MID-CAP VALUE

MARKET COMMENTARY

The Russell Midcap Index rose +8.1% in the first quarter of 2021. Another round of fiscal stimulus was signed and delivered. The $1.9 trillion bill raised the total COVID fiscal response to $5.3 trillion; this sum equates to about 25% of pre-COVID GDP or roughly $16,000 for every American. The bill's passage was widely anticipated and consequently sparked little reaction from equity markets. The acceleration of vaccine availability prompted investor optimism as it was announced that all Americans 16 and older should be eligible by May 1st. On the economic front, the labor market showed signs of improvement as initial jobless claims fell to the lowest level since the pandemic began. The housing market continued its upward trend and consumer confidence also hit its highest level in a year. WTI crude oil prices rose 22% in the quarter, closing the quarter at $59/barrel after peaking at $66 in early March. Corporate America performed well, as more than 80% of S&P 500 companies exceeded consensus earnings expectations during the quarter. The signs of near-term recovery, coupled with the Fed's expanding balance sheet, seemingly point to increased inflation. The gap between the 10-year treasury note and 10-year TIPS, a proxy for expected inflation, finished the quarter at its highest level since mid-2013. In response to increased growth and inflation expectations, interest rates rose with the 10-year treasury yield rising from 0.92% at the beginning of the quarter to 1.74% at its end.

Mid cap value stocks outperformed mid cap growth stocks for the second consecutive quarter; the Russell Midcap Value Index returned +13.1% while the Russell Midcap Growth Index declined -0.6%. Over the past six months, the value index has outperformed the growth index by nearly 18 percentage points (+36.1% vs. +18.4%). In a trend we believe likely to endure, the continued reopening of the economy and the prospect for higher inflation and interest rates has benefited value stocks relative to growth stocks. Despite value's recent outperformance, the valuation gap between growth and value remains considerably wider than historical norms based on any common valuation metric, which highlights the extreme levels reached in 2020.

Price-to-normal earnings ("P/NE") is one of our preferred metrics because it adjusts for the peaks and troughs of business cycles. The P/NE of the Russell Midcap Value is notably higher than its long-term average (17x vs. 14x) while the P/NE of the Russell 1000 Growth is significantly higher than its long-term average (35x vs. 22x). At 7x normal earnings, however, the portfolio is in line with its long-term average. This highlights that despite some richly valued publicly traded stocks, we have been able to identify interesting risk-adjusted opportunities trading at attractive valuations not only on a relative basis but also on an absolute basis. The portfolio exhibits somewhat of a cyclical tilt—this is where value opportunities disproportionately reside—but this is offset by investing in good businesses that are well-capitalized and prudently managed, i.e., companies that can endure cyclical downturns. As we look forward, we believe our clients will continue to benefit from this simple and time-tested combination.

ATTRIBUTION – 1Q21

The Hotchkis & Wiley Mid-Cap Value portfolio (gross and net of management fees) outperformed the Russell Midcap Value Index in the first quarter of 2021 by a wide margin. Stock selection was positive in 8 of the 10 GICS sectors in which we are invested (no positions in the materials sector), driving most of the outperformance. Stock selection was particularly beneficial in consumer discretionary, industrials, communication services, and financials. The overweight exposure to energy and financials, the two top-performing sectors, also helped. Stock selection in energy detracted from performance. The largest positive contributors to relative performance in the quarter were Bed Bath & Beyond, Discovery, Royal Mail, Fluor, and CIT Group; the largest detractors were Cairn Energy, Vistra, Euronet Worldwide, NRG Energy, and Allison Transmission.

LARGEST NEW PURCHASES – 1Q21

Northern Trust is the smallest of the three independent trust banks with total assets under custody of $10 trillion. In addition to its Corporate and Institutional Investment Services segment it also has Personal Financial Services ("PFS") segment which provides high net worth families and individuals with wealth management, trust and banking services. Because of its PFS business, loans are a higher percentage of earning assets relative to peers which gives the company a higher normal net interest margin. While it has a modestly larger loan book, provisions are very low over the cycle as most of the loans are secured by property to high net worth borrowers. The company trades at an attractive multiple of tangible book value for a business that should earn above cost of capital returns.

Universal Health Services owns and operates 360 inpatient facilities and 39 outpatient facilities in 38 states, the UK, and Puerto Rico. Most of the portfolio is composed of behavioral health care facilities. In the past decade since the ACA began, behavioral health care coverage has been more prevalent due to legislation and wider acceptance of the importance of addressing mental illnesses. As such, operators like UHS benefit from government-supported secular tailwinds. On the UK front, the National Health Service also offers robust reimbursement for behavioral health treatments, thus further benefiting large scale hospital networks. The company trades at an attractive valuation considering its advantaged competitive positioning.

Whirlpool Corporation is one of the world's leading kitchen and laundry appliance companies. The company manufactures products in 13 countries and markets products in nearly every country around the world. Key products include laundry, cooking, refrigeration, and dishwashing appliances. It has widely-recognized brand value and trades at an attractive multiple of its normal cash earnings.

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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 Mid-Cap 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. Performance attribution is an analysis of the portfolio's return relative to a selected benchmark (interaction effect is combined with stock selection), 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 Russell Midcap Value 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 Mid-Cap Value strategy may prevent or limit investment in major stocks in the Russell Midcap, Russell Midcap Value and Russell Midcap Growth 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 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.

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 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.

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 managers' opinions and data included in this commentary are as of March 31, 2021 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. Investing in small and medium-sized companies involves greater risks than those associated with investing in large company stocks, such as business risk, significant stock price fluctuations and illiquidity.

Past performance is no guarantee of future results.