LARGE CAP FUNDAMENTAL VALUE

MARKET COMMENTARY

The S&P 500 Index returned +20.5% in the second quarter of 2020, recovering most of its first quarter decline; the index is -3.1% since the beginning of the year. Most US states took steps to reopen during the quarter, and the Federal Reserve announced additional actions to further stimulate the economy: continue large scale asset purchases, hold interest rates near zero through 2022 if needed, and initiate purchases of individual corporate bonds. Employment and consumer spending improved more quickly than the market anticipated, helping fuel the equity market rebound. Volatility remained elevated, however, as an increase in COVID-19 cases accompanied the reopening efforts, and turbulent US/China trade negotiations resurfaced.

The Russell 1000 Growth Index outperformed the Russell 1000 Value Index by more than 13 percentage points in the quarter (+27.8% vs. +14.3%). This extended growth's year-to-date advantage to more than 26 percentage points (+9.8% vs. -16.3%) and its three-year edge to 63 percentage points (+68.5% vs. +5.5%). The wide valuation gap between growth and value now resembles levels only 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 in any one year are impaired, due to a pandemic or otherwise, it will reduce our estimate of intrinsic value. However, unless the company lacks the financial wherewithal to survive challenging times—something we work hard to avoid in the first place—it is unlikely to result in a 50% reduction to our intrinsic value estimate. Yet in many cases recent market prices have declined by this amount or more, often despite little to no solvency/survival risk. 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 by similar amounts. 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. 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. In the 5-year periods following the last 4 recessions (ended June 2009, November 2001, March 1991, and November 1982), the H&W Large Cap Fundamental Value composite historically outperformed the *value* benchmark in each period by considerable magnitudes.

The irrational gap between growth and value indices represent an uncommon opportunity, but in our view, the true opportunity in today's market goes well beyond this simple incongruity. The opportunities within value are extraordinary. The portfolio trades at 6.7x normal earnings which is near record low levels compared to its history; the Russell 1000 Value trades at 13.5x normal earnings which is in line with history; and the Russell 1000 Growth trades at 29.7x which is near record high levels compared to its history. This discount has been achieved without assuming excessive risk, in our view, as evidenced by the portfolio's credit profile—96% investment grade-rated. Historically, when the portfolio's price-to-normal earnings ratio falls into the lowest quintile of its history, as it does today with ease, its subsequent 3-year return has averaged nearly +19%, per year, net of fees.

ATTRIBUTION – 2Q20

The Hotchkis & Wiley Large Cap Fundamental Value portfolio (gross and net of management fees) outperformed the Russell 1000 Value Index in the second quarter of 2020. Positive stock selection trumped the portfolio's value-biased headwind in the quarter. Stock selection was positive in all but two sectors, with financials, energy, and healthcare leading the way. The overweight exposure to energy and technology along with the underweight exposure to consumer staples and utilities also helped performance. Stock selection in industrials and materials were detractors, along with the underweight exposure to materials. The largest positive contributors to relative performance in the quarter were Apache, Hess, Microsoft, AIG, and Magna International; the largest detractors were General Electric, Wells Fargo, Royal Dutch Shell, Hewlett Packard Enterprise, and PPL.

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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 Large Cap Fundamental 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. For the portfolio's total performance attribution, interaction effect is combined with stock selection. Specific securities identified are the largest contributors (or detractors) to the portfolio's performance relative to the Russell 1000 Value Index. Other securities may have been the best and worst performers on an absolute basis. 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 Large Cap Fundamental Value strategy may prevent or limit investment in major stocks in the S&P 500, Russell 1000 Value and Russell 1000 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. Returns for different time periods and/or market environments can result in significantly different results. The H&W LCFV composite (net of fees) through June 30, 2020: 19.78%, -16.12%, 2.66% and 10.14% for 2Q, one-, five-, and ten-years, respectively. Important performance disclosures are included in the strategy's GIPS Compliant Presentation.

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. Value stocks following a recession may start from a lower market value than growth stocks which can contribute to their outperformance. Past recessions and recoveries cannot predict future performance due to different factors and circumstances.

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. All investments contain risk and may lose value. Past performance is no guarantee of future results.