cap Diversified Value strategy at any time, for any reason, without notice, subsequent to the publication date. The securities reflected herein are intended to be for illustrative purposes only and are not intended to be, and should not be construed as, investment recommendations or investment advice. Past performance of these securities, or any other investments, is not an indicator of future results. H&W's opinions regarding these securities are subject to change at any time, for any reason, without notice. No assurance is made that any securities identified, or all investment decisions by H&W were or will be profitable.

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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.