SMALL CAP DIVERSIFIED VALUE

MARKET COMMENTARY

The Russell 2000 Index declined -9.5% in the first quarter of 2025, which was notably worse than the Russell 1000 Index's decline of -4.5%. Small cap stocks were positive in the first half of the quarter, until investors appeared to grapple with the frenetic policymaking of the Administration, particularly with respect to tariffs. 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 sell-off, 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. Utilities returned a positive 5% while consumer staples were flat. Technology (-18%), consumer discretionary (-15%), communication services (-12%), and energy (-12%) were the Russell 2000's biggest laggards. Corporate earnings for small caps were generally positive, with two-thirds of Russell 2000 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. However, small cap equities are "risk on" asset classes and are typically pressured more than large caps during periods of uncertainty. Small cap equities are not followed as closely by Wall Street. There is often little or no sell-side research coverage, particularly in the smaller part of the small cap market. 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. During such periods, we are often inclined to increase the frequency of our rebalancing, to take advantage of such displacements.

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 Small Cap Diversified Value portfolio underperformed the Russell 2000 Value Index in the first quarter of 2025, albeit modestly (gross and net of management fees). The portfolio's micro-cap exposure was a detractor in the quarter, as it generally has been in recent years. Russell 2000 Value stocks that began the year with a market cap of less than $1 billion returned -12% in the quarter compared to -7% for stocks above $1 billion. The portfolio's average weight in the smaller cohort was 28% during the quarter compared to 18% for the index. The underweight position and stock selection in real estate also hurt, along with the overweight exposure and stock selection in consumer discretionary. The underweight exposure and stock selection in healthcare was a positive contributor in the quarter, as was positive stock selection in industrials, energy, and technology.

As of 3/31/25, net of fee composite and Russell 2000 Value Index performance for 1-, 5-, and 10-year periods: -4.77%, 19.58%, 7.74% and -3.12%, 15.31%, 6.07%, respectively. Net performance results are presented after management fees and all trading expenses but before custodial fees; the composite includes all Small Cap Diversified Value discretionary accounts. Additional disclosures provided in Endnotes.

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 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 Small Cap Diversified Value strategy may prevent or limit investment in major stocks in the Russell 2000 Value Index and returns may not be correlated to the index. Composite performance is available at 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. Portfolio information is subject to the firm's portfolio holdings disclosure policy.

The Russell 2000® Index measures the performance of the 2,000 smallest companies in the Russell 3000® Index. The Russell 2000® Value Index measures the performance of those Russell 2000® companies with lower price-to-book ratios and lower forecasted growth values. The Russell 1000® Index, a subset of the Russell 3000 Index, represents the 1000 top companies by market capitalization in the U.S. 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 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. 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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