

MID-CAP VALUE

MARKET COMMENTARY

The Russell Midcap Index rose +7.5%, closing the second quarter of 2021 near an all-time high. It is up +16.3% since the beginning of the year. While the threat of new COVID variants persists, vaccination levels increased and new cases slowed. Consequently, state and local governments continued to ease closures/restrictions spurring renewed economic activity. Manufacturing rose and labor markets improved, highlighting the potential for tight supply conditions. Consumer prices rose 5% year over year, the fastest level in more than a decade. In response, Fed Chairman Powell reiterated his view that inflationary pressures would be transitory. WTI crude oil touched \$74/barrel, its highest level in more than two years. Corporate earnings continued to show strength, with 82% of Russell Midcap companies outperforming consensus expectations.

The Russell Midcap Growth Index outperformed the Russell Midcap Value Index (+11.1% vs. +5.7%) in the second quarter. Even so, the value index has outperformed by more than 12 percentage points over the past 9 months (+43.8% vs. +31.5%). According to data from the Ken French/Dartmouth library, which dates to 1926, the average value-led market¹ has lasted for 33 months and outperformed growth by an average of 55 percentage points. The duration and magnitude of the current rally is far short of that. Nearly all prolonged value-led markets, however, contain stints when growth outperforms value. In perhaps the strongest value rally ever, for example, value outperformed growth by 147 percentage points from March 2000 through December 2006. However, growth outperformed value in nearly one-third of those months (24 out of 82 months). Like that value run, we came from extreme valuation spreads in mid/late 2020 and continue to observe spreads that are considerably wider than average. This gives us confidence that value's advantage this time will persist in a powerful way, for a prolonged period, or both.

Interest rates fell during the quarter, particularly for long-dated bonds (the yield curve flattened). The 10-year treasury note declined from 1.74% to 1.47% over the quarter. Energy was the top-performing mid cap sector, rising by more than +15% as WTI crude prices advanced 24%. Healthcare and real estate (the latter often trades inversely to interest rates) were next best, both returning more than +10%. Utilities was the only mid cap sector that declined in the quarter, though consumer staples, consumer discretionary, and industrials also lagged.

As measured by any common valuation metric, the spread between value and growth stocks is wide. So too is the spread between the portfolio and the value benchmark, which means the spread between the portfolio and either the core or growth index is extreme. We believe this bodes well going forward as value

relationships normalize. We continue to focus on companies trading at large discounts to intrinsic value but that have strong balance sheets, quality businesses, and employ appropriate corporate governance—a combination that we believe should continue to benefit our clients.

ATTRIBUTION – 2Q21

The Hotchkis & Wiley Mid-Cap Value portfolio (gross and net of management fees) underperformed the Russell Midcap Value Index in the second quarter. Stock selection in financials, industrials, and technology detracted from performance, along with the underweight position in real estate. The overweight allocation to energy and positive stock selection in consumer discretionary helped. The largest individual detractors were Fluor, Cairn Energy, Discovery, F5 Networks, and Hewlett Packard Enterprise; the largest positive contributors were CommScope, Embraer, Bed Bath & Beyond, Royal Mail, and APA Corp.

LARGEST NEW PURCHASES – 2Q21

Credit Suisse Group presents an attractive valuation following large lapses in its risk management (e.g., exposure to Archegos). We expect that fixing its risk management process is well within its ability and doing so will have manageable cost and time commitments. While the potential for punitive regulatory actions and/or litigation exists, this is more than reflected in the current share price. While recent events are a blemish, the underlying franchise value remains intact; Credit Suisse is a high-quality business that should generate attractive returns on capital over time.

Huntsman is a chemicals and materials producer with a focus on polyurethanes. Huntsman has recently sold much of its disparate commodity chemicals portfolio at attractive prices and has used the proceeds to reduce debt and invest downstream. The company's remaining businesses are exposed to end markets that grow faster than GDP with minimal incremental capital needs and produce earnings that should be steadier than in the past. It trades at an attractive valuation and is returning substantial capital to shareholders.

(continued)

¹A value-led market is defined as one that outperforms growth by at least 10 percentage points.

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PACCAR is one of the world's largest manufacturer of light, medium, and heavy-duty trucks, marketed under the Peterbilt, Kenworth, DAF, and Leyland brands. In addition to industry-leading brands, it has a growing global presence, and strong returns on capital. Its normal earnings power is higher than pre-pandemic results because it has made investments in technology, brand, and capacity expansions in PACCAR's Engine and Parts operations. PACCAR has an unusually high variable cost structure in its North American truck manufacturing operations, and an overly conservative balance sheet. It is structured to weather whatever the pandemic does to the global truck industry. Finally, PACCAR maintains a disciplined strategy of returning capital to its shareholders.

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 Mid-Cap 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. For the portfolio's total performance attribution, interaction effect is combined with stock selection. 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 the Global Industry Classification Standard by MSCI and S&P. 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 "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 Mid-Cap 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.

The value discipline used in managing accounts in the Mid-Cap Value strategy may prevent or limit investment in major stocks in the Russell Midcap, Russell Midcap Value and Russell Midcap 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.

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. Growth investing tends to work well during speculative, momentum-driven markets, while value investing tends to work well following recessionary periods. Past recessions and recoveries cannot predict future performance due to different factors and circumstances.

Market Disruption: The global coronavirus pandemic has caused disruption in the global economy, unprecedented business and travel disruption and extreme fluctuations in global capital and financial markets. H&W is unable to predict the consequences of the upheaval 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. Portfolio managers' opinions and data included in this commentary are as of June 30, 2021 and are subject to change without notice. Any forecasts made cannot be guaranteed. Information obtained from independent sources is considered reliable, but H&W cannot guarantee its accuracy or completeness. Certain information presented is based on proprietary or third-party estimates, which are subject to change and cannot be guaranteed. 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 small and medium-sized companies involves greater risks than those associated with investing in large company stocks, such as business risk, significant stock price fluctuations and illiquidity.

Past performance is no guarantee of future results.