# GLOBAL VALUE

## MARKET COMMENTARY

The MSCI World Index returned +19.4% in the second quarter of 2020, recovering most of its first quarter decline; the index is -5.8% since the beginning of the year. During the quarter, economic activity began to rebound globally. Prices of risk assets, including equities, also benefited from aggressive central bank and government intervention. Volatility remained elevated, however, as the recovery remains uneven and uncertain, with the virus' continued presence complicating reopening efforts.

The MSCI World Growth Index outperformed the MSCI World Value Index by nearly 13 percentage points in the quarter (+25.5% vs. +12.6%). This extended growth's year-to-date advantage to more than 24 percentage points (+6.5% vs. -17.8%) and its three-year edge to 51 percentage points (+48.6% vs. -2.4%). The wide valuation gap between global growth and global value is approaching levels only previously observed during the late 1990's tech/growth bubble.

Our estimate of a company's intrinsic value is based on its earnings power over the long term, i.e. over a period of many years. If a company's earnings temporarily contract in any period—as will happen to many of our businesses due to the global pandemic and related recession—it should only modestly reduce our estimate of intrinsic value. The exception is when a company lacks the financial wherewithal to survive the contraction—something we work hard to avoid. We believe that the share price declines for many of our cyclical businesses have meaningfully outpaced the declines in intrinsic value. Meanwhile, companies that are largely insulated from COVID-19's reach, and those that benefit from it in the short term, have seen their stock prices rise considerably. Many of these companies traded at elevated valuations even before this period. We recognize the seriousness of the pandemic, including its extensive impact on the economy and capital markets; however, we view the market's response as myopic. While COVID-19 has taken a painful toll, both human and economic, we will get through it. When we do, we are confident that more rational economics will prevail, and valuations will revert toward more normal relationships—our clients are well positioned to benefit from such a scenario.

Recently, the Business Cycle Dating Committee of the National Bureau of Economic Research ("NBER") declared February 2020 as the official start of a recession in the United States. This ended the 128-month expansion, which was the longest, though not the strongest period of sustained economic growth in the history of US business cycles, dating back to at least 1854. Since the Great Depression, the average recession has lasted less than a year. In the recovery following recessions, value has outperformed growth consistently and by a large margin. In the five-year period following a recession's end, value beat growth in *all* 14 recovery periods dating back to the Great Depression, with an average performance advantage of more than 50 percentage points. Value has demonstrated similar performance trends in international markets.

The irrational gap between global growth and value indices represent an uncommon opportunity, but in our view, the true opportunity in today's market goes well beyond this simple relative incongruity. The opportunities within value are extraordinary. The portfolio trades at 6.4x normal earnings which is near record low levels compared to its history; this represents a significant discount to the MSCI World Index, which trades at 16.2x normal earnings.

## ATTRIBUTION – 2Q20

The Hotchkis & Wiley Global Value portfolio (gross and net of management fees) underperformed the MSCI World Index in the second quarter of 2020. The strategy's value bias caused the underperformance as growth outperformed value considerably; the strategy did outperform the MSCI World Value Index meaningfully. Relative to the broad benchmark, stock selection in technology and industrials detracted from performance. The overweight exposure to financials and underweight exposure to technology also hurt. Positive stock selection in real estate and financials helped performance, along with the underweight exposure to real estate and utilities. The largest individual detractors to relative performance in the quarter were General Electric, Wells Fargo, Tokio Marine Holdings, BAE Systems, and Embraer; the largest positive contributors were Magna International, AIG, Siemens, Royal Mail, and News Corp.

## LARGEST NEW PURCHASES – 2Q20

Euronet Worldwide is a provider of electronic payment systems, with a network of ATMs, a money transfer business, and a digital media payment business. Core markets are sensitive to travel, and as a result are under pressure today. We believe that travel ultimately resumes and recovers. The business has a long runway for growth, a history of consistent execution, a good balance sheet, and strong leadership. The current share price does not reflect these qualities.

Evercore has built a strong investment banking advisory business that has consistently gained market share from its peers. The company has a clean balance sheet and the business model generates extremely high incremental returns and should be able to return most of its net income to shareholders. Concerns about a sharp decline in M&A advisory activity have pressured shares, but we believe that the company's earnings will recover.

Popular, the largest bank in Puerto Rico, has a dominant market share of loans and deposits in the US territory. In addition to its leading share in Puerto Rico, it has a niche US regional banking business with operations primarily in Florida and New York City targeting the Hispanic market. As a result of this unique market position, the bank earns very high returns on its capital. The bank has substantial excess capital on its balance sheet, positioning it well to manage through the current environment.

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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 Global 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. Equity performance attribution is an analysis of the portfolio's return relative to a selected benchmark, is calculated using daily holdings information and does not reflect management fees and other transaction costs and expenses. Specific securities identified are the largest contributors (or detractors) to the portfolio's performance relative to the MSCI World Index. Other securities may have been the best and worst performers on an absolute basis. 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. Securities identified do not represent all of the securities purchased or sold for advisory clients and are not indicative of current or future holdings or trading activity. H&W has no obligation to disclose purchases or sales of the securities. 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 Global Value strategy may prevent or limit investment in major stocks in the MSCI World, MSCI World Value and MSCI World Growth indices 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 Characteristics 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, please contact H&W at hotchkisandwiley@hwcm.com. Portfolio information is subject to the firm's portfolio holdings disclosure policy. MSCI makes no express or implied warranties or representations and shall have no liability whatsoever with respect to any MSCI data contained herein. The MSCI data may not be further redistributed or used as a basis for other indices or any securities or financial products. This report is not approved, reviewed, or produced by MSCI. See www.hwcm.com / *Index definitions* for full disclaimer.

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. Growth investing tends to work well during speculative, momentum-driven markets, while value investing tends to work well following recessionary periods. Past recessions and recoveries cannot predict future performance due to different factors and circumstances, including differences in US and international financial markets.

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 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 managers' opinions and data included in this commentary are as of June 30, 2020 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. Certain information presented is based on proprietary or third-party estimates, which are subject to change and cannot be guaranteed. 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. The strategy invests in foreign securities which involve greater volatility and political, economic and currency risks and differences in accounting methods. All investments contain risk and may lose value. Past performance is no guarantee of future results.