SMALL CAP DIVERSIFIED 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. Manufacturing rose and labor markets improved, highlighting the potential for tight supply conditions. Consumer prices rose 5% year over year, the fastest level in more than a decade. In response, Fed Chairman Powell reiterated his view that inflationary pressures would be transitory. WTI crude oil touched $74/barrel, its highest level in more than two years. Corporate earnings continued to show strength, with 68% of Russell 2000 companies outperforming consensus expectations.

Large growth outperformed large value in the quarter, but the Russell 2000 Value Index slightly outperformed the Russell 2000 Growth Index (+4.6% vs. +3.9%) in the second quarter. The small value index has outperformed by more than 27 percentage points over the past 9 months (+68.9% vs. +41.2%). According to data from the Ken French/Dartmouth library, which dates to 1926, the average value-led market[1] has lasted for 33 months and outperformed growth by an average of 55 percentage points. The duration and magnitude of the current rally is far short of that. Nearly all prolonged value-led markets, however, contain stints when growth outperforms value. In perhaps the strongest value rally ever, for example, value outperformed growth by 147 percentage points from March 2000 through December 2006. However, growth outperformed value in nearly one-third of those months (24 out of 82 months). Like that value run, we came from extreme valuation spreads in mid/late 2020 and continue to observe spreads that are considerably wider than average. This gives us confidence that value's advantage this time will persist in a powerful way, for a prolonged period, or both.

Interest rates fell during the quarter, particularly for long-dated bonds (the yield curve flattened). The 10-year treasury note declined from 1.74% to 1.47% over the quarter. 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 Diversified Value portfolio (gross and net of management fees) underperformed the Russell 2000 Value Index in the second quarter. The portfolio's overweight to stocks under $1 billion in market cap (30% vs. 15%) and underweight to stocks over $1 billion in market cap (68% vs. 85%) detracted from performance as smaller stocks lagged. From a stock specific perspective, all of the underperformance can be attributable to not owning AMC Entertainment, which returned more than +455% and was a large benchmark weight. The underweight in real estate and stock selection in technology also detracted from performance. The overweight and positive stock selection in energy helped relative performance. Positive stock selection in financials also helped.

[1]A value-led market is defined as one that outperforms growth by at least 10 percentage points.

SMALL CAP DIVERSIFIED 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 Diversified Value portfolio. Client portfolio holdings may vary due to different restrictions, cash flows, and other relevant considerations. Performance attribution is an analysis of the portfolio's return relative to the 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. No assurance is made that holdings, or all investment decisions by H&W were or will be profitable.

The value discipline used in managing accounts in the Small Cap Diversified 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, please 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.