

SMALL CAP DIVERSIFIED VALUE

MARKET COMMENTARY

The Russell 2000 Index finished a challenging 2023 on a positive note, increasing +14.0% in the fourth quarter. The Russell 2000 Value Index outperformed the Russell 2000 Growth Index for the quarter, returning +15.3% vs. +12.8%. The strong fourth quarter helped lift the Russell 2000 calendar year 2023 return to +16.9%, while the small value and growth indexes returned +14.7% and +18.7%, respectively.

Throughout much of 2023, small cap stocks trailed behind their larger counterparts before narrowing the gap in the year's final months. Over the last two years, the fear of an economic recession sparked by the Fed's efforts to tame rising inflation cast a cloud over small cap stocks. Adding to economic uncertainty, a regional banking crisis in early 2023 further weighed on investors, affecting the small cap equity market disproportionately. Despite prevailing concerns, we believe investor sentiment will experience positive adjustments as interest rates continue on a path of normalization.

Meanwhile, the valuation gap between the Russell 2000 Growth and Russell 2000 Value widened significantly, expanding from 8.1x at the close of 2022 to 15.0x by the end of 2023¹. The large valuation gap is based on small growth stocks at historically rich valuations, while small value stocks are at slight discounts to their long-term average valuation. The portfolio also trades at a slight discount to its historical average. This has been achieved, we believe, without assuming undue risk. We have several mechanisms embedded within our process that help us avoid stocks most exposed to the risks of cyclical downturns/recessions. We believe companies with low levels of debt, a robust capacity to generate free cash flow, and a proven track record of prudently and effectively allocating capital are best positioned to navigate any economic landscape.

We hold steady in our commitment to the principles of value investing and remain diligent in our search for new opportunities. With a stable and committed team, a healthy firm, and consistent approach, we believe our clients will be rewarded.

ATTRIBUTION ANALYSIS – 4Q23 & 2023

The Hotchkis & Wiley Small Cap Diversified Value portfolio (gross and net of management fees) underperformed the Russell 2000 Value Index in the fourth quarter of 2023. Stock selection and the underweight in healthcare detracted the most from relative underperformance. Stock selection in industrials, energy, and materials also detracted in the quarter. Conversely, the overweight and stock selection in financials contributed positively to relative performance, as did stock selection in real estate and the underweight in energy. Stock selection and the underweight in communication services also worked well.

The portfolio outperformed the benchmark over calendar year 2023 (gross and net of management fees). The underweight in healthcare and stock selection in consumer discretionary were the largest positive contributors to relative performance. Stock selection in financials and the overweight in technology also helped relative performance, along with the overweight in industrials. Stock selection in materials, healthcare, industrials, and energy detracted from relative performance in the year.

¹Source: Bloomberg. Based on FY2 price-to-earnings ratio.

Net of fee composite performance as of 12/31/23: 16.50%, 12.86%, and 9.22% 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.

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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. 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.

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, Russell 2000 Value, and Russell 2000 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.

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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. The Russell 2000® Growth Index measures the performance of those Russell 2000® Index companies with higher price-to-book ratios and higher forecasted growth values.

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 smaller and/or newer companies involves greater risks than those associated with investing in larger companies, such as business risk, significant stock price fluctuations and illiquidity.

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.

Information contained in this material may represent or be based on 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. 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.

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