

George Davis didn't change his investing approach when COVID crashed the market, and now 2 of his stock funds are among the best in the world. Here are 3 things his firm did to set up one of its best years ever.

Marley Jay

- George Davis is the chairman and a fund manager at the \$34 billion firm Hotchkis & Wiley.
- Two of his stock funds are in Kiplinger's top 10 for performance over the last 12 months.
- Davis told Insider about his approach, and why it didn't need to change.

George Davis Jr. has been investing for more than 30 years, so he's heard what people have to say about value investing. Right now he's being rewarded for sticking with it – not reworking it, updating it, or reinventing it.

Davis is the executive chairman of Hotchkis & Wiley, a Los Angeles firm with \$34 billion in assets that hunts for bargains in stocks and fixed income. While investors have been skeptical of that bargain-hunting approach, preferring to pay higher prices for faster-growing stocks, Davis and company stuck to what they do.

"The average tenure of the 24 people on the investment team is 16 years," he told Insider in an exclusive interview. "We have been through tough times and really good times before. And because of the integrity of the research and the depth of the research, we're able to really have high conviction in stocks."

So he was comfortable sticking with calls that were unpopular, like substantial bets on Wells Fargo, Citigroup, and AIG. He explains that in his role as a mutual fund manager, he'd rather buy a cheap stock and wait for it to prove to the market that it's worthwhile than pay top dollar for a company that will eventually struggle to sustain an active hot streak.

"When you have high expectations, you pay high prices for those, you can find yourself disappointed because they're difficult to sustain," he said. "If you can find businesses with the right assets, then over time, management can improve returns on those assets. And you have ultimately a double whammy effect where you have a higher base of earnings and then a better multiple placed on those earnings."

For the last year, those double-whammies have been coming in bunches. Two of Hotchkis & Wiley's funds are among the best large-cap funds in the world over the 12 months that ended September 30: Kiplinger ranked the Diversified Value Fund fifth with a 62.3% return and Large Cap Value eighth with a return of 58.7%.

Oakmark Funds is the only other firm that placed multiple funds in Kiplinger's top 10 during that stretch.



Hotchkis & Wiley
George Davis Jr., executive chairman
and fund manager for Hotchkis & Wiley.

Davis says that he and his co-managers avoid the most expensive stocks by sticking to realistic time frames and projecting how companies are likely to perform over the next five years.

"It creates a profile of cash flows for that business that we can discount back to a present value," he said. "If you pay a low price for those earnings, your returns can be pretty high."

There's more to picking those stocks than refusing to overpay. Davis says his teams think about three basic components of risk: **Business quality**, meaning the company's business strength and its ability to adapt; the health of its **balance sheet**; and its **governance**, which needs to focus on sustaining performance.

"What we've learned in the last decade is that

businesses that are subject to the disruptive technologies, or that may have had a long-term position in the market, aren't necessarily sustainable when things are changing so fast," he said.

While his approach hasn't been revamped, Davis says his team has often made room for companies that "reinvented themselves" and created growth that justifies high valuations. Microsoft and Alphabet are current examples.

But a larger part of the portfolio is in deep value areas like banks, which proved during the 2020 downturn that they are survivors.

"You have an interesting combination of businesses that have excess capital on their balance sheets, that have been profitable even in the face of low interest rates, that have opportunities to raise productivity and become more efficient through the use of technology," he said.

Industrials, too, have seen a change of fortune. He made General Electric one of the largest positions in both funds in early 2018, and that's worked out extremely well lately – a trend that continued after the storied conglomerate said it would split into three companies.

"You have a tremendous aviation business, you have a tremendous healthcare business. You then have a struggling power business," he said. "We think it's going to unlock an enormous amount of value."

If the year ended today, the Diversified Value and Large Cap Value funds both would have booked their best years since 2013. But Davis doesn't see much need to remake their portfolios at this point because many of their holdings are still cheap relative to their histories and other corners of the market.

"I think we're just kind of getting started and having an advantage or a wind at our back as opposed to a wind at our face," he said.

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HOTCHKIS & WILEY LARGE CAP VALUE AND DIVERSIFIED VALUE FUNDS

PERFORMANCE (%) as of June 30, 2022

Large Cap Value Fund	2Q22	1 Year	3 Year	5 Year	10 Year	Since Inception of Class I	Class Inception Date	Gross Expense Ratio
Class A (w/o sales charge)	-14.75	-9.53	6.54	6.29	10.64	8.56	10/26/01	1.18%
Class A	-19.23	-14.28	4.64	5.15	10.04	8.39	10/26/01	
Class I	-14.69	-9.31	6.81	6.56	10.91	8.81	6/24/87	0.98%*
Russell 1000 Value Index	-12.21	-6.82	6.87	7.17	10.50	n/a		

Diversified Value Fund	2Q22	1 Year	3 Year	5 Year	10 Year	Since Inception of Class I	Class Inception Date	Gross Expense Ratio
Class A (w/o sales charge)	-14.81	-8.49	7.90	6.97	10.69	6.94	8/30/04	1.24%*
Class A	-19.29	-13.31	5.98	5.82	10.09	6.62	8/30/04	
Class I	-14.79	-8.27	8.14	7.23	10.97	7.21	8/30/04	1.03%*
Russell 1000 Value Index	-12.21	-6.82	6.87	7.17	10.50	7.79		

The performance shown represents past performance. Past performance is no guarantee of future results and current performance may be higher or lower than the performance shown. Investment results and principal value will fluctuate so that shares, when redeemed, may be worth more or less than their original cost. To obtain performance data current to the most recent month-end, access our website at www.hwcm.com.

Returns shown for Class A shares for periods prior to inception are derived from the historical performance of Class I shares during such periods and has been adjusted to reflect the higher total annual operating expenses of each specific class. Performance for classes without sales charges would be lower if the sales charges were shown. Total returns with sales charges reflect the deduction of the current maximum initial sales charges of 5.25% for Class A shares. Class I shares are sold to a limited group of investors. Periods over one year are average annual total return. Average annual total returns include reinvestment of dividends and capital gains. Expense limitations may have increased the Funds' total returns. Expense ratios shown are gross of any fee waivers or expense reimbursements.

*Net expense ratios: Large Cap Value Fund - Class I 0.95%. Diversified Value Fund - Class I 0.80%, Class A 1.05%. The Advisor has contractually agreed to waive advisory fees and/or reimburse expenses through August 31, 2022.

You should consider the Fund's investment objectives, risks, and charges and expenses carefully before you invest. This and other important information is contained in the Fund's summary prospectus and prospectus, which can be obtained by calling 1-800-796-5606 or visiting our website at www.hwcm.com. Read carefully before you invest.

The Funds may invest in foreign securities. Please read each fund's prospectus for a full list of fund risks.

The Russell 1000® Value Index measures the performance of those Russell 1000® companies with lower price-to-book ratios and lower forecasted growth values. The index does not reflect the payment of transaction costs, fees and expenses associated with an investment in the Fund. It is not possible to invest directly in an index. The Fund's returns may not correlate with the returns of the benchmark index.

Top ten holdings as of 6/30/22 as a % of Fund net assets: *Large Cap Value Fund* - General Electric Co. 4.9%, Citigroup Inc. 4.9%, Wells Fargo & Co. 3.9%, American Int'l Group Inc. 3.7%, General Motors Co. 3.4%, Elevance Health Inc. 3.2%, F5 Inc. 3.1%, Oracle Corp. 3.1%, Goldman Sachs Group Inc. 3.0%, and FedEx Corp. 2.8%. *Diversified Value Fund* - Citigroup Inc. 4.8%, General Electric Co. 4.7%, Wells Fargo & Co. 3.9%, American Int'l Group Inc. 3.8%, Microsoft Corp. 2.9%, Alphabet Inc. 2.8%, Oracle Corp. 2.8%, Goldman Sachs Group Inc. 2.7%, Elevance Health Inc. 2.7%, and PPL Corp. 2.7%. Fund holdings are subject to change and are not recommendations to buy or sell any security. Diversification does not assure a profit or protect against a loss in a declining market.

Kiplinger recognized the Hotchkis & Wiley Diversified Value Fund and Hotchkis & Wiley Large Cap Value Fund as "Top-Performing Mutual Funds" in their fund analysis for the period ending 9/30/21. The H&W Diversified Value Fund (HWCAX) ranked fifth and the H&W Large Cap Value Fund (HWLAX) ranked eighth in the Large-Company Stock Funds category for the 1-year annualized return based on Morningstar's universe of 25,000+ funds. (HWCAX and HWLAX were not ranked in the top 10 for the 3-, 5-, or 10-year time periods). Ranking is for the share class indicated only. Other share classes will have different rankings.

Opinions expressed are those of the author and are subject to change, are not intended to be a forecast of future events, a guarantee of future results, nor investment advice.

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.

Extraordinary performance is attributable in part due to unusually favorable market conditions and may not be repeated or consistently achieved in the future.

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