# CAPITAL INCOME FUND
## Commentary
Second Quarter 2019

Hotchkis & Wiley

## Manager Review and Economic Outlook

### Investment Strategy

The Hotchkis & Wiley Capital Income Fund invests in both value equity securities and high yielding fixed income securities with an emphasis on income generation. The long-term allocation target between value equities and high yielding fixed income securities is 50/50. The portfolio has two benchmarks, the S&P 500 Index ("the equity benchmark") and the ICE BofAML US Corporate, Government & Mortgage Index ("the fixed income benchmark"). These benchmarks are averaged, using the portfolio's long-term allocation targets, to produce a "50/50 blended benchmark" to help assess performance.

### Market Commentary

The S&P 500 Index returned +4.3% in the second quarter and is now up +18.5% since the beginning of the year, fully recouping its losses from the fourth quarter of 2018. An increasingly dovish tone from central banks, most notably the US Federal Reserve, contributed to positive equity markets. Fed Chairman Jay Powell indicated a readiness to lower interest rates for the first time in more than a decade, and the futures market is pricing in a high likelihood of a rate cut during the Fed's next meeting. In addition, geopolitical tensions subsided, as the US reached a deal with Mexico to halt proposed tariffs, and US-China trade talks resumed. All equity and high yield sectors were positive except energy, as crude prices declined by 3% in the quarter.

Growth equities again outpaced value, further widening the valuation gap. Over the past five years, the Russell 1000 Growth Index has more than doubled the Russell 1000 Value Index, returning +87% compared to +43%, cumulatively. A top-down view would suggest that the global equity markets are fairly valued. However, this is far from a normal market; significant valuation differences exist within and between sectors, geographies and even asset classes. On the one hand, the market's valuation suggests that investors have a reasonably healthy risk appetite. On the other hand, certain attributes imply that investors are exceptionally risk averse. A glaring example is the negative yield on some country's government debt, like German bunds, where investors are guaranteed to lose money if held to maturity. A preference for a small, yet certain loss over a wider range of outcomes exemplifies extreme risk aversion. This risk aversion is borne out in equity markets through a comparison of different sectors. Sectors with low economic sensitivity and stable earnings streams have outperformed sectors believed to be more cyclical. Regulated utilities, for example, are largely insulated from economic slowdowns and exhibit more stable earnings than most other businesses. This has appealed to risk averse equity investors, which have flooded the sector with capital. As a result, utilities' P/E multiples are now close to 20x, an increase of 20% over the past five years. We view this as a rich price to pay for a sector with modest prospects for growth, and do not view this as a safe investment. While it does not represent a certain loss, the long-term upside potential at these valuations are paltry at best. Most REITs, consumer staples, and healthcare companies exhibit a similarly unappealing long-term risk-reward tradeoff.

In many cases, banks and other financials trade at half the valuation of the non-cyclical markets segments. Select companies within industrials, energy, and consumer discretionary also trade at substantial discounts to their intrinsic values. These sectors may have a higher correlation with economic cycles than non-cyclicals, but valuations render the long-term return prospects more appealing irrespective of near-term economic growth. Businesses with strong balance sheets that are well-positioned competitively should be able to sustain and grow their value through the full economic cycle. Some may even enhance their value at the expense of weaker peers during times of economic volatility. In our view, these types of businesses represent compelling investment opportunities.

The high yield default environment remains benign relative to average. The default rate, including distressed exchanges, is 1.55% which is less than half of the 20-year average. This is down 0.34% since the beginning of the year and down 0.50% year-over-year. During the first half of 2019, 13 high yield bonds defaulted and 2 went through a distressed exchange, for a total par value of about $14 billion ($8 billion occurred during the second quarter). The market's average post-default recovery rate stands at 36%, slightly less than the long-term average of 41%. This is a bit misleading, however, considering that defaults have been few and far between. About one-third of this year's default activity was in the energy sector. Less than 1% of the market trades for under 50% of par value and less than 5% trades for under 70% of par value, reflecting the market's view that fundamentals remain sound. The new issue market has picked up from 2018's slowdown, and remains on a pace slightly lighter than average for the past decade. About two-thirds of all issuance has been for refinancing and less than 20% for leveraged buyout/acquisition activity. Just 10% of new issuance was CCC-rated debt and more than two-thirds of that was for refinancing.

Both the high yield and equity markets are close to fairly valued, but both also provide opportunities for active managers. We view the ability to invest across companies of all sizes and across the capital structure as a considerable advantage in such environments. We have identified interesting opportunities across both spectrums and are optimistic about the portfolio's prospects as we look forward.

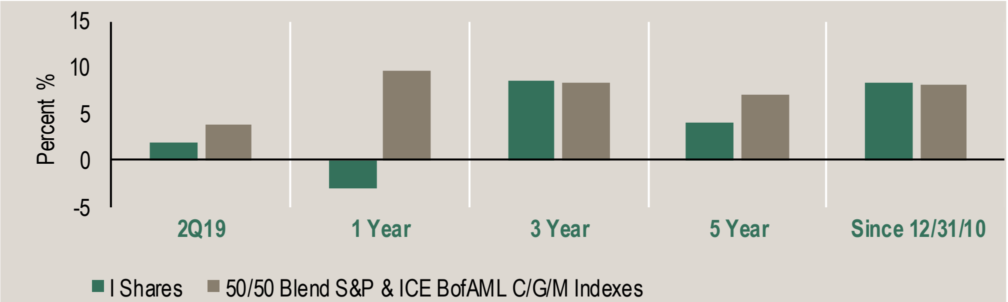
### Attribution and Management Discussion: 2Q 2019

The Hotchkis & Wiley Capital Income Fund underperformed the 50/50 blended benchmark in the second quarter of 2019. The average equity weight was 56% and the average high yield bond weight was 44% over the course of the quarter. The equity overweight helped modestly as equities outperformed bonds.

The equity portion of the portfolio underperformed the S&P 500 Index during the quarter. Growth again outperformed value which represents a headwind for our value focused investment approach. Small and mid cap stocks lagged large caps, which was another stylistic headwind as the strategy invests across the cap spectrum. From a sector standpoint, the overweight position and stock selection in energy was the largest detractor. The overweight position in financials, underweight position in healthcare, and positive stock selection in industrials helped relative performance. The largest individual detractors to relative performance were Whiting Petroleum, Office Depot, Royal Mail, Quintana Energy Services, and Credito Valtellinese; the largest positive contributors were WestJet Airlines, AIG, Adient, Discovery, and Fifth Street Asset Management.

The high yield bond portion of the portfolio underperformed the ICE BofAML US Corporate, Government & Mortgage Index and the ICE BofAML US High Yield Index. The overweight position in mid and small cap credits hurt relative performance as larger credits outperformed. Credit selection in basic industry, consumer goods, and retail hurt performance along with the underweight position in telecommunications. The overweight position in energy also hurt but this was offset by positive credit selection in the sector.

## Performance as of June 30, 2019




| | 2Q19 | 1 Year | 3 Year | 5 Year | Since 12/31/10 |
|---|---|---|---|---|---|
| I Shares | 1.98% | -3.13% | 8.49% | 4.14% | 8.38% |
| A Shares without sales charge | 1.91 | -3.17 | 8.24 | 3.95 | 8.48 |
| A Shares | -2.93 | -7.80 | 6.49 | 2.94 | 7.86 |
| S&P 500 Index | 4.30 | 10.42 | 14.19 | 10.71 | 12.85 |
| ICE BofAML US Corp., Govt. & Mtg. Index | 3.17 | 8.03 | 2.33 | 3.03 | 3.42 |
| 50/50 Blend S&P & ICE BofAML C/G/M Indexes | 3.89 | 9.71 | 8.33 | 7.02 | 8.25 |
| ICE BofAML US High Yield Index | 2.56 | 7.58 | 7.54 | 4.70 | 6.61 |

| Yield | I Shares | A Shares | A Shares (Load) |
|---|---|---|---|
| 30-Day SEC Yield with expense waiver | 3.97% | 3.55% | 3.38% |
| 30-Day SEC Yield without expense waiver | 3.50% | 3.10% | 2.95% |

**The Advisor has contractually agreed to waive advisory fees and/or reimburse expenses through August 29, 2020 so the net expense ratio does not exceed 0.80% for I Shares and 1.05% for A Shares. Over the past 12 months, the Fund invested in business development companies, which produced acquired fund fees and expenses ("AFFE") of 0.01%. The reported net expense ratio is the expense ratio cap plus AFFE, or 0.81% for I Shares and 1.06% for A Shares. Net expense ratios were applicable to investors. The Fund's total annual operating gross expense ratio as of the most current prospectus is 1.34% for I Shares and 1.62% for A Shares.**

**The performance shown represents past performance. Past performance is no guarantee of future results and current performance may be higher or lower than the performance shown. Short-term performance, in particular, is not a good indication of the fund's future performance, and an investment should not be made based solely on returns. Investment results and principal value will fluctuate so that shares, when redeemed, may be worth more or less than their original cost. To obtain performance data current to the most recent month-end, access our website at www.hwcm.com.**

**You should consider the Fund's investment objectives, risks, and charges and expenses carefully before you invest. This and other important information is contained in the Fund's summary prospectus and prospectus, which can be obtained by calling 1-800-796-5606 or visiting our website at www.hwcm.com. Read carefully before you invest.**

**Returns shown for A shares for the periods prior to their inception are derived from the historical performance of I Shares of the Fund during such periods and have been adjusted to reflect the higher total annual operating expenses of each specific Share class (Inception date: Class I-12/31/10, Class A-2/28/11). Returns shown for A returns without sales charge does not reflect the maximum sales load of 4.75%; if reflected, performance would be lower than shown. All other returns reflect the deduction of the current maximum initial sales charges of 4.75%.** Class I shares sold to a limited group of investors. Total returns include reinvestment of dividends and capital gains. Expense limitations may have increased the Fund's total return.

Investment grade indicates that a municipal or corporate bond has a relatively low risk of default. Price-to-Earnings (P/E) is calculated by dividing the current price of a stock by the company's trailing 12 months' earnings per share. Top ten equity holdings as of 6/30/19 as a % of the Fund's net assets: General Electric Co. 3.2%, American Int'l Group Inc. 2.6%, Whiting Petroleum Corp. 2.3%, Goldman Sachs Group Inc. 2.2%, Wells Fargo & Co. 2.0%, Discovery Inc. 1.9%, BAE Systems PLC 1.8%, Seritage Growth Properties 1.7%, Magna International Inc. 1.5% and GEO Group Inc. 1.5%. Fund holdings are subject to change and are not recommendations to buy or sell any security. Credit quality weights by rating were derived from the highest bond rating as determined by S&P, Moody's or Fitch. Bond ratings are grades given to bonds that indicate their credit quality as determined by private independent rating services such as Standard & Poor's, Moody's and Fitch. These firms evaluate a bond issuer's financial strength, or its ability to pay a bond's principal and interest in a timely fashion. Ratings are expressed as letters ranging from 'AAA', which is the highest grade, to 'D', which is the lowest grade. In limited situations when none of the three rating agencies have issued a formal rating, the Advisor will classify the security as nonrated.

### Classes & Tickers

| | |
|---|---|
| I Shares | HWIIX |
| A Shares | HWIAX |

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. 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 ICE BofAML US Corp., Govt. & Mtg. Index is a broad-based measure of the total rate of return performance of the US investment grade bond markets. The ICE BofAML US High Yield Index tracks the performance of below investment grade, but not in default, US dollar-denominated corporate bonds publicly issued in the US domestic market, and includes issues with a credit rating of BBB or below, as rated by Moody's and S&P. The 50/50 benchmark is an average, equal weighted blend of the S&P 500® Index and ICE BofAML US Corp., Govt. & Mtg. Index. The indices do not reflect the payment of transaction costs, fees and expenses associated with an investment in the Fund. The Fund's value disciplines may prevent or restrict investment in major stocks in the benchmark indices. It is not possible to invest directly in an index. The Fund's returns may not correlate with the returns of their benchmark indices.

*Mutual fund investing involves risk. Principal loss is possible. Investments in debt securities typically decrease in value when interest rates rise. This risk is usually greater for longer-term debt securities. Investment by the fund in lower-rated and non-rated securities presents a greater risk of loss to principal and interest than higher-rated securities. The Fund may invest in derivative securities, which derive their performance from the performance of an underlying asset, index, interest rate or currency exchange rate. Derivatives can be volatile and involve various types and degrees of risks. Depending on the characteristics of the particular derivative, it could become illiquid. Investment in Asset Backed and Mortgage Backed Securities include additional risks that investors should be aware of such as credit risk, prepayment risk, possible illiquidity and default, as well as increased susceptibility to adverse economic developments. The Fund may invest in foreign as well as emerging markets which involve greater volatility and political, economic and currency risks and differences in accounting methods.*

Specific securities identified are the largest contributors (or detractors) on a relative basis to the S&P 500 Index. Securities' absolute performance may reflect different results. The Fund may not continue to hold the securities mentioned and the Advisor has no obligation to disclose purchases or sales of these securities. Attribution is an analysis of the portfolio's return relative to a selected benchmark, is calculated using daily holding information and does not reflect the payment of transaction costs, fees and expenses of the Fund.

**NOT FDIC INSURED**
**NO BANK GUARANTEE**
**MAY LOSE VALUE**

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