

LARGE CAP DIVERSIFIED VALUE

MARKET COMMENTARY

In calendar year 2022, the economy and capital markets experienced numerous milestones that had not been observed for quite some time. The S&P 500 declined -18.1%. Since the Great Depression, only three years have been worse: 1974 (oil crisis), 2002 (tech bubble burst), and 2008 (financial crisis). Value stocks declined but held up much better than growth stocks. The Russell 1000 Value declined -7.5% compared to the Russell 1000 Growth's -29.1% decline. The more than 21 percentage point difference represented value's largest advantage since 2000. Despite the outperformance, the P/E gap between growth and value remains almost a full standard deviation wider than average¹. Considering the still wide valuation gap and value's significant outperformance in periods of elevated/rising inflation and interest rates, we are optimistic that value's outperformance can persist.

Inflation peaked midyear at 9.1%, the highest reading in more than 40 years². To combat rising prices, the FOMC increased the Fed Funds rate by more than 400 basis points over the course 2022, from 0.25% to 4.5% (upper bounds). This was the largest rate hike in any calendar year since 1973, and the current 4.5% level is its highest in more than 15 years. Other interest rates followed suit. 10-year treasury yields peaked above 4% for the first time in more than a decade; 30-year mortgage rates peaked above 7% for the first time in more than 2 decades. Yields on corporate credit also increased significantly. The treasury yield curve remains significantly inverted, which has been a harbinger of recessions historically. The tight labor market exhibited strong contrasting signals, however, with the unemployment rate reaching a 50-year low. Expectations for future corporate earnings are roughly flat, thus the stock market's decline was entirely due to a compression in valuation multiples as opposed to an actual or expected decline in earnings.

Forecasting economic growth and/or predicting recessions is not our expertise. We do, however, fully acknowledge current warnings signs, e.g., continued Fed tightening and the yield curve. 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 S&P 500 Energy sector returned +65% in 2022, the best-performing sector by substantial margin. The only other S&P 500 sector with a return above zero was Utilities, which was up about +2%. 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, and second largest overweight relative to the index. 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. Information Technology represents the portfolio's second largest weight, and largest overweight relative to the index (Energy is the third largest overweight). The valuation multiples of the portfolio's technology positions are higher than those in financials and energy, but still attractive given the quality of the business, the bullet proof balance sheets, and the appealing growth prospects. These businesses deserve valuation multiples well above the market average, yet often trade at modest discounts, thus significantly below their intrinsic values.

ATTRIBUTION – 4Q22 & 2022

The Hotchkis & Wiley Large Cap Diversified Value portfolio (gross and net of management fees) outperformed the Russell 1000 Value Index in the fourth quarter of 2022 by a considerable margin. Stock selection was positive or neutral in 10 of the 11 GICS sectors in the period, resulting in the vast majority of the period's outperformance. Stock selection was especially positive in Industrials, Energy, Information Technology, and Financials. The overweight exposure to Energy and underweight exposure to Real Estate also helped. The portfolio's overweight positions in Information Technology and Communication Services, along with underweight positions in Consumer Staples and Materials detracted slightly. The largest positive contributors to relative performance in the quarter were General Electric, AIG, Oracle, APA Corp., and Halliburton; the largest detractors were Warner Bros. Discovery, Alphabet, F5 Inc., Microsoft, and Wells Fargo.

The portfolio also outperformed the Russell 1000 Value over the full calendar year (gross and net of management fees). The portfolio's average weight in Energy over the course of the year was 13.3% compared to 7.6% for the index, i.e., nearly 6 percentage points overweight. Accordingly, the portfolio's overweight position in Energy was the largest positive contributor over the year, by far. The underweight exposure to Real Estate, which was among the worst performing sectors in the year, also helped. Stock selection in Financials, Information Technology, and Industrials were meaningfully positive as well. Stock selection in Consumer Discretionary and Communication Services detracted from performance, as did the overweight position in Information Technology. The largest positive contributors to relative performance in 2022 were Marathon Oil, APA Corp., Hess Corp., AIG, and NOV; the largest detractors were Warner Bros. Discovery, General Motors, F5 Inc., Alphabet, and Citigroup.

(continued)

¹Based on price/FY1 consensus estimates dating back to the mid-1990s (longest available).

²US CPI Urban Consumer year-over-year, not seasonally adjusted.

Past performance is no guarantee of future results

LARGE CAP DIVERSIFIED VALUE

LARGEST NEW PURCHASES – 4Q22

Fidelity National Information Services provides credit and debit card processing, electronic banking services, check risk management, check cashing, and merchant card processing services to financial institutions and merchants. We believe the core banking business is quite sticky, while the merchant business is reasonably scaled and well-positioned in the enterprise/e-commerce segments. The company is trading at an attractive valuation and pays a reasonable dividend that we expect to rise in the future.

US Bancorp is the 5th largest bank in the US by assets with a strong market position in the Mid-West and Western US. US Bancorp has a long history of producing among the highest returns on assets and equity in the banking sector. We feel USB's franchise is very attractive and will be further improved by its recent acquisition of Union Bank from MUFG as the merger offers the potential for substantial cost synergies and will materially increase its market share in its core western US markets.

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 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.

The Global Industry Classification Standard ("GICS") was developed by and is the exclusive property and a service mark of MSCI Inc. ("MSCI") and Standard & Poor's Financial Services, LLC ("S&P") and is licensed for use by Hotchkis & Wiley ("H&W"). All rights reserved. Neither S&P nor MSCI is liable for any errors or delays in this report, or for any actions taken in reliance on any information contained herein. 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.

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.

Portfolio managers' opinions and data included in this commentary are as of December 31, 2022 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.

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.

Past performance is no guarantee of future results.