

# Hotchkis & Wiley Mid-Cap Value I HWMIX

These days, being contrarian means being deep value.

## Morningstar's Take HWMIX

**Morningstar Rating** ★★

**Morningstar Analyst Rating** Bronze

### Morningstar Pillars

Process	+	Positive
Performance	+	Positive
People	+	Positive
Parent	+	Positive
Price	-	Negative

### Role In Portfolio

Supporting

### Fund Performance HWMIX

Year	Total Return (%)	+/- Category
YTD	16.12	3.18
2018	-19.29	-6.43
2017	7.78	-5.44
2016	21.00	2.94
2015	-12.53	-7.12

Data through 3-31-19

3-06-19 | by Kevin McDevitt

Hotchkis & Wiley Mid-Cap Value is consistently aggressive, although not always deep value. It earns a Morningstar Analyst Rating of Bronze.

This fund's results during the five months through February 2019 were a performance microcosm. Its historical pattern has been to lag its average peer and the Russell Mid-Cap Value Index during downturns but compensate with outperformance during rallies. That combination played out recently as the fund fell 15.2% during 2018's fourth-quarter correction versus the index's 10.5% decline. But the market turned on a dime in 2019, and the fund gained a roaring 23.2% for the year to date through Feb. 22 versus 14.6% for the index. This volatility has led to index-beating returns during manager Stan Majcher's tenure but more modest results on a risk-adjusted basis.

Much of the fund's recent volatility stems from its deep-value portfolio. Majcher moved the fund into more deep-value names in recent years as the valuation gap between value and growth stocks grew. His conviction contrasted with some relative-value peers who drifted toward higher-multiple stocks to avoid getting left behind as growth stocks soared. He particularly favored energy and financials stocks, with the two sectors claiming 45% of the December 2018 portfolio. The fund also had 18.3% of the portfolio in foreign stocks, which tend to have lower price multiples than their U.S. counterparts. That stake is the fifth-greatest weighting in the mid-value Morningstar Category. The net result is average price multiples that are well below the index's.

But Majcher doesn't buy deep-value stocks as a matter of course; his conviction there is based on the potential opportunity. As recently as 2017, the portfolio's average price multiples landed close to the category norms. That said, Majcher has kept the fund consistently in value territory. He has also maintained a big position in small-cap stocks, which claimed 35.6% of the December 2018 portfolio, nearly triple the category average.

This fund's aggressiveness makes it appropriate for a complementary role in a portfolio and for those who can handle its dramatic swings.

**Process Pillar** + Positive | Kevin McDevitt 03/06/2019

Hotchkis & Wiley has long used the same contrarian, value-oriented philosophy across the firm's equity strategies. It tries to capitalize on short-term market mispricings of companies with better long-term earnings potential, using normalized earnings and adjusting for risk. Valuation screens are done by each sector team to come up with ideas and include such metrics as P/E, enterprise value/EBIT, price/book, high free cash flow, balance-sheet strength, and return on capital. The sector teams also evaluate

industry and company dynamics and assess company management and risk factors.

Each sector team does peer reviews of each potential holding to challenge assumptions and review stock-specific and industry-level risk. The team also occasionally brings in sell-side analysts to aid in discussions and present an opposing case. It sells stocks because of rising valuations, better opportunities, deteriorating fundamentals, or to improve the fund's diversification. The fund, usually close to fully invested, typically holds 55-65 stocks with about a third of assets in the top 10. Turnover has averaged 57% over the past decade. Sector weightings are a reflection of where the team is finding value rather than closely tracking a benchmark. The contrarian process comes with volatility, but the team has stuck with it—even in down periods—supporting its Positive Process rating.

Owing to what he believes is a historically wide spread between value and growth-stock valuations, manager Stan Majcher has doubled down on deep-value stocks. The fund's average price metrics (price/book, P/E, price/sales) are all well below the Russell Mid Cap Value Index's as of December 2018. The portfolio's P/B ratio was just 0.8 versus the index's 1.8. However, these are not high-quality names, as the portfolio also had lower average returns on assets and net margins.

These low price multiples and quality metrics stem largely from the fund's big position in cyclical stocks. As of December 2018, it had a 20% energy position, more than triple the index's weighting. That said, Majcher doesn't believe that energy demand in particular is as cyclical as the market believes; plus, he believes that U.S. shale growth will decline, putting pressure on supply. He also had notable overweightings in industrials (14.3% versus the index's 12.0%) and financials (25.4% versus 17.7%).

The fund maintained little exposure to value staples, utilities, and real estate stocks. Majcher believes both sectors remain expensive as bond proxies, with utilities dividend yields more akin to what's found among financials. As a result, the fund held just 2.1% in utilities versus the index's 11.2% and 3.1% in real estate stocks versus the index's 14.5%.

**Performance Pillar** + Positive | Kevin McDevitt  
03/06/2019

This fund is volatile and not a great downside performer, but it has compensated for this in up markets. From the start of lead manager Stan Majcher's tenure in late 1997, the fund gained 10.5% annualized through January 2019, surpassing the Russell Mid Cap Value Index's 9.0% and the mid-value category's 8.1%. This owed in part to an upside-capture ratio of 117.9% during rising markets. Its strong long-term record results in a Positive Performance rating.

However, like some of its siblings, the fund loses its edge against the index on a risk-adjusted basis. This owes to volatility (as measured by standard deviation) that was significantly greater than the index's. From January 1998 to January 2019, the fund's standard deviation was 20.9% versus 16.2% for the index. As a result, its 0.41 Sharpe ratio trailed the index's 0.43, although it beat the category average's 0.37.

The fund also tends to struggle during downturns. Its 66% loss during the 2007-09 financial crisis lagged the benchmark by 9 percentage points. During the 2015-16 correction, the fund dropped 28.0% peak-to-trough (March 20, 2015-Feb. 11, 2016) versus a 17.9% loss for the index. Finally, during 2018's fourth-quarter correction, the fund fell 15.2% versus the index's 10.5% drop.

This fund works best as a complementary piece within a well-diversified portfolio.

**People Pillar** + Positive | Kevin McDevitt  
03/06/2019

Hotchkis & Wiley's investment team is experienced, has had low turnover, and shows high levels of manager investment, earning a Positive People

rating. Hotchkis & Wiley has 22 investment professionals focused on equities and high-yield bonds who average 23 years of industry experience and 15 years at the firm. There are six equity sector teams (capital goods, consumer, energy/commodities, financials, healthcare, and technology) with five to seven members each; analysts are part of more than one team to provide greater perspective. Typically two or three analysts take the lead on a sector, with the others serving as peer reviewers; this system was put in place around 2009 to strengthen the research process following dismal performance during the financial crisis. Nearly all team members have equity ownership in the firm. This practice has helped retain talent through the years and is a benefit, as the team has worked together through various market cycles.

CEO George Davis and James Miles have run the fund since its 1997 inception, with Stan Majcher the lead portfolio coordinator since late 1997. Davis' tenure at the firm dates back to 1988, Majcher's to 1996, and Miles' to 1995. Davis is part of the financials and capital goods sector teams, Majcher focuses on energy/commodities and financials, and Miles on consumer and tech. Davis and Majcher have more than \$1 million invested here, and Miles has less than \$500,000.

**Parent Pillar** + Positive | Kevin McDevitt  
03/06/2019

Hotchkis & Wiley is a value-oriented, institutional-focused boutique that boasts high manager retention, a team-oriented culture, and a stable of 10 funds that have not ventured beyond the firm's core competencies. Key-person risk is low given the team approach, and analyst turnover has been close to zero for the past decade. Most of the investment team members (who average 15 years at Hotchkis & Wiley) are owners of the firm, and manager ownership of fund shares is solid. Plus, the firm has shown a willingness to close strategies that reach capacity limits, as it closed all of its strategies in 2006. Today, Hotchkis & Wiley Small Cap Value is closed.

Fees are less of a drawback than they used to be, but they're still too high overall. More than a third of assets are in share classes priced above-average or high relative to peers, despite the fact that the firm has close to \$30 billion in assets under management.

Plus, the equity funds' aggressive, often deep-value nature means performance can be boom-or-bust, which can affect risk-adjusted performance, investor returns, and asset flows. But patient investors who understand what they are buying can benefit. The firm offers true active management and sticks with its discipline through thick and thin. Hotchkis & Wiley's culture is investor-friendly in most respects, earning a Positive Parent rating.

**Price Pillar** - Negative | Kevin McDevitt  
03/06/2019

This fund's Institutional share class holds about 85% of assets; its 0.99% expense ratio fell 4 basis points over the past 12 months, but it is still 10 basis points greater than the mid-cap institutional peer median. For this reason, the fund receives a Negative Price rating. The three other share classes have either Average or Above Average Morningstar Fee Levels.

Morningstar's Take as of April 18, 2019  
Hotchkis & Wiley Mid-Cap Value Fund

Average Annual Returns as of March 31, 2019

	1 Year	3 Year	5 Year	10 Year	Since 1/2/97
Class I	-4.31%	6.46%	2.61%	16.67%	11.25%
Class A (w/o sales charge)	-4.56	6.19	2.36	16.38	10.98
Class A	-9.58	4.30	1.26	15.75	10.71
Class C (w/o CDSC)	-5.30	5.40	1.59	15.52	10.18
Class C	-6.30	5.40	1.59	15.52	10.18
Class R	-4.80	5.93	2.10	16.10	10.77
Russell Midcap Value Index	2.89	9.50	7.22	16.39	10.15
Morningstar Mid-Cap Value Category Average	0.66	8.55	5.87	14.46	n/a

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. 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](http://www.hwcm.com).

The Fund's total annual operating expense ratio as of the most current prospectus is 0.99% for I Shares, 1.24% for A Shares, 1.99% for C Shares and 1.49% for R shares. Expense ratios shown are gross of any fee waivers or expense reimbursements.

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](http://www.hwcm.com). Read carefully before you invest.

Returns shown for A, C and R 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: I Shares-1/2/97, A and C Shares-1/2/01, R Shares-8/28/03). Returns shown for A Shares and C Shares without sales charge do not reflect the maximum sales load of 5.25% or the Contingent Deferred Sales Charge (CDSC) of 1.00% for the first year; if reflected, performance would be lower than shown. Returns for A and C shares reflect the deduction of the current maximum initial sales charges of 5.25% and 1.00% CDSC. C Shares convert automatically to A Shares approximately eight years after purchase. A Shares are subject to lower annual expenses than C Shares. I Shares sold to a limited group of investors. Periods over one year are average annual total return. Average annual total returns include reinvestment of dividends and capital gains. Expense limitations may have increased the Fund's total return.

Mutual fund investing involves risk. Principal loss is possible. 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. The Fund may invest in foreign securities which involve greater volatility and political, economic and currency risks and differences in accounting methods.

The Russell Midcap® Value Index measures the performance of those Russell Midcap® companies with lower price-to-book value ratios and lower forecasted growth values. The index does 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 index. It is not possible to invest directly in an index. The Fund's returns may not correlate with the returns of their benchmark index.

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; Price/Book (P/B) is the price of a stock divided by its book value; Free cash flow is earnings before depreciation, amortization, and non-cash charges minus maintenance capital expenditures; Return on capital measures how effectively a company uses the money (borrowed or owned) invested in its operations; Standard deviation measures the degree to which a fund's quarterly return varies from the fund's mean return over a specified time period; Price/Sales is the aggregate portfolio capitalization to aggregate portfolio historical sales of all stocks in the fund's portfolio as of that date; Enterprise value/EBIT is the ratio of a company's enterprise value (market capitalization of a firm's equity plus the market value of the firm's debt) to its earnings before non-cash items (earnings before interest and tax); Sharpe ratio is a measure that indicates the average return minus the risk-free return divided by the standard deviation of return on an investment; and basis point is a unit equal to 1/100th of 1% and is used to denote the change in a financial instrument.

Top 10 holdings as of 3/31/19 as a % of the Fund's net assets: Whiting Petroleum Corp. 4.7%, Kosmos Energy Ltd. 4.4%, Citizens Financial Group Inc. 3.8%, CIT Group Inc. 3.7%, Hewlett Packard Enterprise 3.5%, Popular Inc. 3.5%, Office Depot Inc. 3.3%, Discovery Inc. 2.9%, Cairn Energy PLC 2.9% and Avnet Inc. 2.9%. Portfolio weightings, sector allocations, and/or fund holdings are subject to change and should not be considered a recommendation to buy or sell any security. Opinions expressed are those of the author and are subject to change, are not intended to be a forecast of future events, a guarantee of future results, nor investment advice.

The Hotchkis and Wiley Mid-Cap Value Fund (HWMIX) received a 2-Star Overall Morningstar Rating among 368 Mid-Cap Value Funds for the period ending 3/31/19 (derived from a weighted average of the Fund's three-, five- and ten-year risk adjusted return measure, if applicable). The Morningstar Rating™ for funds, or "star rating", is calculated for managed products (including mutual funds, variable annuity and variable life subaccounts, exchange-traded funds, closed-end funds, and separate accounts) with at least a three-year history. Exchange-traded funds and open-ended mutual funds are considered a single population for comparative purposes. It is calculated based on a Morningstar Risk-Adjusted Return measure that accounts for variation in a managed product's monthly excess performance, placing more emphasis on downward variations and rewarding consistent performance. The top 10% of products in each product category receive 5 stars, the next 22.5% receive 4 stars, the next 35% receive 3 stars, the next 22.5% receive 2 stars, and the bottom 10% receive 1 star. The Overall Morningstar Rating™ for a managed product is derived from a weighted average of the performance figures associated with its three-, five-, and 10-year (if applicable) Morningstar Rating™ metrics. The weights are: 100% three-year rating for 36-59 months of total returns, 60% five-year rating/40% three-year rating for 60-119 months of total returns, and 50% 10-year rating/30% five-year rating/20% three-year rating for 120 or more months of total returns. While the 10-year overall star rating formula seems to give the most weight to the 10-year period, the most recent three-year period actually has the greatest impact because it is included in all three rating periods. HWMIX received 1 star for the three- and five-year and 3 stars for the ten-year time periods ended 3/31/19 among 368, 318 and 225 Mid-Cap Value Funds, respectively. Ratings for other share classes may vary.

Morningstar Rankings represent a fund's total-return percentile rank relative to all funds that have the same Morningstar Category. The highest percentile rank is 1 and the lowest is 100. It is based on Morningstar total return, which includes both income and capital gains or losses and is not adjusted for sales charges or redemption fees. Morningstar ranked the Hotchkis and Wiley Mid-Cap Value Fund Class I in the top 89%, 94% and 9% out of 417, 318 and 225 Mid-Cap Value Funds for the one-, five- and ten-year periods ending March 31, 2019, respectively. Ranking is for the share class indicated only. Other share classes will have different rankings. ©2019 Morningstar, Inc. All Rights Reserved. The information contained herein: (1) is proprietary to Morningstar; (2) may not be copied or distributed; and

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Each Morningstar Category Average represents a universe of funds with similar investment objectives. The Morningstar Analyst Rating™ for funds is the summary expression of Morningstar's forward-looking analysis of a fund. Morningstar analysts assign the ratings on a five-tier scale with three positive ratings of Gold, Silver, and Bronze, a Neutral rating, and a Negative rating. Morningstar evaluates funds based on five key pillars—Process, Performance, People, Parent, and Price—which its analysts believe lead to funds that are more likely to outperform over the long term on a risk-adjusted basis. Morningstar Analyst Rating is not a credit or risk rating. It is a subjective evaluation performed by the mutual fund analysts of Morningstar, Inc. Morningstar evaluates funds based on five key pillars, which are process, performance, people, parent, and price. Morningstar's analysts use this five pillar evaluation to identify funds they believe are more likely to outperform over the long term on a risk-adjusted basis. Analysts consider quantitative and qualitative factors in their research, and the weighting of each pillar may vary. The Analyst Rating ultimately reflects the analyst's overall assessment and is overseen by Morningstar's Analyst Rating Committee. The approach serves not as a formula but as a framework to ensure consistency across Morningstar's global coverage universe.

The Analyst Rating scale ranges from Gold to Negative, with Gold being the highest rating and Negative being the lowest rating. A fund with a "Gold" rating distinguishes itself across the five pillars and has garnered the analysts' highest level of conviction. A fund with a "Silver" rating has notable advantages across several, but perhaps not all, of the five pillars—strengths that give the analysts a high level of conviction. A "Bronze"- rated fund has advantages that outweigh the disadvantages across the five pillars, with sufficient level of analyst conviction to warrant a positive rating. A fund with a "Neutral" rating isn't seriously flawed across the five pillars, nor does it distinguish itself very positively. A "Negative" rated fund is flawed in at least one if not more pillars and is considered an inferior offering to its peers. Analyst Ratings are reevaluated at least every 14 months. For more detailed information about Morningstar's Analyst Rating, including its methodology, please go to <http://corporate.morningstar.com/us/documents/MethodologyDocuments/AnalystRatingforFundsethology.pdf>.

**The Morningstar Analyst Rating should not be used as the sole basis in evaluating a mutual fund. Morningstar Analyst Ratings are based on Morningstar's current expectations about future events; therefore, in no way does Morningstar represent ratings as a guarantee nor should they be viewed by an investor as such. Morningstar Analyst Ratings involve unknown risks and uncertainties which may cause Morningstar's expectations not to occur or to differ significantly from what we expected.**

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