

# LARGE CAP FUNDAMENTAL VALUE

## MARKET COMMENTARY

The S&P 500 Index declined -4.3% in the first quarter of 2025. The market had been positive until March, when investors appeared to grapple with the frenetic policymaking of the Administration, particularly with respect to tariffs. In a major reversal from recent periods, the decline was led by mega cap growth stocks. The Magnificent Seven comprised more than one-third of the S&P 500 at the beginning of the quarter and declined -14% collectively. The other 493 stocks returned a collective +0.6%. The Magnificent Seven comprises more than half of the large growth index; consequently, large value trounced large growth in the quarter. The Russell 1000 Value Index returned +2.1% compared to -10.0% for the Russell 1000 Growth Index. The 12-percentage point advantage represents value's largest calendar quarter outperformance since early 2001. We have been espousing similarities between today's equity market and that of the early 2000s. Like then, we continue to observe rather severe value dislocations across various segments of the market and believe further correction/normalization is more likely than not.

Treasuries rallied during the equity market selloff, with the yield on the 10-year note declining from 4.6% to 4.2% over the quarter. The US dollar weakened by about 4% relative to a basket of other major currencies, which along with the absence of the Magnificent Seven helps explain the significant outperformance of non-US equities over US equities. Performance deviations by sector were significant. Only 4 of the 11 S&P 500 GICS sectors were negative in the quarter, though these four sectors comprise about 60% of the index. Consumer discretionary (10% of index, -14% decline), technology (30%, -13%), communication services (9%, -6%), and industrials (8%, -0.2%) were the decliners. Energy was the top-performing sector. Oil prices were little changed, but natural gas prices rose. More importantly, energy company earnings exceeded expectations, with 19 of the 23 S&P 500 energy companies reporting a positive surprise by an average magnitude of 26%. This was a bit better than the overall market, where 78% of S&P 500 companies beat consensus earnings, by an average magnitude of 16%. Less cyclical

sectors also performed well: healthcare returned +7%, consumer staples +5%, and utilities +5%. As a group, we are slightly underweight these sectors relative to the Russell 1000 Value (25% vs. 28%), but we have increased our exposure by 5 percentage points over the past year, and 8 percentage points over the past 2 years. This reallocation has worked in our favor.

The portfolio trades at 8x our estimate of normal earnings, which is right in line with its historical average. The Russell 1000 Value, however, trades at about 17x normal earnings, a more than 20% premium to its historical average. The Russell 1000 Growth, even after this quarter's correction, trades at 29x normal, a nearly 40% premium to its historical average. Our portfolio exhibits a ~12% earnings yield, an attractive valuation, particularly considering the broad market's frothy price multiples. Valuation advantages can often be achieved by assuming outsized risks, but this is not something we are willing to do. Over the past several years, the portfolio's Fundamental Risk Ratings have remained steady in the face of high market multiples. The portfolio's return-on-equity, an imperfect though reasonable yardstick for quality, has also been consistent in the mid- to high-teens. We believe the overall balance of valuation/upside relative to risk is attractive.

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.

*(continued)*

As of 3/31/25, net of fee composite and Russell 1000 Value performance for 1-, 5-, and 10-year period: 5.63%, 21.64%, 9.89% and 7.18%, 16.15%, 8.79%, respectively. Net performance results are presented after management fees and all trading expenses but before custodial fees; the composite includes all Large Cap Fundamental Value discretionary accounts. Additional disclosures provided in Endnotes.

Past performance is no guarantee of future results.



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## ATTRIBUTION ANALYSIS – 1Q25

The Large Cap Fundamental Value portfolio outperformed the Russell 1000 Value Index in the first quarter of 2025 (gross and net of management fees). Healthcare was the largest positive contributor to relative performance in the quarter by a significant margin. Three years ago, healthcare was among the portfolio's largest underweight positions. Since then, the sector has underperformed the rest of the market, and we identified numerous attractive risk-adjusted valuation opportunities. We increased the portfolio's healthcare weight meaningfully and are now slightly overweight. While this overweight helped modestly in the quarter, stock selection was significantly positive as our healthcare stocks rose +19% vs. +6% for the index's healthcare stocks. Positive stock selection in technology was also considerably positive. On the negative side, stock selection in communication services, energy, materials, and consumer discretionary detracted from relative performance.

## LARGEST INDIVIDUAL CONTRIBUTORS – 1Q25

CVS Health Corp. (CVS) is a diversified healthcare company operating a Pharmacy Benefits Manager (PBM), health insurer, and retail stores and pharmacies. In January, CVS and other health insurers with large Medicare Advantage plans rose after the Centers for Medicare & Medicaid Services published better-than-expected reimbursement rates for 2026. CVS maintained that momentum in February by reporting expected fourth-quarter results. It then reported decent quarterly results. The PBM segment and physical stores were in line with expectations. However, Aetna incurred losses across multiple lines of business, driven by Medicare Advantage and the Exchanges. Despite this, the losses in the health insurance segment were less severe than anticipated, leading to a positive market reaction.

American International Group Inc. (AIG) is a leading commercial insurance company, providing property-casualty insurance, life insurance, and risk management products. Over the quarter, shares of AIG rose after the insurer authorized the repurchase of \$7.5 bn of common stock and announced an ambitious 2025-2027 growth target for operating EPS. We believe AIG is poised for further improvements in operating performance. AIG has an improving return on equity and good management that is committed to smart allocation of its excess capital, which its current valuation does not fully reflect.

Elevance Health Inc (ELV), formerly known as Anthem, is a large health insurer, and the largest commercial health insurer. ELV is priced at a discount to the market; however, it is a superior business, growing faster than GDP while still returning most of its cash to shareholders. ELV reported earnings that were in line with consensus. Costs remain elevated but ELV reported signs of stabilization in Medicaid utilization trends. Management also provided guidance for stable Medicare Advantage margins in 2025. Overall, this was a positive quarter for ELV as commercial performance remains strong and it showed signs of normalization for utilization and cost trends.

## LARGEST INDIVIDUAL DETRACTORS – 1Q25

Olin Corp. (OLN) is one of the largest producers of chlor alkali chemicals and chlorine derivatives. The stock price fell during the quarter after posting weak earnings results due to low operating rates, weak commodity prices, and continued destocking in the Winchester business. Chlorine derivative and caustic soda prices should increase over time as the North American chlor alkali industry faces a tightening 5+ year supply/demand outlook. As the swing producer in North America, Olin should capture more than its share of the industry's volume improvement off the trough. Olin's balance sheet is strong, and capital allocation has been shareholder friendly. The company continues to provide diversification benefits to our existing commodity exposure.

Magna International Inc. (MGA) based in Ontario Canada, is the fifth largest global auto supplier. Shares fell over the period, along with other Canadian auto parts suppliers, due to the potential of heightened tariffs between Canada and the United States. The stock was further pressured after the company provided FY2025 guidance that was below consensus estimates. The weak guide was driven by lower light vehicle production estimates. We believe the stock is undervalued as it is a cyclical auto supplier that is facing near-term headwinds. Magna has the capability to supply close to two thirds of a vehicle's content, including Auto2.0 technology.

Alphabet's Google (GOOGL) declined in the quarter after reporting mixed Q4 earnings results. Shares continue to trade at an attractive valuation despite healthy growth potential, an overcapitalized balance sheet, and significant value in Cloud, Other Bets, and new advertising products.

See previous page for full strategy performance. The specific investments shown are for informational purposes only and represent the top contributors and detractors for the relevant performance time period. The selection criteria used to determine the top contributors and detractors remains the same across performance measurement periods; 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 Large Cap Fundamental Value portfolio. Attribution is an analysis of the portfolio's gross of fee returns 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.

Specific securities identified are the three 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. There is no assurance that the securities discussed will remain in the portfolio or that securities sold have not been repurchased. The securities discussed do not represent the entire portfolio, may only represent a small portion of the portfolio and should not assume the securities discussed were or will be profitable or that recommendations made in the future will be profitable or will equal the performance of the securities discussed. H&W's opinions regarding these securities are subject to change at any time, for any reason, without notice. Certain client portfolio(s) may or may not hold the securities discussed due to each account's guideline restrictions and other relevant considerations.

The value discipline used in managing accounts in the Large Cap Fundamental Value strategy may prevent or limit investment in major stocks in the Russell 1000 Value 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 Russell 1000® Value Index measures the performance of those Russell 1000® companies with lower price-to-book ratios and lower forecasted growth values. The Russell 1000® Growth Index measures the performance of those Russell 1000® Index companies with higher price-to-book ratios and higher forecasted growth values. The S&P 500® Index is a broad-based unmanaged index of 500 stocks, which is widely recognized as representative of the equity market in general. 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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The Magnificent Seven represents Meta, Alphabet, Tesla, Nvidia, Apple, Amazon, and Microsoft.

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 foreign as well as emerging markets involves additional risk such as greater volatility, political, economic, and currency risks and differences in accounting methods. Investment risk disclosures for the firm's strategies are described in Part 2A of Form ADV of H&W.

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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