

INTERNATIONAL SMALL CAP DIVERSIFIED VALUE

MARKET COMMENTARY

The MSCI World ex-USA Small Cap Index declined -7.2% in the first quarter of 2022. Value continued to outperform during the first quarter. The MSCI World ex-USA Small Value Index declined -2.9% while the MSCI World ex-USA Small Growth Index declined -11.5%.

Inflation data globally continues to accelerate. Eurozone CPI hit 7.5%, while the United Kingdom rose to 6.3%. Russia's invasion of Ukraine fueled inflation worries further. Sanctions and trade disruption create supply shocks, putting inflationary pressures on significant Russian exports like oil, natural gas, and metals—each experienced meaningful price increases in the period. Brent crude oil increased by 37%, finishing the quarter at \$104/barrel, while European natural gas futures rose +61%. Our view has been that the lack of investment in new energy projects/production would create an imbalance once demand recovered to pre-pandemic levels; the resulting supply shortage would put upward pressure on energy prices. While this continues to be our view, Russia's invasion of Ukraine has exacerbated the situation. Russia is the world's 11th largest economy, representing just 2% of global GDP. It is the world's largest exporter of natural gas; however, and the third-largest exporter of crude oil. Russia provides more than 40% of Europe's natural gas and more than 25% of its oil.

Europe is particularly impacted by rising energy costs, and a prolonged conflict in Ukraine increases the risk of sustained inflation, resulting in a more hawkish tone by the ECB. Meanwhile, the Bank of England raised its key interest rate for a third time since December despite acknowledging a gloomier economic outlook. The Bank of Canada also raised its overnight interest rate by 25 points in March and is expected to raise it by another 50 basis points at its next policy meeting in April. Japan, on the other hand, continues to keep its short-term interest rate below zero. Higher interest rates are generally bad for equities because it increases the cost of capital and makes fixed income investments a more appealing alternative. It is typically less bad for value than growth for two primary reasons. First, financials represent the lone sector that benefits from rising rates (higher earnings), and financials comprise significantly larger portions of value portfolios/indexes. Second, value equities are shorter duration securities than growth equities. In a discounted cash flow analysis, the terminal value estimate represents the lion's share of a conventional growth stock's value, whereas a conventional value stock will generate meaningful cash flows sooner. We believe the large valuation spreads and macroeconomic backdrop should continue to benefit value relative to growth, which should be a conducive environment for our investment approach.

ATTRIBUTION – 1Q22

The Hotchkis & Wiley International Small Cap Diversified Value portfolio (gross and net of management fees) outperformed the MSCI World ex-USA Small Cap Index in the first quarter of 2022 by a considerable margin. The overweight and stock selection in energy was a positive contributor to performance. Positive stock selection in technology, consumer discretionary, and consumer staples also helped. Stock selection in materials and utilities detracted from performance, along with the underweight exposure to real estate.

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Portfolio characteristics and attribution based on representative International Small Cap Diversified 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 the index, is calculated using daily holdings information and does not reflect management fees and other transaction costs and expenses; interaction effect is combined with stock selection. 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 International Small Cap Diversified Value strategy may prevent or limit investment in major stocks in the MSCI World ex-USA Small Cap, MSCI World ex-USA Small Cap Value and MSCI World ex-USA Small Cap Growth and returns may not be correlated to the indexes. Index returns include reinvestment of dividends, net foreign withholding taxes. 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.

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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.

Market Disruption: The global coronavirus pandemic has caused disruption in the global economy and extreme fluctuations in global capital and financial markets. H&W is unable to predict the impact caused by coronavirus pandemic, which has the potential to negatively impact the firm's investment strategies and investment opportunities.

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