

# SMALL CAP VALUE

## MARKET COMMENTARY

In the second quarter the best returns occurred in the large cap market where mega cap tech stocks continued to fuel large cap index returns. Returns in the small cap market were solid as the Russell 2000 Index increased 5.2% in the second quarter of 2023. The Russell 2000 Value Index underperformed for the quarter, returning +3.2% vs. +7.1% for the Russell 2000 Growth Index.

It appears the catalyst for positive stock returns this year is due to more encouraging inflation news which suggests the Fed's interest rate hike process is nearing its final stages. While most economists expect the US economy will slip into recession, many forecasters are beginning to see a soft landing as more likely than a hard landing. Our study of historical stock price returns around recessions shows that the small cap market was pricing a painful, but not devastating, recession. As the macro-economic data begins to support a soft landing scenario, stocks are rallying to reflect a less negative outlook. Not all sectors are reporting positive results and the small cap market is still in bear territory. The underperformance of small versus large and value versus growth can be laid at the foot of the regional bank crisis which hit small cap financials (bank in particular) very hard. In an otherwise ebullient market, small cap bank stocks were down about -8% during the second quarter which was a significant drag on the over all small cap market and value portfolios.

So where does this market rally leave us in terms of valuation? Given the recent growth spurt, small cap value trades at a larger-than-normal discount to large caps and to its small cap growth counter parts. We continue to see the market environment shifting to favor active investing and value, which should be a stylistic tailwind for our strategy. This year's market leadership is narrowly focused in a few mega cap stocks. For example, the 3 largest market cap stocks in the S&P 500 generated nearly half of the index return this year. While the advent of artificial intelligence is exciting, it will likely benefit more than three companies. In our experience, narrow markets create opportunities for active managers who are not forced to own the biggest companies simply because they represent a disproportionate weight in the "market" index.

## ATTRIBUTION – 2Q23

The Hotchkis & Wiley Small Cap Value portfolio (gross and net of management fees) outperformed the Russell 2000 Value Index in the second quarter of 2023. On a sector basis, the largest contributor to relative performance during the quarter came from stock selection in financials where we continue to be underweight banks stocks. The overweight positions in technology and industrials also contributed to outperformance. Stock selection in industrials, consumer discretionary, and energy detracted during the quarter. The largest positive contributors to relative performance in the quarter were SLM Corp., Equitrans Midstream, Itron, Greenbrier, and Allison Transmission; the largest detractors were Kosmos Energy, Berry Petroleum, Stagwell, Sonic Automotive, and Adient.

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Net of fee composite performance as of 6/30/23: 20.58%, 7.34% and 9.60% 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.**

**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.

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](http://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](mailto:hotchkisandwiley@hwcm.com). Portfolio information is subject to the firm's portfolio holdings disclosure policy.

The securities reflected herein are intended for illustrative purposes only and not a recommendation to buy or sell specific securities. There is no assurance that the securities discussed will remain in the portfolio or that securities sold have not been repurchased. The securities discussed do not represent the entire portfolio, may only represent a small portion of the portfolio and should not assume the securities discussed were or will be profitable or that recommendations made in the future will be profitable or will equal the performance of the securities discussed. H&W's opinions regarding these securities are subject to change at any time, for any reason, without notice. Certain client portfolio(s) may or may not hold the securities discussed due to each account's guideline restrictions and other relevant considerations.

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 S&P 500® Index is a broad-based unmanaged index of 500 stocks, which is widely recognized as representative of the equity market in general. 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.

Certain information contained in this material represents or based upon 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.

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