International Value
3Q 2017 Commentary

Hotchkis & Wiley

September 30, 2017

MARKET COMMENTARY

In US Dollar terms, the Russell Developed ex-US Index returned +5.9% in the three months ended September 30th, its 3rd consecutive positive quarter. In local currency, the index was up slightly less as both the Euro and the Pound appreciated relative to the Dollar by about 3%. The index's solid performance over the past 5 years reflects an attractive starting point, a period of reasonably healthy corporate earnings growth, and what has generally been a supportive global economic environment. Accordingly, we consider much of the performance over this period to represent a justified reversion towards more normal market valuations as opposed to the speculative gains of a market that has overheated dramatically. With most valuation measures above long-term historical averages, the rally may have overshot but not wildly so—we are not alarmed, we are guarded.

We continue to find value opportunities selectively, though it is more difficult today than it was 5 years ago. An important benefit of a global strategy is that the opportunity set to select from is broad. Consequently, we are able to find attractive investments even when the broader global equity market appears to be fully valued, as it does today. Industrials, financials, and technology represent the portfolio's largest weights; we are underweight materials, consumer discretionary, consumer staples, real estate, and utilities. The former sectors not only trade at considerable valuation discounts but also have higher earnings growth expectations over the next two years compared to the latter sectors. We are always leery of paying high multiples for stocks, particularly when growth prospects are bleak.

While select market segments appear richly valued, others remain quite attractive. Given this dichotomy, our portfolio's composition and its characteristics are vastly different from the index. The valuation discount is particularly striking; the portfolio trades at 9x normal earnings compared to 15x for the Russell Developed ex-US Index. The portfolio trades at 1.3x book value compared to 1.7x for the index.

ATTRIBUTION: 3Q 2017

The Hotchkis & Wiley International Value portfolio (gross of management fees) performed in line with the Russell Developed ex-US Index in the third quarter; underperformed net of fees. Positive stock selection in consumer staples, consumer discretionary, and healthcare helped relative performance. This was offset by stock selection in materials and technology. The largest individual contributors to relative performance in the period were WestJet Airlines, Frank's International, Philips, WorleyParsons, and Kosmos Energy; the largest detractors were Ericsson, Tikkurila, Royal Mail, Ophir Energy, and Barclays.

PORTFOLIO ACTIVITY: 3Q 2017

The International Value portfolio added two new positions during the quarter:

Frank's International (FI) provides tubular services for the drilling of offshore oil & gas wells. The company has a leading market share in this business and generates strong mid-cycle margins and returns on capital. The shares trade at a low multiple of normal earnings and the company has a net cash balance sheet with no debt. The company believes it should be able to sustain cash flow break-even or better even in the current difficult environment.

Johnson Controls (JCI) is a diversified industrial company. The company is a leading provider of security products and services, lead acid batteries, and products and services related to building and energy management such as HVAC. These businesses have leading market positions protected by durable advantages. We believe that the market is underestimating both the potential for profitable growth from these businesses, as well the tax and operational synergies that may emerge from the company's 2016 merger with Tyco International.

Composite performance is available at www.hwcm.com, located on the strategy's Performance tab. Returns discussed can differ from actual portfolio returns due to intraday trades, cash flows, corporate actions, accrued/miscellaneous income, and trade price and closing price difference of any given security. Portfolio attribution is based on a representative International 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. Equity performance attribution is an analysis of the portfolio's return relative to a selected benchmark, is calculated using daily holding information and does not reflect management fees and other transaction costs and expenses. Specific securities identified are the largest contributors (or detractors) to the portfolio's performance relative to the Russell Developed ex-US Index. Other securities may have been the best and worst performers on an absolute basis. The Portfolio Activity section includes the largest new positions in the period excluding any security received as a result of a corporate action; if fewer than three new positions were purchased, all new purchases are included. Securities identified do not represent all of the securities purchased or sold for advisory clients, and are not indicative of current or future holdings or trading activity. H&W has no obligation to disclose purchases or sales of the securities. No assurance is made that any securities identified, or all investment decisions by H&W were or will be profitable. Quarterly characteristics and portfolio holdings are available at www.hwcm.com, located on the strategy's Characteristics 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, please contact H&W at hotchkisandwiley@hwcm.com. Portfolio information is subject to the firm's portfolio holdings disclosure policy.

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