FOURTH QUARTER 2020 COMMENTARY

Visibility to recovery helped value shares outperform by a wide margin. Better growth prospects for the next two years at a fraction of the price could be the impetus for a long and sustained value rally.

MOMENTUM IS WITH VALUE

The market rally off the March 23rd bottom picked up significant momentum in the fourth quarter. Vaccine announcements gave investors visibility to the end of the pandemic and impending earnings recovery, leading to improved sentiment toward value shares.

Fourth quarter returns were decidedly in value's favor, and while the rotation to value has been long-awaited and impossible to predict, it should hardly be surprising. Discrete events, such as the TARP announcement during the global financial crisis or the introduction of vaccines in this COVID downturn, often signal the beginning of long and enduring value rallies, especially when they follow the type of long, deep anti-value cycle of recent experience.

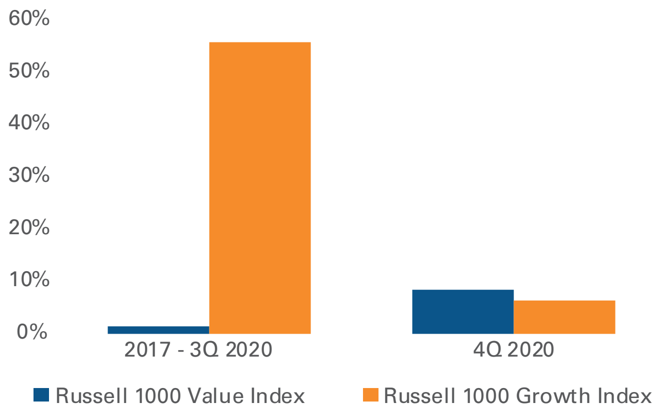
We believe results to date could signal the start of a long pro-value cycle. Several catalysts (see our recent piece: "Catalysts for Change") are aligning in value's favor, the most visible of which are companies' earnings growth as they recover from the COVID recession, and the normalization of multiples that investors assign to those earnings.

THE 4Q VALUE RALLY IN CONTEXT

Value's powerful fourth-quarter rally was driven in roughly equal parts by EPS growth and multiple expansion, the latter accelerating after the announcement of successful vaccines. However, the massive differential in earnings multiples between value and growth stocks that developed over the last three years was only minimally retraced; value multiples still trail growth by a wide margin (Figure 1). As we wrote last quarter, multiples have historically mean reverted over the cycle. If history is prologue, the re-rating of value stocks is in its early days and can be a powerful contributor to value's returns as this multiple differential normalizes.

[1] Source: FactSet consensus estimates of 2020 earnings

Figure 1: Value's Multiple Has More Ground to Make Up



Source: FactSet, Pzena analysis
Percentage change in multiples based on Price/Earnings. Full year 2020 earnings based on consensus estimates as of 9/30/2020 and 12/31/2020.

Earnings, on the other hand, have contributed the most to long term returns, and we expect this cycle to be no different. The vast majority of value's underperformance this year came from a collapse in earnings, setting the stage for a powerful earnings recovery coming out of the downturn.

RECESSION HIT VALUE STOCKS HARD

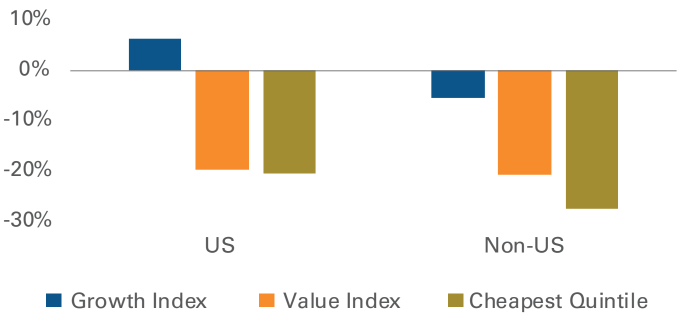
The unprecedented impact to the economy from the COVID lockdowns was particularly unkind to cyclical stocks, most notably in energy, financials, and travel-related businesses. The carnage, however, created a once-in-a-generation opportunity to buy market leaders with strong balance sheets and liquidity to survive the severe disruption. Stock selection, however, has been crucial, as many companies faced uncertain futures, including some with financial positions that might not survive a prolonged downturn. For a disciplined value investor, it was an opportunity to deploy capital into well positioned companies that had been valued as if COVID would never end.

The disproportionate impact on earnings can be seen in Figure 2. While the earnings of the Russell 1000 Growth Index are estimated to have risen by 6%[1] in 2020, Russell 1000 Value Index earnings fell by 20%, and the earnings of deep value stocks fell by 21%.

Similarly, outside the US, earnings are estimated to have fallen by 5% for growth stocks, by 21% for value stocks, and by 28% for deep value stocks.

So then, what might we expect as global economic activity recovers?

Figure 2: Earnings for Value Companies Collapsed in 2020

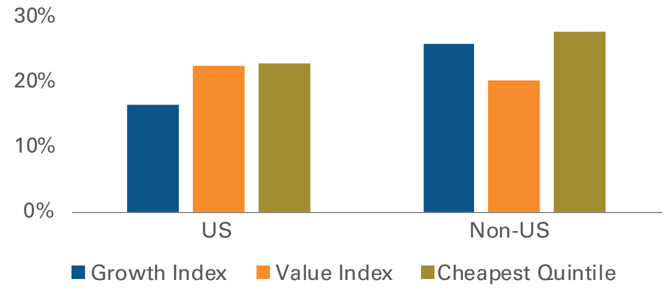


Source: Bloomberg, FactSet, Pzena analysis
Full year 2020 earnings based on consensus estimates as of 12/31/2020. US and Non-US Growth is the Russell 1000 Growth Index and MSCI ACWI ex USA Growth Index. US and Non-US Value is the Russell 1000 Value Index and MSCI ACWI ex USA Value Index. US and Non-US Cheapest Quintile is the cheapest 20% of stocks based on Pzena's estimates of their price-to-normal valuations, measured on an equally weighted basis within their relative universes. Universes comprise the largest stocks by market capitalization for each region as follows: ~1,000 largest US; ~1,500 largest Non-US.

EARNINGS RECOVERY FAVORS VALUE STOCKS

Companies reacted to the operational challenges of COVID-19 the way they do to any crisis: by cutting costs, drawing down inventories, and suspending capital expenditures. Corporate reaction to the onset of COVID was swift, particularly among the cyclical companies most affected by the downturn. These aggressive actions, coupled with a rebound in economic activity, should provide significant operating leverage to sustain a strong earnings recovery over the next couple of years, especially among value stocks.

Figure 3: 2020E-2022E Earnings Growth (CAGR) is Faster Among Cheaper Stocks



Source: Bloomberg, FactSet, Pzena analysis
Full year 2020 and 2022 earnings based on consensus estimates as of 12/31/2020. US and Non-US Growth is the Russell 1000 Growth Index and MSCI ACWI ex USA Growth Index. US and Non-US Value is the Russell 1000 Value Index and MSCI ACWI ex USA Value Index. US and Non-US Cheapest Quintile is the cheapest 20% of stocks based on Pzena's estimates of their price-to-normal valuations, measured on an equally weighted basis within their relative universes. Universes comprise the largest stocks by market capitalization for each region as follows: ~1,000 largest US; ~1,500 largest Non-US.

Looking across the universe of US stocks, the Russell 1000 Growth Index is expected to grow earnings at a 17% compound annual growth rate[2] (CAGR) over the next two years and is trading at 27x 2022 estimated earnings. The Russell 1000 Value Index is expected to grow earnings at 23% annually over the same period and is trading at only 15x 2022 estimates. Importantly, deep value is also expected to grow earnings at a 23% CAGR, while also offering a significant opportunity for re-rating, trading at just 11x 2022 estimates. Even this appraisal might be conservative since 2021 earnings estimates for financials and energy stocks within the S&P 500 Index are 29% and 37% below 2019 results, respectively, setting the stage for potential earnings beats from these two sectors. These two sectors represent a large portion of the cheapest stocks.

Similar dynamics are at play outside the US. The MSCI ACWI ex-US Growth Index is expected to grow earnings at a 26% CAGR over the next two years and now trades at 20x 2022E, while the MSCI ACWI ex-US Value Index is expected to grow earnings at 20%, and trades at 11x 2022E. Once again, deep value offers the best opportunity, with earnings expected to grow at a 28% CAGR, while trading at just 8x 2022E.

[2] Source: FactSet consensus earnings estimates

Pzena Investment Management | 320 Park Avenue, 8th Floor | New York, NY 10022 | www.pzena.com

2022E P/E Multiples

	US	Non-US
Growth	27.3x	20.0x
Value	15.2x	10.6x
Cheapest Quintile	10.9x	8.4x

Source: Bloomberg, FactSet, Pzena analysis
Full year 2022 earnings based on consensus estimates and pricing as of 12/31/2020. US and Non-US Growth is the Russell 1000 Growth Index and MSCI ACWI ex USA Growth Index. US and Non-US Value is the Russell 1000 Value Index and MSCI ACWI ex USA Value Index. US and Non-US Cheapest Quintile is the cheapest 20% of stocks based on Pzena's estimates of their price-to-normal valuations, measured on an equally weighted basis within their relative universes. Universes comprise the largest stocks by market capitalization for each region as follows: ~1,000 largest US; ~1,500 largest Non-US.

CONCLUSION — EARLY STAGES OF THE VALUE CYCLE

We concluded last quarter's commentary with a simple question: If you're not going to invest in value now, when will you? Vaccine announcements drove a dramatic turn to value in the fourth quarter, as investors saw a path to economic recovery. Given the length of past value cycles, the massive gap in multiples that has yet to normalize, and the prospects for earnings recovery, it certainly seems like an opportune time to turn to value and benefit from what could be a long and enduring value cycle.

FURTHER INFORMATION

These materials are intended solely for informational purposes. The views expressed reflect the current views of Pzena Investment Management ("PIM") as of the date hereof and are subject to change. PIM is a registered investment adviser registered with the United States Securities and Exchange Commission. PIM does not undertake to advise you of any changes in the views expressed herein. There is no guarantee that any projection, forecast, or opinion in this material will be realized. Past performance is not indicative of future results. All investments involve risk, including risk of total loss.

This document does not constitute a current or past recommendation, an offer, or solicitation of an offer to purchase any securities or provide investment advisory services and should not be construed as such. The information contained herein is general in nature and does not constitute legal, tax, or investment advice. PIM does not make any warranty, express or implied, as to the information's accuracy or completeness. Prospective investors are encouraged to consult their own professional advisers as to the implications of making an investment in any securities or investment advisory services.

The Russell 1000® Value Index measures the performance of the large-cap value segment of the US equity universe. It includes those Russell 1000® companies with lower price-to-book ratios and lower expected growth values. The Russell 1000® Growth Index measures the performance of the large-cap growth segment of the US equity universe. It includes those Russell 1000® companies with higher price-to-book ratios and higher forecasted growth values. The indices cannot be invested in directly.

The MSCI information may only be used for internal use, may not be reproduced or redisseminated in any form and may not be used as a basis for or a component of any financial instruments or products or indices. None of the MSCI information is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. Historical data and analysis should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. The MSCI information is provided on an "as is" basis and the user of this information assumes the entire risk of any use made of this information. MSCI, each of its affiliates and each other person involved in or related to compiling, computing or creating any MSCI information (collectively, the MSCI Parties) expressly disclaims all warranties (including, without limitation, any warranties of originality, accuracy, completeness, timeliness, non-infringement, merchantability and fitness for a particular purpose) with respect to this information. Without limiting any of the foregoing, in no event shall any MSCI party have any liability for any direct, indirect, special, incidental, punitive, consequential (including, without limitation, lost profits) or any other damages.

The MSCI ACWI ex USA Value Index is a free float-adjusted market capitalization index that is designed to measure developed and emerging market equity performance, excluding the U.S., capturing large and mid-cap securities exhibiting overall value style characteristics. The MSCI ACWI ex USA Growth Index is a free float-adjusted market capitalization index that is designed to measure developed and emerging market equity performance, excluding the U.S., capturing large and mid-cap securities exhibiting overall growth style characteristics. The indices cannot be invested in directly.

For U.K. Investors Only:

This financial promotion is issued by Pzena Investment Management, Ltd. ("PIM UK"). PIM UK is a limited company registered in England and Wales with registered number 09380422, and its registered office is at 34-37 Liverpool Street, London EC2M 7PP, United Kingdom. PIM UK is an appointed representative of Mirabella Advisers LLP, which is authorised and regulated by the Financial Conduct Authority. The Pzena documents are only made available to professional clients and eligible counterparties as defined by the FCA. Past performance is not indicative of future results. The value of your investment may go down as well as up, and you may not receive upon redemption the full amount of your original investment. The views and statements contained herein are those of Pzena Investment Management and are based on internal research.

For Australia and New Zealand Investors Only:

This document has been prepared and issued by Pzena Investment Management, LLC (ARBN 108 743 415), a limited liability company ("Pzena"). Pzena is regulated by the Securities and Exchange Commission (SEC) under U.S. laws, which differ from Australian laws. Pzena is exempt from the requirement to hold an Australian financial services license in Australia in accordance with ASIC Corporations (Repeal and Transitional) Instrument 2016/396. Pzena offers *financial services in Australia to 'wholesale clients' only pursuant to that exemption. This document is not intended to be distributed or passed on, directly or indirectly, to any other class of persons in Australia.*

In New Zealand, any offer is limited to 'wholesale investors' within the meaning of clause 3(2) of Schedule 1 of the Financial Markets Conduct Act 2013 ('FMCA'). This document is not to be treated as an offer, and is not capable of acceptance by, any person in New Zealand who is not a Wholesale Investor.

For Jersey Investors Only:

Consent under the Control of Borrowing (Jersey) Order 1958 (the "COBO" Order) has not been obtained for the circulation of this document. Accordingly, the offer that is the subject of this document may only be made in Jersey where the offer is valid in the United Kingdom or Guernsey and is circulated in Jersey only to persons similar to those to whom, and in a manner similar to that in which, it is for the time being circulated in the United Kingdom, or Guernsey, as the case may be. The directors may, but are not obliged to, apply for such consent in the future. The services and/or products discussed herein are only suitable for sophisticated investors who understand the risks involved. Neither Pzena Investment Management, Ltd. nor Pzena Investment Management, LLC nor the activities of any functionary with regard to either Pzena Investment Management, Ltd. or Pzena Investment Management, LLC are subject to the provisions of the Financial Services (Jersey) Law 1998.

For South African Investors Only:

Pzena Investment Management, LLC is an authorised financial services provider licensed by the South African Financial Sector Conduct Authority (licence nr: 49029).