

**MARKET COMMENTARY**

The Russell Midcap Index declined -27% in the first quarter of 2020 as investors contemplated the economic impact of the COVID-19 pandemic. Shelter-in-place orders, travel bans, layoffs, etc. will have material and widespread effects on global economic activity. In an attempt to combat these effects, governments have taken swift and unprecedented action. Monetary policy responses included the Federal Reserve cutting its Fed Funds rate to near zero and injecting massive amounts of liquidity into an array of government, corporate, and money market credit facilities. Fiscal policy responses included a \$2.2 trillion package intended to stimulate the economy, and to provide relief for companies and individuals most affected by the economic consequences of the pandemic. As equities sold off, treasuries rallied—the yield on the 10-year Treasury note declined from 1.9% at the beginning of the year to less than 0.7% at the end of the quarter, reaching an all-time low of 0.5% in early March.

All Russell Midcap sectors declined by double digits. Healthcare, consumer staples, utilities, and technology declined the least while energy, consumer discretionary, and financials declined the most. Energy was the largest laggard, with the sector falling -62% in the three-month period. Government-imposed efforts to mitigate the COVID-19 pandemic, particularly travel/transportation bans, have decreased the global demand for oil. Meanwhile, negotiations between Saudi Arabia and Russia designed to limit oil production reached an impasse. Increased supply of oil, which coupled with the aforementioned decreased demand, sent West Texas Intermediate WTI oil prices plummeting -66%, closing the quarter at close to \$20/barrel. Financials declined -36%; banks declined disproportionately, falling -45% as interest rates collapsed and investors became concerned with the potential for increased credit defaults.

In light of both the prevailing and potential adverse economic developments of the quarter, we stress-tested the liquidity and cost structure the portfolio's positions—essentially an in depth evaluation of both financial and operating leverage. The first objective was to evaluate each business' ability to survive an economic downturn more severe than what seemed conceivable just a few weeks ago. The second objective was to reevaluate weight changes that would result in an improved risk/return profile for the overall portfolio. While the cyclical tilt in portfolio holdings has hurt near-term earnings prospects, it is still, in our judgment, far too costly to shift to non-cyclical sectors given historic disparities in valuation. We believe the portfolio's positions can survive a difficult economy in the weeks and months ahead, and their stock price declines have created enormous opportunity.

The Russell Midcap Growth Index trades at 17.5x consensus earnings and 4.3x book value, which are, rather remarkably, close to historical averages (17.0x and 4.4x, respectively). The Russell Midcap Value Index, however, trades at 10.8x consensus earnings (FY2) and 1.3x book value, both of which fall in the lowest quintile of

its own history (i.e. the index traded at higher multiples more than 80% of the time). Historically, when the Russell Midcap Value Index's valuation falls into the lowest quintile, as it does today, its subsequent 3-year annualized return has averaged +18 to +19% compared to +9.2% over all periods. The portfolio trades at 3.4x normal earnings, 6.0x consensus earnings (FY2), and 0.6x book value, which not only falls in the lowest quintile of its own history but all-time lows. Therefore, despite the value index trading at valuations well below average, the portfolio's valuation relative to the index is at/near an all-time discount. So while the portfolio is composed of companies with business models and balance sheets able to withstand a draconian environment, the valuation potential is highly compelling in both absolute and relative terms.

A stable investment team is an irreplaceable luxury during challenging periods. We have not encountered a global pandemic the likes of which we face today, but we have certainly encountered challenging environments before. While we do not discount the human toll the virus has taken, our clients have charged our team with managing their assets through various investment environments. We take that responsibility in earnest. We speak to experts daily and read research constantly to try and understand COVID-19's potential ramifications on the economy, capital markets, and most importantly, the portfolio. Despite the unusually opaque nature of today's environment, we are confident that the current portfolio can exceed client expectations in the long-term notwithstanding economic activity or market direction in the near-term.

**ATTRIBUTION – 1Q20**

The Hotchkis & Wiley Mid-Cap Value Fund underperformed the Russell Midcap Value Index in the first quarter of 2020. Two stylistic factors combined to detract from performance in a major way: size and valuation. Larger cap stocks held up better than smaller cap stocks and growth held up better than value. The portfolio's average weight to stocks over \$20 billion in market cap was 10% compared to 29% for the index. Conversely, the portfolio's average weight to stocks under \$5 billion was 49% compared to 13% for the index. This smaller cap bias detracted from relative performance considerably. The portfolio had more than double the benchmark exposure to stocks that began the year trading at less than 10x consensus earnings (33% vs. 13%) and nearly four times the benchmark exposure to stocks that began the year trading at a discount to book value (43% vs. 11%). The outsized exposure to these deeply discounted stocks was a considerable detractor. Energy, industrials, and financials detracted from performance. The largest individual detractors to relative performance in the period were Kosmos Energy, Cairn Energy, Apache, NexTier Oilfield Solution, and Goodyear Tire & Rubber; the largest positive contributors were Centene, Amerco, Ericsson, Avis Budget, and Enstar Group.

*(continued)*

Portfolio managers' opinions and data included in this commentary are as of 3/31/20 and are subject to change without notice. Any forecasts made cannot be guaranteed. Information obtained from independent sources is considered reliable, but H&W cannot guarantee its accuracy or completeness. Fund holdings and/or sector allocations are subject to change and are not buy/sell recommendations. Current and future portfolio holdings are subject to risk. Certain information presented based on proprietary or third-party estimates are subject to change and cannot be guaranteed. **Past performance is no guarantee of future results. Diversification does not assure a profit nor protect against loss in a declining market.**

# MID-CAP VALUE FUND

HWMIX  
HWMAX  
HWMCX  
HWMZX

## MANAGER REVIEW & ECONOMIC OUTLOOK

MARCH 31, 2020

### LARGEST NEW PURCHASES – 1Q20

General Motors is one of the world's largest manufacturers of passenger vehicles. The stock declined and qualified for the mid cap universe. GM has made numerous improvements over the past decade. It maintains a highly profitable truck business, strong business in China, an improved global manufacturing base, strong free cash flow generation, a good balance sheet, and a commitment to return large amounts of cash to shareholders. Importantly, it also possesses a vertically integrated autonomous transportation business that offers significant upside over the long term. Considering these factors, the current stock price represents an attractive valuation.

Omnicom is the second largest ad agency holding company with premier agencies DDB, BBDO, and TBWA. Traditional brand advertising earns about half the revenue, with most of the balance

from other marketing services such as public relations, direct marketing support, and specialty sectors such as healthcare. Its stock has underperformed the market in the most recent selloff due to concerns about revenue declines in the cyclical downturn. We believe revenue will be volatile, but earnings will be relatively stable because of the cost flexibility inherent in the business.

PDC Energy is an energy exploration & production company with acreage in the Wattenberg field in Colorado and the Delaware basin in Texas. The company recently completed an all-stock merger with SRC Energy, which consolidated its acreage position and strengthened its balance sheet. We purchased the stock for its high quality asset base, minimal leverage, hedged production, ability to generate FCF at low prices, and significant discount to NAV.

### PERFORMANCE (%) as of March 31, 2020

	QTR	YTD	1 Yr	3 Yr	5 Yr	10 Yr	Since 1/2/97
Mid-Cap Value Fund – I Shares	-47.74	-47.74	-49.19	-20.17	-11.54	1.93	7.56
Russell Midcap Value	-31.71	-31.71	-24.13	-5.97	-0.76	7.22	8.39

*The performance shown represents past performance. Past performance is no guarantee of future results and current performance may be higher or lower than the performance shown. Investment results and principal value will fluctuate so that shares, when redeemed, may be worth more or less than their original cost. To obtain performance data current to the most recent month-end, access our website at [www.hwcm.com](http://www.hwcm.com).*

The Fund's total annual operating gross expense ratio as of the most current prospectus is 1.03% for I Shares. Expense ratios shown are gross of any fee waivers or expense reimbursements. I Shares sold to a limited group of investors. Periods over one year are average annual total return. Average annual total returns include reinvestment of dividends and capital gains. Expense limitations may have increased the Fund's total return.

*You should consider the Fund's investment objectives, risks, and charges and expenses carefully before you invest. This and other important information is contained in the Fund's summary prospectus and prospectus, which can be obtained by calling 1-800-796-5606 or visiting our website at [www.hwcm.com](http://www.hwcm.com). Read carefully before you invest.*

*Investing in small and medium-sized companies involves greater risks than those associated with investing in large company stocks. Please read the fund prospectus for a full list of fund risks. Investing in value stocks presents the risk that value stocks may fall out of favor with investors and underperform other asset types during a given period. Equities, bonds, and other asset classes have different risk profiles, which should be considered when investing. All investments contain risk and may lose value. Specific securities identified are the largest contributors (or detractors) on a relative basis to the Russell Midcap Value Index. Securities' absolute performance may reflect different results. The Fund may not continue to hold the securities mentioned and the Advisor has no obligation to disclose purchases or sales of these securities. Attribution is an analysis of the portfolio's return relative to a selected benchmark, is calculated using daily holding information and does not reflect the payment of transaction costs, fees and expenses of the Fund. The "Largest New Purchases" section includes the three largest new*

security positions during the quarter/year based on the security's quarter/year-end weight adjusted for its relative return contribution; does not include any security received as a result of a corporate action; if fewer than three new security positions during the quarter/year, all new security positions are included.

Market Disruption: The recent global coronavirus pandemic has caused and continues to cause disruption in the global economy, unprecedented business and travel disruption and extreme fluctuations in global capital and financial markets. H&W is unable to predict the consequences of the upheaval caused by coronavirus pandemic, which, depending on the severity and the length of the outbreak, has the potential to negatively impact the firm's investment strategies and reduce available investment opportunities.

The Russell Midcap<sup>®</sup> Index, an unmanaged index, measures the performance of the 800 smallest companies in the Russell 1000<sup>®</sup> Index. The Russell Midcap<sup>®</sup> Value Index measures the performance of those Russell Midcap<sup>®</sup> companies with lower price-to-book value ratios and lower forecasted growth values. The Russell Midcap<sup>®</sup> Growth Index measures the performance of those Russell Midcap<sup>®</sup> Index companies with higher price-to-book ratios and higher forecasted growth values. The indices do not reflect the payment of transaction costs, fees and expenses associated with an investment in the Fund. It is not possible to invest directly in an index. Price-to-Normal Earnings is the current market price per share divided by normalized earnings per share. Price-to-Earnings (P/E) is calculated by dividing the current price of a stock by the company's trailing 12 months' earnings per share. Price-to-Book is the price of a stock divided by its book value. Book value is the net asset value of a company, calculated by subtracting total liabilities from total assets. Free cash flow is earnings before depreciation, amortization, and non-cash charges minus maintenance capital expenditures. Fiscal year two (FY2). Top ten holdings as of 3/31/20 as a % of the Fund's net assets: Popular Inc. 4.5%, Citizens Fin'l Group 4.0%, Cairn Energy 4.0%, Amerco 3.6%, Office Depot 3.4%, CNO Financial Group 3.0%, PPL Corp. 2.9%, Magna Int'l 2.8%, Royal Mail PLC 2.8% and Vistra Energy 2.8%.

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