LARGE CAP DIVERSIFIED VALUE

MARKET COMMENTARY

The S&P 500 Index returned +8.7% in the second quarter of 2023 and is now up +16.9% since the beginning of the year. The catalyst of the market's performance this year appears to be the decrease in rates of inflation. The US CPI Index has fallen from its 9.1% peak in mid-2022 to 4.0% and is expected to decline further. Lower inflation and lower interest rates are generally good for equities. This seems to have trumped concerns about an economic slowdown. Bloomberg publishes a *United States Recession Probability Forecast*, which surveys a group of economists on what they think the chances of a recession are in the next 12 months. The index currently stands at 65%. However, equity markets fell in 2022 more than they have risen in 2023, i.e., the S&P 500 is still down over the past year and a half suggesting a slowdown might be priced in already. Also, not all recessions/slowdowns are created equally. Balance sheets of consumers and companies are generally healthy, unlike 2007/2008. Fewer excesses in the financial system are likely to limit the severity of a recession if one occurs.

Performance deviations between value and growth have been stark in recent periods. Large growth outperformed large value in the quarter by 8.7% (+12.8% vs. +4.1%), extending its year-to-date edge to +23.9% (+29.0% vs. +5.1%). Over the past year and a half, however, large value remains ahead of large growth due to its substantial outperformance last year. At the beginning of calendar year 2022, growth traded at a near-record premium to value[1]. Value's outperformance in 2022 brought this premium down by year end, but it remained about 1 standard deviation above average. With growth's dramatic outperformance thus far in 2023, its valuation premium has again spiked, and now sits more than 2 standard deviations wider than normal. We do not view this gap as sustainable, and a reversion toward more normal valuation relationships would be significantly favorable to value relative to growth going forward. We view the overall equity market as rather richly valued, though this is driven by growth stocks, not value.

As it stands today, the growth index trades at a large premium to its own history using any common valuation metric and the value index trades reasonably in line with its own history. The portfolio, however, trades at a considerable discount to its past. This is attainable because the portfolio is significantly different than the value index. Importantly, however, we do not blindly invest in companies/industries with the lowest price multiples. We invest in those that trade at the largest discounts to intrinsic value, and that intrinsic value is highly dependent on a company's risk profile—lower risk companies have higher intrinsic values all else equal and should command higher fair value multiples. The portfolio's second and third largest sector exposures are technology and healthcare respectively, and our holdings in those sectors epitomize this construct.

Technology comprises just over 15% of the portfolio[2], slightly less than at the beginning of the year. We own companies with attractive growth rates, stable customer bases, and healthy returns of capital to shareholders. These should also trade at premium valuations, and after strong performance year-to-date, several do. We trimmed accordingly but maintain meaningful exposure to these excellent businesses.

Healthcare positions comprise about 13% of the portfolio, which is 3 percentage points higher than at the beginning of the year. The largest increase within the sector has been healthcare providers & services, with Elevance Health the largest individual increase. Elevance, formerly Anthem, is the second largest health insurer in the US. The company trades at less the 14x normal earnings—a discount to the S&P 500 (21x) and the Russell 1000 Value (15x)—despite having a sticky customer base, faster-than-average growth, and prudent capital allocation. We believe this is the sort of business that should trade at a premium to the market, yet trades at a discount—an attractive opportunity.

Financials remain the largest sector weight. The portfolio is well-diversified across banks, capital markets, insurance, and other financial services (e.g., payment processors). Banks remain the largest exposure, and our thesis remains largely unchanged. We are invested in companies with meaningful franchise value and scale/deposit share advantages. This should enable our positions to earn above cost-of-capital returns, yet the stocks prices reflect otherwise. The industry will always face regulatory, interest rate, and behavioral risks, but the industry has managed through various regulatory and interest rate environments with more effectiveness and flexibility than generally understood. While select banks may be at risk during times of financial stress, we view obsolescence risk as exceptionally remote for the industry overall and for our positions specifically.

ATTRIBUTION – 2Q23

The Hotchkis & Wiley Large Cap Diversified Value portfolio (gross and net of management fees) underperformed the Russell 1000 Value Index in the second quarter of 2023, though it remains ahead of the benchmark since the beginning of the year. In the quarter, stock selection in communication services detracted from performance. While a couple of media positions declined, the biggest detractor relative to the index was not owning Meta Platforms/Facebook (+36%). As of the June reconstitution, Meta is no longer a part of the Russell 1000 Value, so we would not benefit from a performance reversal. Stock selection in consumer discretionary also detracted in the quarter. Stock selection in technology contributed positively to relative performance. Stock selection in healthcare was also positive, along with the underweight consumer staples and utilities. The largest individual detractors to relative performance, excluding benchmark-only names, were Warner Bros. Discovery, Citizens Financial Group, NOV Inc., APA Corp., and Paramount Global; the largest positive contributors were Microsoft, AIG, Wells Fargo, Oracle, and First Citizens Bancshares.

(continued)

[1] Based on consensus forward PE (FY2)

[2] This would be about 17.7% including Alphabet (communication services)

LARGE CAP DIVERSIFIED VALUE

LARGEST NEW PURCHASES – 2Q23

BorgWarner is a Tier 1 global automotive and commercial vehicle components supplier, focused on engine systems, transmissions systems, and EV technologies. Company sales are roughly evenly split across North America, Europe, and China. A series of recent acquisitions appear to have put BorgWarner in a position to be over-indexed to EV technology. While additional expenses related to R&D and higher new-tech launch costs are expected to be elevated, we project that BorgWarner's sales, profit, and cash flow will steadily rise, over time, as business activity outpaces growth in expenses. We believe BorgWarner's balance sheet is adequate, while its valuation is attractive.

Timken Co., based in Canton, OH, has been in the bearings business since 1899. The company now designs and manufactures both engineered bearings (69% of sales) and industrial motion products (31% of sales) that are used by OEMs and parts distributors operating in a broad array of end markets. The company has exited low return businesses in recent years, initiated Lean manufacturing practices, transitioned to low-cost countries, implemented advanced IT pricing analytics, and through a series of bolt-on acquisitions, broadly diversified both their end markets and their product lines. The resulting sales mix continues to shift to higher-return, faster growing businesses. Since 2017, net income and EPS rose at 15% and 16% CAGRs, respectively, despite challenges from COVID, the war in Ukraine, rising inflation and other economic headwinds. We believe these positive trends will continue.

Net of fee composite performance as of 6/30/23: 17.49%, 9.17%, and 10.33% 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.**

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.

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 "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.

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.

Certain information contained in this material represents or based upon forward-looking statements. Due to various risks and uncertainties, actual events/results or performance of the strategy may differ materially from those reflected or contemplated in such forward-looking statements.

Portfolio managers' opinions and data included in this commentary are as of June 30, 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.