

SMALL CAP DIVERSIFIED VALUE

MARKET COMMENTARY

The Russell 2000 Index returned +12.4% in the third quarter of 2025, closing the period near all-time highs. Small caps outperformed large caps and gold was up 17%, closing the period at an all time high. It is unusual for this duo to perform well over the same period, though the current economic and political landscapes are also unusual.

Inflation remains closer to 3% rather than the Fed's stated long-term target of 2%, but it has been relatively steady over the past few quarters. Persistent signs that inflation is not reaccelerating, combined with indications of a softening labor market, prompted the Federal Open Market Committee to cut its Fed Funds target rate by 0.25% to 4.25% (upper bound). The futures market suggests that another 0.25% cut in October is a near certainty, and an additional 0.25% cut in December is probable. The market's increasingly dovish interest rate outlook buoyed equities. Nearly two-thirds of the Russell 2000 constituents reported earnings that beat consensus estimates. The portfolio fared better than this, unfortunately fundamentals were not rewarded in the quarter.

In our view, the small cap market's performance in the quarter epitomizes a low quality rally. Highly speculative, risky stocks dominated. Companies with negative earnings returned more than +25% in the quarter compared to less than +10% for those with positive earnings. Companies in the lowest quintile of return-on-equity (ROE), a common gauge for quality, returned +22% compared to +9% for the highest quintile. Stocks falling in the highest beta quintile returned +23% compared to +8% for the lowest quintile. Biotechnology, precious metals miners, bitcoin miners, satellites, and coal were among the best performing small cap market segments. These are not areas typically associated with first rate businesses.

Ten years ago, the portfolio had a price-to-earnings (P/E) ratio of 10x, a meaningful discount to the Russell 2000 Value Index. It had an ROE of 11% compared to 9% for the index. The strategy returned net +167% in the ensuing 10 years compared to +142% for the index (+10.3% and +9.2% annualized, respectively). Today, the portfolio's P/E ratio is lower than it was 10 years ago (9x) while its ROE is higher (12%). The index trades at 12x P/E with an ROE of 8%. The portfolio's composition consists of quality, profitable businesses trading at attractive valuations. This has been a winning recipe over the long run, and we are optimistic it will be in the future as well.

ATTRIBUTION ANALYSIS – 3Q25

The Small Cap Diversified Value portfolio underperformed the Russell 2000 Value Index in the third quarter of 2025 (gross & net of management fees). The underperformance was more about what we did not own rather than what we did own. For example, 7 of the 10 largest detractors were index-only names that returned between +68% and +176% in the quarter. Common traits among these, and other small stocks that posted heroic returns in the quarter, are low/negative earnings, high betas, and low returns on equity. The portfolio's underweight exposure to biotechnology, precious metals miners, bitcoin miners, and coal also hurt.

As of 9/30/25, net of fee composite and Russell 2000 Value performance for 1-, 5-, and 10-year periods: 1.59%, 16.75%, 10.31% and 7.88%, 14.59%, 9.23%, respectively. Net performance results are presented after management fees and all trading expenses but before custodial fees; the composite includes all Small Cap Diversified Value discretionary accounts. Additional disclosures provided in Endnotes.

Past performance is no guarantee of future results.



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Endnotes:

All investments contain risk and may lose value. This commentary is for general information only and should not be relied on for investment advice or recommendation of any particular security, strategy, or investment product.

Portfolio characteristics and attribution are based on a representative Small Cap Diversified Value portfolio. The representative portfolio is used for informational purposes only, does not predict future portfolio characteristics, and may differ from other portfolios in the strategy due to asset size, client guidelines, and other variables. H&W selected the representative portfolio based on non-performance criteria. The portfolio reflects the management style of the strategy, is part of the strategy's composite, and has the longest continuous duration under the Adviser's discretion. Selection of the representative portfolio considers one or more of the following factors, such as the portfolio's investment guidelines/restrictions, cash flow activity, or continuous duration under the Adviser's discretion.

Attribution is an analysis of a portfolio's gross of fee returns (without the deduction of fees and expenses) relative to the Index. Bloomberg calculates returns using daily holdings information. Returns calculated using this buy-and-hold methodology can differ from actual client portfolio returns due to data differences, cash flows, trading, and other activity (report is generated at a point in time and will not include any adjustments thereafter). Sector performance only covers the subset of investments specific to that sector. Analysis for different time periods and/or market environments can result in significantly different results.

The value discipline used in managing accounts in the Small Cap Diversified Value strategy may prevent or limit investment in major stocks in the Russell 2000 Value Index and returns may not be correlated to the index. 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 Russell 2000® Index measures the performance of the 2,000 smallest companies in the Russell 3000® Index. The Russell 2000® Value Index measures the performance of those Russell 2000® companies with lower price-to-book ratios and lower forecasted growth values. Any indices and other financial benchmarks shown are provided for illustrative purposes only, are unmanaged, reflect reinvestment of income and dividends and do not reflect the impact of advisory fees. It is not possible to invest directly in an index.

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Federal Open Market Committee directs open market operations in the United States and is made up of 12 members; Return on Equity (ROE) is a measure of a company's financial performance calculated by dividing net income by shareholders' equity; and Price-to-Earnings (P/E) is a valuation metric that compares a company's stock price to its earnings per share (EPS), revealing how much investors are willing to pay for each dollar of a company's earnings.

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. Investing in smaller, medium-sized and/or newer companies involves greater risks not associated with investing in large company stocks, such as business risk, significant stock price fluctuations and illiquidity. 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. Principal Risks Disclosure for the firm's strategies are described in Part 2A of Form ADV of H&W (www.hwcm.com/wp-content/uploads/2025/07/HW-Principal-Risks-Disclosure-July-2025.pdf).

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