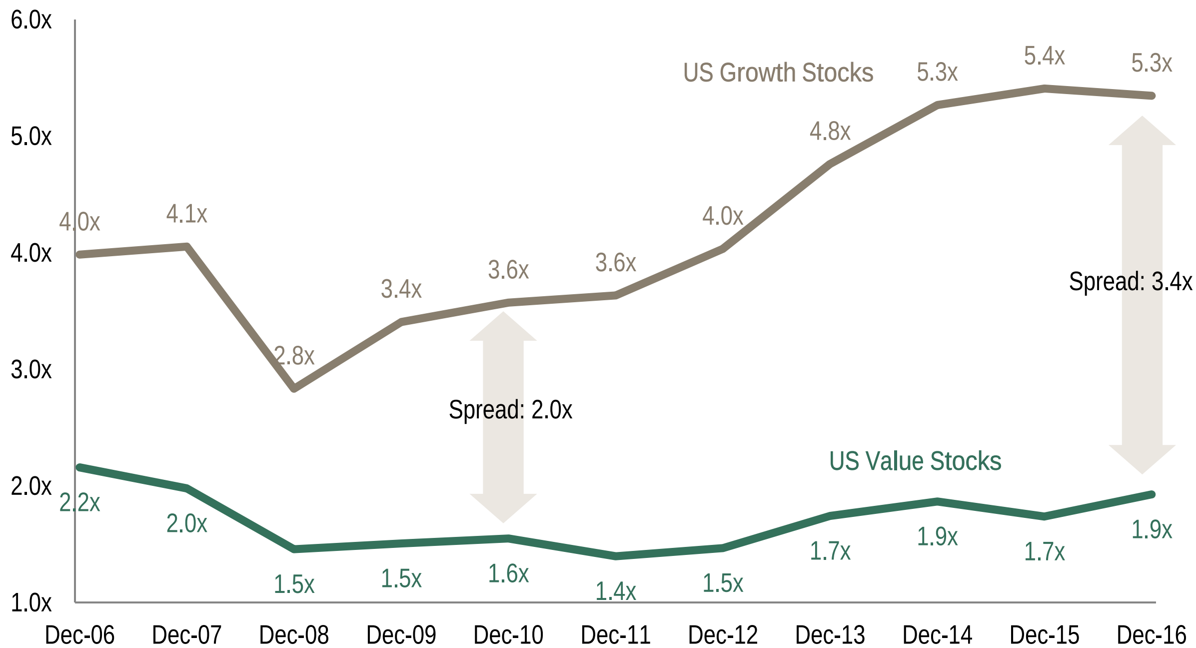
A Good Time for Value Investors

Hotchkis & Wiley

Data as of December 31, 2016

Innumerable studies have demonstrated that value stocks have outperformed growth stocks in the long run[1]. The market moves in growth and value cycles; however, growth stocks do outperform intermittently. The duration of these intermittent periods can vary tremendously, and attempting to time cycle turning points can be a futile effort. The most recent growth cycle has persisted for an unusually long period, with growth stocks having outperformed value stocks in the US by more than 45 percentage points cumulatively over the past decade (the Russell 1000 Growth Index has returned +121%, the Russell 1000 Value Index has returned +75%). This differential between value and growth in other developed countries has been comparable. As a result, the valuation premium of growth stocks relative to value stocks has widened considerably. As shown in the chart below, the price-to-book ratio for value stocks has remained rather stable while the price-to-book ratio for growth stocks has ballooned. The premium, or spread, has widened by a large magnitude. We do not know when value dislocations will revert, nor are we certain that these dislocations will not widen further before reverting. We have learned from past experience, however, that these cycles inevitably do normalize and we believe that value investors are well-positioned to reap the rewards.

Price-to-Book Ratio



Source: Bloomberg, US Growth Stocks: Russell 3000 Growth Index, US Value Stocks: Russell 3000 Value Index

One of the causes of value dislocations has been what many pundits have described as “risk off”, “flight to safety”, “low volatility”, “bond proxy” etc. Investors have flooded to non-cyclical businesses at the expense of cyclical business, regardless of valuation. Macroeconomic shocks like Brexit have only exacerbated this divergence. True to Benjamin Graham, we view stocks trading at discounts to intrinsic value as having a “margin of safety”. Ironically, it has become difficult to identify a “margin of safety” in businesses currently perceived as “safe” because their valuations have become stretched. We believe investing in the stock of a stable business is not a safe investment if you have to overpay for the value of the underlying enterprise.

Past Performance is not a guarantee or a reliable indicator of future results.

Again, timing cycle turning points is difficult at best. By definition, however, all cycles revert and the value dislocations in the current market cannot widen indefinitely. As such, the current environment has presented value investors with some uncommon opportunities. The valuation discrepancy between our portfolios and their benchmarks is rather striking in today's market, and we believe prudent investors should consider increasing allocations to value given the attractive prospects.

Index performance is not indicative of fund performance. An investment cannot be made directly in an index. To obtain fund performance please visit www.hwcm.com or call 800-796-5606.

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Mutual fund investing involves risks. Principal loss is possible. Investing in value stocks presents the risk that value stocks may fall out of favor with investors and underperform other asset types during a given periods. Investing in small and medium-sized companies involves greater risks than those associated with investing in large company stocks, such as business risk, significant stock price fluctuations and illiquidity. An investment in the Hotchkis and Wiley mutual funds may include, but is not limited to, non-diversified fund risk, ETF risks, derivative securities risk, Asset Backed and Mortgage Backed Securities risk, debt security risk, high yield security risk, credit risk, prepayment risk, illiquidity and default risk, foreign security risk, and ADR risk. Please read the prospectus carefully for a complete list of risks.

Equities, bonds, and other asset classes have different risk profiles, which should be considered when investing. All investments contain risk and may lose value. Price-to-Book Ratio is the price of a stock divided by its book value. Margin of safety is a principle of investing in which an investor only purchases securities when the market price is significantly below its intrinsic value. In other words, when market price is significantly below your estimation of the intrinsic value, the difference is the margin of safety. The Russell 1000® Index measures the performance of those 1,000 largest companies in the Russell 3000® Index, which represents approximately 92% of the total market capitalization of the Russell 3000® Index. The Russell 1000® Value Index measures the performance of those Russell 1000® Index 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 indices do not reflect the payment of transaction costs, fees and expenses associated with an investment in the Fund. It is not possible to invest directly in an index. The Fund's returns may not correlate with the returns of its benchmark indices.

[1]Chan, Louis K.C. and Lakonishok, Josef (2004), Value and Growth Investing: Review and Update, Financial Analysts Journal. Capaul, Carlo, Rowley, Ian, and Sharpe, William F. (1993), International Value and Growth Stock Returns, Financial Analysts Journal.

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