MARCH 31, 2023

LARGE CAP DIVERSIFIED VALUE

MARKET COMMENTARY

The S&P 500 Index returned +7.5% in the first quarter of 2023, a welcomed rebound from last year's -18.1% decline. Inflation fears appear to have lessened as the CPI decelerated to 6% year-over-year, a far cry from its mid-2022 peak of more than 9%. The FOMC increased the Fed Funds rate twice during the quarter, both 25 basis point hikes. The important benchmark rate now stands at 5.0% (upper bound), the first time it has reached this level in more than 15 years. The market implied probability of another small rate hike at the next meeting is about 50/50.

After outperforming growth by 22% in 2022 (by declining less), value underperformed growth in the first quarter of 2023 by 13% (+1% vs. +14%). The technology sector was up about 20% in the quarter. Technology comprises a much larger portion of the Russell 1000 Growth than the Russell 1000 Value (42% vs. 8%). Conversely, the financial and energy sectors declined -4% and -6%, respectively. These sectors comprise a much larger portion of the Russell 1000 Value than the Russell 1000 Growth (28% vs. 8%). As a result, value spreads widened considerably over the course of the quarter. Going back nearly 30 years, the growth index has traded at a 6.5 multiple point premium to the value index. At the beginning of the quarter, the growth index had a P/E ratio that was about 10 multiple points higher than the value index—at the end of the quarter, it was 13 multiple points higher. Historically, value spreads have eventually reverted toward average/normal levels. Should this transpire as it has in the past, value is poised to do well relative to growth.

The Russell 1000 Growth trades at an elevated valuation relative to its historical median using any common valuation metric. The Russell 1000 Value trades reasonably in line with its historical median. The portfolio, however, trades at a considerable discount to its own history. The portfolio's price-to-normal earnings ratio is 8.4x, which is the 25th percentile, i.e., it has been more attractively valued just 25% of the time. While we have identified attractive valuation opportunities in a variety of market segments, the portfolio's overweight exposure to financials and energy is a meaningful contributor to its valuation discount.

We remain partial to financials, with banks representing the largest absolute and relative weight. The banking industry has been in the crosshairs of skeptics since the early March failure of Silicon Valley Bank ("SVB"). SVB failed due to a combination of unique characteristics and mismanagement. It had an unusually concentrated depositor base composed of large corporate depositors; 97% of its deposits exceeded the $250,000 FDIC insurance limit, and thus were uninsured. This makes it more susceptible to a bank run because it takes significantly fewer customers withdrawing their money compared to a bank with a more diversified customer base. Further, SVB invested in long duration securities much more heavily than it should have, creating a risky asset/liability mismatch. Several other regional banks have similar problems, albeit nothing to the extreme of SVB. Nonetheless, well-capitalized, well-managed banks sold off in sympathy, and now trade at attractive valuations for the risks at hand. The portfolio's bank exposure trades at close to 6x normal earnings and 0.8x book value, uncommonly attractive levels. We have thoroughly assessed widespread bank concerns about declining deposits, an impending recession, and potential regulatory changes. We conclude that these valuations more than compensate us for those risks. Our portfolio of banks is also well diversified across 9 different companies each with a different business mix and therefore different risks.

Technology is the portfolio's second-largest sector weight and overweight relative to the index (financials is the largest overweight, energy is third). In tech, we do own some high quality businesses, and we are willing to pay higher valuation multiples accordingly. The portfolio's aggregate technology positions trade at less than 13x normal earnings, which we view as a bargain considering the quality of the businesses. Common traits among our tech holdings are excellent balance sheets, sticky customers that generate recurring/predictable cash flow, and promising prospects for growth. We view these businesses as less cyclical than generally understood and prefer this exposure to other non-cyclical parts of the market that trade at rich valuations and grow modestly, e.g., consumer staples, utilities. This exposure is much different than the exposure to energy and financials, thus acting as an effective offset/complement.

ATTRIBUTION – 1Q23

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 2023. The outperformance came despite growth's considerable outperformance over value, which is typically not a conducive environment for our value-focused approach. Positive stock selection in Industrials, Health Care, and Consumer Discretionary helped relative performance in the quarter. The overweight exposure to the strong-performing Information Technology sector was also a positive contributor. The portfolio's exposure to Energy and Financials detracted from performance, as these were among the worst-performing sectors in Q1. The largest positive contributors to relative performance in the quarter were General Electric, Warner Bros. Discovery, Microsoft, FedEx, and Workday; the largest detractors were APA Corp., AIG, Ovintiv, Citizens Financial, and Wells Fargo.

LARGEST NEW PURCHASES – 1Q23

No new purchases.

Past performance is no guarantee of future results

LARGE CAP DIVERSIFIED VALUE

Net of fee composite performance as of 3/31/23: -3.36%, 9.06%, and 10.55% for 1-, 5-, and 10-year, respectively. Net performance results are presented after management fees and all trading expenses but before custodial fees. **Past performance is no guarantee of future results.**

Portfolio managers' opinions and data included in this commentary are as of March 31, 2023, and subject to change without notice. Information based on forecasts, proprietary or third-party estimates cannot be guaranteed and are subject to change. Information obtained from independent sources is considered reliable, but H&W cannot guarantee its accuracy or completeness.

Portfolio characteristics and attribution are based on a representative Large Cap Diversified Value portfolio. 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. Returns can differ from certain client portfolio(s) due to data differences, cash flows, trading, and other activity. 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. Composite performance is available at www.hwcm.com, located on the strategy's Performance tab along with important disclosures included in the strategy's GIPS Report; quarterly characteristics and portfolio holdings are located on the 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.

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. Certain client portfolio(s) may or may not hold the securities discussed due to each account's guideline restrictions and other relevant considerations.

The Russell 1000® Value Index measures the performance of those Russell 1000® companies with lower price-to-book ratios and lower forecasted growth values. The Russell 1000® Growth Index measures the performance of those Russell 1000® Index companies with higher price-to-book ratios and higher forecasted growth values. The S&P 500® Index is a broad-based unmanaged index of 500 stocks, which is widely recognized as representative of the equity market in general. The 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 GICS by MSCI and S&P.

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. Investing in foreign as well as emerging markets involves additional risk such as greater volatility, political, economic, and currency risks and differences in accounting methods.

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.

All investments contain risk and may lose value. The commentary is for information purposes only and should not be considered as investment advice or a recommendation of any particular security, strategy or investment product.

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