SMALL CAP VALUE

MARKET COMMENTARY

The Russell 2000 Index increased 2.7% in the first quarter of 2023, a welcomed rebound from last year's -20.4% decline. Inflation fears appear to have lessened as the CPI decelerated to 6% year-over-year, a far cry from its mid-2022 peak of more than 9%. The FOMC increased the Fed Funds rate twice during the quarter, both 25 basis point hikes. The important benchmark rate now stands at 5.0% (upper bound), the first time it has reached this level in more than 15 years. The market implied probability of another small rate hike at the next meeting is about 50/50.

After outperforming growth by 12% in 2022 (by declining less), small value underperformed small growth in the first quarter of 2023 by 6.7% (-0.7% vs. +6.0%). The Russell 2000 technology sector was up about 14% in the quarter. Technology comprises a much larger portion of the Russell 2000 Growth than the Russell 2000 Value (18% vs. 6%). Conversely, the financials sector declined -9%. This sector comprises a much larger portion of the Russell 2000 Value than the Russell 2000 Growth (26% vs. 7%). As a result, value spreads widened over the course of the quarter.

Much of the value underperformance can be attributed to the impact of a regional banking crisis and the follow-on effects to the broader economy. As a result of this event, recession expectations increased, and cyclical stocks retreated. While we see value in banks, especially large cap banks, in the small cap market we see better opportunities in cyclical sectors that offer similar value and arguably strong franchises.

Our energy thesis remains largely unchanged, and it remains our largest sector overweight. The portfolio's energy positions trade at attractive valuations and are generating impressive cash flows. Balance sheets have been improved and we believe these companies will continue to reap the benefits of higher oil/gas prices for the foreseeable future, as the lack of investment in new production fails to supply global demand. We recognize these are not the most spectacular businesses, but high quality valuations and unusual industry tailwinds make for a convincing investment opportunity, especially if one expects inflation to persist.

Technology is the portfolio's second-largest overweight relative to the index. In tech, we do own some quality businesses, and we are willing to pay higher valuation multiples accordingly. Common traits among our tech holdings are strong balance sheets, sticky customers that generate recurring/predictable cash flow, and promising prospects for growth. We view these businesses as less cyclical than generally understood and offer attractive diversification to complement other cyclical positions.

ATTRIBUTION – 1Q23

The Hotchkis & Wiley Small Cap Value portfolio (gross and net of management fees) outperformed the Russell 2000 Value Index in the first quarter of 2023. On a sector basis, the largest contributor to relative performance during the quarter came from stock selection in Financials. The overweight in Information Technology also contributed to outperformance, as did the underweight in Health Care. Stock selection in Real Estate, Information Technology, and Industrials detracted during the quarter. The largest positive contributors to relative performance in the quarter were Stagwell, Kosmos Energy, Brink's, Euronet Worldwide, and Adient; the largest detractors were Seritage Growth Properties, SLM Corp., Popular, Murphy Oil, and Fluor.

Net of fee composite performance as of 3/31/23: -2.13%, 8.59% and 9.62% 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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Portfolio characteristics and attribution are based on a representative Small Cap 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. 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 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. 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. The 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 GICS by MSCI and S&P.

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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.

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