

# INTERNATIONAL SMALL CAP DIVERSIFIED VALUE

## MARKET COMMENTARY

The MSCI World ex-USA Small Cap Index returned +3.4% in the first quarter of 2025. In local currency, the non-US developed market small caps stocks were closer to flat, as the US dollar weakened by about 4% relative to a basket of other major currencies. This was still significantly better than the -9.5% return of US small cap stocks, which sold off sharply as investors appeared to grapple with the frenetic policymaking of the US Administration, particularly with respect to tariffs.

Unlike in the US, where Treasuries rallied and government bond yields fell, non-US government bond yields generally rose. 10-year yields on German, UK, and Japanese government bonds rose modestly. International large caps outperformed small caps, directionally similar to what we observed in the US. Also directionally similar, value outperformed growth by a considerable margin. In US dollar terms, the MSCI World ex-USA Small Cap Value Index returned +5.8% compared to +0.9% for MSCI World ex-USA Small Cap Growth Index. We also observed significant disparity among international small cap sectors, which partly explains the outperformance of value over growth. Materials (+11.6%) and financials (+9.3%) were the top performing sectors, and both are larger weights in the value index, especially financials. Technology (-2.2%) was the biggest laggard and comprises a larger portion of the growth index. Corporate earnings in non-US small cap companies were reasonable, with 56% of companies exceeding consensus expectations.

Small caps are more domestic-focused than large caps, so they should be somewhat less exposed to the effect of tariffs and trade wars. However, small cap equities are “risk on” asset classes and are typically pressured more than large caps during periods of uncertainty. There is often little or no sell-side research coverage, particularly in the smaller part of the small cap market where we find opportunities disproportionately. It is during these periods uncertainty that we see the greatest displacement of stock valuations from the intrinsic values of companies, providing opportunities for value focused investors who have done their homework to generate long-term performance.

Ben Graham referred to the stock market as a voting machine in the short-term and weighing machine in the long-term. Eventually stock prices begin to reflect the underlying businesses’ fundamentals. The stock market favorites of recent years are likely to reflect more realistic projections rather than be priced for perfection. Conversely, shunned companies operating in very good though perhaps less captivating businesses, are likely to be better appreciated for their true earnings power. Put another way, fundamentals should drive the market. We believe such an environment, which could already be underway, would be very conducive to our investment approach.

## ATTRIBUTION ANALYSIS – 1Q25

The International Small Cap Diversified Value portfolio outperformed the MSCI World ex-USA Small Cap Index in the first quarter of 2025 (gross and net of management fees), though lagged the value version of the same index (it was right in between the two). Relative to the broad index, the overweight position in financials helped, as this was among the top performing sectors in the quarter. Positive stock selection in industrials, consumer staples, and energy also helped. The underweight exposure and negative stock selection in materials detracted from performance.

Financials comprise a larger portion of the value index than the core index, so we are less overweight relative to value. This explains part of the reason for the disparity between relative performance. Technology was a lagging sector, and we are more overweight relative to the value sector than the core sector, which was another reason for the difference. Also, value in general outperformed, so our stock selection in other sectors was either negative or less positive relative to the value index. Stock selection in technology and staples helped, while materials hurt.

The portfolio’s outsized exposure to stocks with a market cap of less than \$1 billion hurt relative to both benchmarks as this group of stocks lagged, though positive stock selection in this cohort largely offset the overweight exposure.

As of 3/31/25, net of fee composite and MSCI World ex-USA Small Cap performance for 1-year and Since Inception (7/1/20) periods: 6.01%, 14.10% and 3.58%, 6.80%, respectively. Net performance results are presented after management fees and all trading expenses but before custodial fees; the composite includes all International Small Cap Diversified Value discretionary accounts. Additional disclosures provided in Endnotes.

Past performance is no guarantee of future results.



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**Endnotes:**

All investments contain risk and may lose value. This commentary is for general information only and should not be relied on for investment advice or recommendation of any particular security, strategy, or investment product.

Portfolio characteristics and attribution are based on a representative International Small Cap Diversified Value portfolio. 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. Returns can differ from certain client portfolio(s) due to data differences, cash flows, trading, and other activity (data source: Bloomberg, Russell).

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 and returns may not be correlated to the index. Composite performance is available at [www.hwcm.com](http://www.hwcm.com), located on the strategy's Performance tab along with important disclosures included in the strategy's GIPS Report; quarterly characteristics and portfolio holdings are located on the 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](mailto:hotchkisandwiley@hwcm.com). Portfolio information is subject to the firm's portfolio holdings disclosure policy.

The MSCI World ex-USA Small Cap Index is a free float-adjusted weighted index capturing small cap stocks. The MSCI World ex-USA Small Cap Value and MSCI World ex-USA Small Cap Growth Indices are free float-adjusted weighted indexes capturing small cap stocks, exhibiting overall value or growth style characteristics, respectively. The MSCI indices represent stocks across 22 of 23 Developed Markets (DM) countries, excluding the United States and include reinvestment of dividends, net foreign withholding taxes. Any indices and other financial benchmarks shown are provided for illustrative purposes only, are unmanaged, reflect reinvestment of income and dividends and do not reflect the impact of advisory fees. It is not possible to invest directly in an index.

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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

Information contained in this material may represent or be based on forward-looking statements. Due to various risks and uncertainties, actual events/results or performance of the strategy may differ materially from those reflected or contemplated in such forward-looking statements. Information based on forecasts, proprietary or third-party estimates cannot be guaranteed and are subject to change. Information obtained from independent sources is considered reliable, but H&W cannot guarantee its accuracy or completeness.

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