SMALL CAP VALUE

MARKET COMMENTARY

The value investment style continued to outperform the market during the first quarter of 2022. The Russell 2000 Value Index was down a modest -2.4% while the Russell 2000 Growth Index declined -12.6%. Nearly all economic sectors declined in the quarter with the notable exception of Energy which was up an impressive +42%.

After a long period of fighting deflation, the Fed must now contend with the highest level of inflation in 40 years. While initial assessments indicated recent inflation was likely due to pandemic disruptions, many economists and the Fed are increasingly concerned that this new inflation might be with us longer than originally thought and that Fed action is needed to keep inflation under control. Add to this concern Russia's invasion of Ukraine which accelerated inflationary forces in important commodities such as oil and gas. While inflation is a real concern, our view is the Fed is more concerned about deflation and maintaining economic growth. While the Fed will likely raise interest rates, we expect they will ease at the first signs of economic weakness.

The price of crude oil increased by 33%, finishing the quarter at $100/barrel; natural gas rose +51%, finishing the quarter at $5.64/MMBtu. Sanctions and trade disruption create supply shocks, putting inflationary pressures on significant Russian exports like oil, natural gas, and metals—each experienced meaningful price increases in the period. Our view has been that the lack of investment in new energy projects/production would create an imbalance once demand recovered to pre-pandemic levels; the resulting supply shortage would put upward pressure on energy prices. While this continues to be our view, Russia's invasion of Ukraine has exacerbated the situation. The rise in energy prices has effectively de-risked energy sector. These companies are flush with cash and are reducing debt. Consequently, energy remains a significant sector overweight in the portfolio notwithstanding the strong recent performance.

Higher interest rates are generally bad for equities and particularly bad for growth stocks. Value equities are shorter duration securities compared to growth equities. In a discounted cash flow analysis, the terminal value estimate represents the lion's share of a conventional growth stock's value, whereas a conventional value stock will generate meaningful cash flows sooner. In addition, financials, the largest sector in the value market, represent the lone sector that benefits from rising rates (higher earnings).

Despite value's recent outperformance, the valuation spread between growth and value remains wide because the spread at the period's outset was extreme. The Russell 2000 Value trades at 14x forward P/E (consensus FY1) compared to the Russell 2000 Growth at 44x. This equates to a gap of 30x, which is much wider than the historical median of 18x. The gap has been wider than current levels only 20% of the time dating back to the mid-1990s, using monthly data. At a 12x forward P/E and less than 11x normal P/E, the portfolio trades at an even larger discount. We believe these large spreads and the macroeconomic backdrop should continue to benefit value relative to growth, which should be a conducive environment for our investment approach.

ATTRIBUTION – 1Q22

The Hotchkis & Wiley Small Cap Value portfolio (gross and net of management fees) outperformed the Russell 2000 Value Index in the first quarter of 2022 by a considerable margin. The overweight and stock selection in energy was the largest positive contributor. Positive stock selection in industrials, consumer discretionary, and financials also helped. The overweight position in technology and stock selection in communication services detracted from performance. The largest positive contributors to relative performance in the quarter were Range Resources, Kosmos Energy, Meritor, NOV Inc., and Fluor; the largest detractors were Stagwell, Telos, Evercore, Arrow Electronics, and Equitrans Midstream.

SMALL CAP VALUE

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 Small 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 an 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. 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 Small Cap 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. 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. 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.

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.

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 March 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.