SMALL CAP VALUE

MARKET COMMENTARY

The Russell 2000 Index rose 4.3% in the quarter and is up +17.5% since the beginning of the year. While the threat of new COVID variants persists, vaccination levels increased and new cases slowed. Consequently, state and local governments continued to ease closures/restrictions spurring renewed economic activity. The restart of the physical economy and unprecedented fiscal stimulus appears to be sparking inflation. Whether inflation is "transitory" or the beginning of an extended period of higher inflation remains an open question for many investors. Meanwhile, consumer prices rose 5% year over year, the fastest level in more than a decade. WTI crude oil touched $74/barrel, its highest level in more than two years. Corporate earnings continued to show strength, albeit from a depressed COVID base, with 68% of Russell 2000 companies outperforming consensus expectations.

Over the last nine months, the Russell 2000 Value Index has outperformed the Russell 2000 Growth Index by 27%. Based on prior value cycles, the prospects for continued economic expansion, modestly higher interest rates, and the spread in valuation ratios, it appears the value cycle is far from over. The typical value cycle has lasted about 33 months and the cumulative outperformance was 55%, according to data from the Ken French/Dartmouth library, which dates to 1926. On the economic front, the natural recovery from the Covid lows and the prospect of enormous fiscal stimulus bodes well for value stocks. In fact, small value stocks outperformed small growth following each of the past 13 recessions. Higher interest rates and higher inflation tend to benefit value stocks because the growth premium (i.e., multiple of earnings) one should pay for high growth stocks should contract, especially in relation to value stocks. Value spreads have narrowed but growth stock multiples are still near record highs. While the stage is set for the value investment style to outperform, we note that there will be periods of underperformance within a prolonged value rally. For example, in the 5+ year value rally post the tech bubble of 1999, growth carried the day in about 1 out of 3 months. A bad quarter is not in and of itself an indicator that the rally is over.

The Russell 2000 Value Index edged out the Russell 2000 Index by a narrow margin. Within the Russell 2000 Value, communication services was the Russell 2000's top performing sector in the quarter, which was due to AMC Entertainment's +455% return. Energy was next best, returning more than +20%. Utilities was the only sector that declined in the quarter, though industrials, financials, and consumer staples also lagged.

As measured by any common valuation metric, the spread between value and growth stocks is wide. So too is the spread between the portfolio and the value benchmark, which means the spread between the portfolio and either the core or growth index is extreme. We believe this bodes well going forward as value relationships normalize. We continue to focus on companies trading at large discounts to intrinsic value but that have strong balance sheets, quality businesses, and employ appropriate corporate governance—a combination that we believe should continue to benefit our clients.

ATTRIBUTION – 2Q21

The Hotchkis & Wiley Small Cap Value portfolio (gross and net of management fees) outperformed the Russell 2000 Value Index in the second quarter. Energy was the largest contributor as both the overweight allocation and positive stock selection helped relative performance. Positive stock selection in consumer discretionary and financials also helped, along with the overweight position in communication services. Stock selection in industrials, healthcare, and real estate detracted from performance. The largest positive contributors to relative performance in the quarter were Range Resources, MDC Partners, Oasis Petroleum, EnPro Industries, and International Game Technology; the largest detractors were Fluor, Triple-S Management, Frank's International, Avista, and Global Indemnity. Not owning AMC Entertainment was the largest individual detractor to relative performance as the stock returned more than +450% and was a large benchmark weight.

SMALL CAP VALUE

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 Small 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 an index, 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. 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 the Global Industry Classification Standard by MSCI and S&P. 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. 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 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. 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. Past recessions and recoveries cannot predict future performance due to different factors and circumstances.

Market Disruption: The global coronavirus pandemic has caused 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 has the potential to negatively impact the firm's investment strategies and 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 June 30, 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 smaller and/or newer companies involves greater risks than those associated with investing in larger companies, such as business risk, significant stock price fluctuations and illiquidity.

Past performance is no guarantee of future results.