SMALL CAP DIVERSIFIED VALUE

MARKET COMMENTARY

The Russell 2000 Index returned +2.2% in the fourth quarter of 2025, bringing its full-year return to +12.8%. Over the course of the year, companies with negative earnings dominated, returning +26%, compared to +7% for companies generating profits. We have limited exposure to unprofitable companies, which has historically been a long-term performance tailwind. In 2025, however, this low-quality rally became a significant headwind. Low-ROE stocks outperformed high-ROE stocks, and high-beta stocks outperformed low-beta stocks.

A meaningful portion of the non-earning cohort is concentrated in market segments we view as highly speculative. Companies tied to themes such as space/satellite, artificial intelligence, next-generation energy, rare earth materials, and quantum computing now represent more than 10% of the index and returned over +100% as a group in 2025. As a result, this cohort contributed a disproportionate share of the Russell 2000's return for the year.

Historical comparisons suggest the magnitude of this low-quality rally is consistent with some of the most severe dislocations on record, including the dot-com bubble. If history is a guide, this implies the rally may be largely exhausted and a reversal increasingly likely. In 2025, the Russell 2000 Index outperformed the S&P 600 Index by roughly 7 percentage points, much of which can be attributed to index construction: the S&P 600 requires positive profitability for inclusion, while the Russell 2000 does not. Dating back to the early 1990s, there have been only three other years in which the Russell 2000 outperformed by a comparable margin. In each instance, the S&P 600 outperformed in subsequent years as investors refocused on profitability and economic fundamentals—conditions that are typically far more favorable for our investment approach.

We suspect that the speculative mania was triggered by AI euphoria and then amplified by the escalation in retail trading. Retail trading now comprises well over a third of trading volume in the US, significantly higher than it was a decade ago. High frequency quantitative trading has also grown. Combined, this short-term investing cohort, that we believe is less anchored to fundamental analysis, comprises about 57% of all trading volume.

Today's small-cap market shares uncomfortable similarities with the dot-com era. Some of the best-performing stocks are those associated with the "technology of the moment," irrespective of risk, fundamentals, or financial viability. There are now examples of companies valued at over $20 billion that have never generated revenue, let alone earnings. In many cases, valuations are not merely elevated—they are increasingly difficult to define and justify. The rise of the retail investor also echoes the late 1990s, when many participants left traditional employment to pursue day trading full-time.

Fortunately, periods of extreme excess have rarely persisted indefinitely. Over time, we believe economic fundamentals and rational pricing have tended to reassert themselves and we will be well positioned to benefit as this environment normalizes. We expect the correction could be meaningful and potentially prolonged.

ATTRIBUTION ANALYSIS – 4Q25 & 2025

The Small Cap Diversified Value portfolio underperformed the Russell 2000 Value Index in the fourth quarter of 2025 (gross and net of management fees). Between 80% and 90% of the underperformance in the quarter is explained by the lack of exposure to the biotechnology industry. The portfolio is about 5 percentage points underweight relative to the benchmark, and the industry returned more than +25% in the quarter. Stock selection in real estate and communication services also hurt, which was offset by positive stock selection in financials and utilities.

For the full calendar year, the Small Cap Diversified Value portfolio underperformed the Russell 2000 Value Index by a considerable margin (gross and net of management fees). Traditional attribution analysis indicates that stock selection was broadly negative across most sectors. However, a key driver beneath the surface was the outsized impact of low-quality and highly speculative benchmark constituents that performed exceptionally well and that we did not own. We estimate that a disproportionate share of the underperformance was attributable to our lack of exposure to market segments we view as risky and speculative. In that context, relative results were most impacted in healthcare (lack of biotech), materials (lack of gold miners), consumer discretionary, communication services (lack of space/satellites), and technology (lack of bitcoin miners). The underweight exposure to real estate and stock selection in energy helped.

As of 12/31/25, net of fee composite and Russell 2000 Value Index performance for the following periods: 1-year (3.35%, 12.59%); 5-year (9.96%, 8.88%); and 10-year (10.12%, 9.27%), respectively. Average annual total returns for periods greater than one year. 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.

Hotchkis & Wiley

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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. The S&P 600® Index is a market-capitalization-weighted stock market index tracking 600 U.S. small-cap companies. 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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Return on Equity (ROE) is a measure of a company's financial performance calculated by dividing net income by shareholders' equity.

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).

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. Data source: H&W, Russell, Bloomberg.

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Past performance is no guarantee of future results.