



## YEAR-END LETTER FOR 2023

### U.S. Opportunistic Value Strategy

Dear Client,

The U.S. Opportunistic Value Strategy (USOV) seeks to outperform the broad market as measured by the S&P Composite 1500 Index by tilting to the most attractive segment of the value universe. Today, **the cheapest 20% of the market (“deep value”) is trading inexpensively and near a record discount to the market.** While the strategy rose a solid 16.2% net of fees last year, keeping up with the broad market was challenging given the wide disparity between U.S. value and growth due largely to the exceptional returns from the “Magnificent Seven,” the frenzy around AI stocks, and the regional banking crisis. Despite strong gains in 2023, the dislocation we seek to exploit in deep value sets the portfolio up to generate attractive absolute and relative returns.

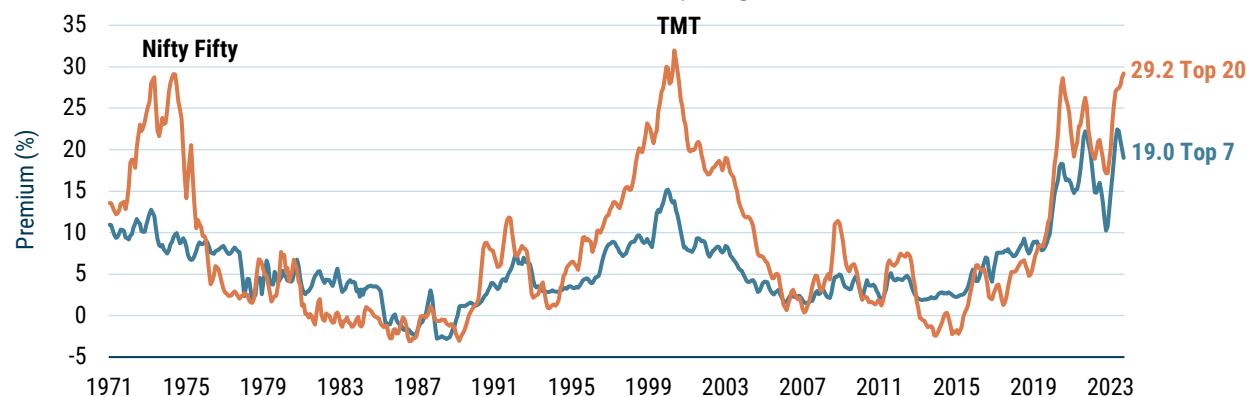
### Performance

USOV rose 16.2% in 2023 trailing the S&P Composite 1500 Index by 9.3%. While the strategy underperformed the S&P Composite 1500 Value Index by 5.5%, it decidedly beat more traditional value benchmarks. The market and S&P’s definitions of value, typically quite similar, diverged sharply in December 2022 leading S&P value indexes to include more exposure to the narrow group of IT and Media stocks – the Magnificent Seven – which dominated performance in 2023.<sup>1</sup>

The U.S. market has become very concentrated and, as a collection, the Magnificent Seven look expensive.<sup>2</sup> To be fair, the group has delivered strong relative fundamental growth. However, the cohort’s share of market cap has grown more rapidly than their fundamentals, meaning they have had an outsized impact on the valuations of the index. The blue line in the display below plots how much more expensive the S&P 500 actually is including those top seven (and top 20 in the orange line) stocks relative to what it would look like without them. Today, those valuation premiums are near multi-decade highs.<sup>3</sup>

## S&P 500: EXTREME CONCENTRATION IN MARKET CAP AND VALUATION

### S&P 500 Concentration in Valuation: Valuation Premium of Largest Names in the Index



Preliminary as of 12/31/2023

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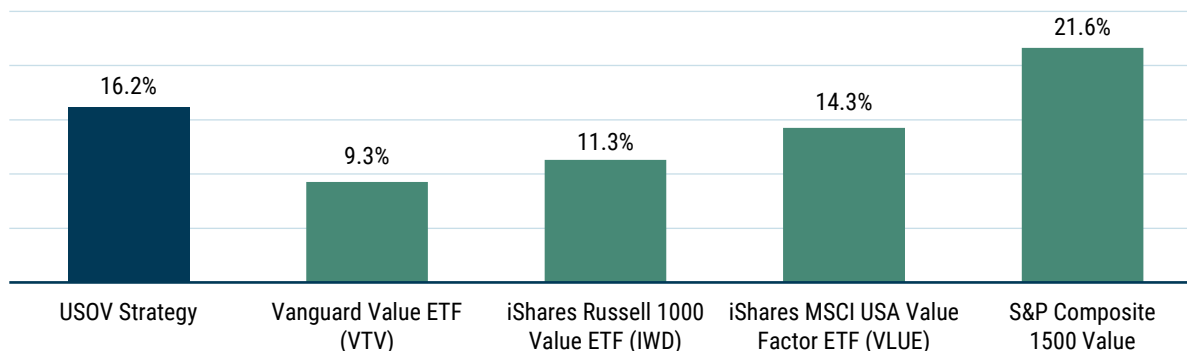
<sup>1</sup> S&P’s use of a 1-year momentum signal in its construction process resulted in atypical shifts in its value sector exposures given the strong selloff in the Information Technology and Communication Services sectors and gains in Energy in 2022. S&P’s construction methodology had a significant impact in 2023 given IT and Communication Services rallied 59.6% and 54.3%, respectively, while Energy trailed the broad market with a negative return of -0.6%.

<sup>2</sup> Not all of the Magnificent Seven are overvalued. In fact, two of the companies in the group, Alphabet and Meta, were top positions in USOV throughout 2023 and remain so at year end. Meta was the second largest position in USOV coming into 2023 and proved to be the strategy’s largest contributor for the year. We added to Alphabet through the year as two of the models we use to construct the portfolio, Price to Fair Value and Quality Boosted Value models, signaled cheapness. Asset-lite Information Technology and Communication Services stocks like Alphabet tend to look expensive on traditional backward-looking Composite Value, the third valuation model employed in USOV.

<sup>3</sup> Given the unusual level of concentration in the S&P 500, we have conducted a variety of analyses on the concentration and growth characteristics of the index through time. For more information about our research, please contact your GMO relationship manager.

While USOV trailed the S&P Composite 1500 Value Index, we expect this style anomaly to moderate in 2024 given the S&P’s December 2023 rebalance realigned the S&P 1500 Composite Value Index closer to traditional value. Compared to most “traditional” value implementations, USOV handily outperformed in 2023. The display below charts USOV’s performance against a variety of value implementations in 2023.

## 2023 NET RETURNS: USOV VS. VARIOUS VALUE IMPLEMENTATIONS



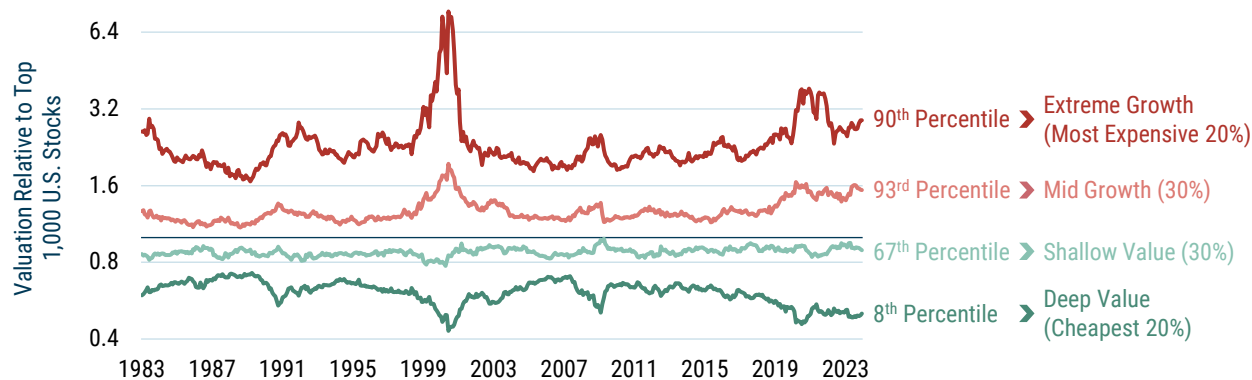
As of 12/31/2023 | Source: GMO, Vanguard, Blackrock

### Outlook: An Attractive asset in an otherwise pricey U.S. market

Value remains cheap across the globe, but in the U.S. a nuanced view is needed to tap into the attractive part of the value universe. **Deep value, the cheapest 20% of the U.S. market, is severely dislocated, trading at an 8th percentile discount on data going back to the early 1980s.** The rest of value (“shallow” value) is expensive relative to its history.

## U.S. “DEEP VALUE” SEGMENT (CHEAPEST 20%) IS TRULY DISLOCATED

Valuation Groups in Top 1,000 U.S. Stocks



Preliminary as of 12/31/2023 | Source: GMO

Stock valuations are calculated on a blend of Price/Sales, Price/Gross Profit, Price/Book, and Price/Economic Book. Groups of value and market are weighted by square root of market cap.

Based on our estimates, **if all quintiles of the U.S. market revert to their historic median valuation (which is a strong assumption), we believe that U.S. deep value is priced to outperform the rest of the market by roughly 30%-40%.**

The overall portfolio characteristics for USOV remain quite attractive. Given the unusual opportunity afforded by the dislocation of deep value, we have been able to build a portfolio that is significantly cheaper than the market and traditional value implementations (anywhere from **30-50% cheaper on a variety of valuation metrics**), and yet **compares favorably to value through the quality lenses** such as debt/equity and ROE (see table below).

## CHARACTERISTICS OF OUR U.S. OPPORTUNISTIC VALUE EXPOSURE

### Exposure Characteristics

	U.S. Opportunistic Value	S&P Composite 1500		S&P Composite 1500 Value		
		Multiple/Metric	% Superiority	Multiple/Metric	% Superiority	
Price / Book <sup>(1)</sup>	1.9x	4.1x	54%	2.6x	26%	Value
Price / Cash Flow <sup>(2)</sup>	8.8x	20.4x	57%	14.8x	40%	
Price / Earnings <sup>(2)</sup>	13.5x	31.3x	57%	22.8x	41%	
Price / Fwd Earnings <sup>(3)</sup>	11.0x	22.3x	51%	16.6x	34%	
Dividend Yield <sup>(1)</sup>	2.8%	1.5%	89%	2.3%	19%	Quality
Debt / Equity <sup>(2)</sup>	0.7x	0.7x	-1%	0.8x	4%	
ROE <sup>(2)</sup>	17.6%	23.1%	-24%	15.7%	12%	
Market Capitalization <sup>(4)</sup>	\$ 107.2	\$ 158.5	--	\$ 93.6	--	Market Cap

As of 12/31/2023 | Source: GMO

<sup>(1)</sup> Historical 1-year weighted average, <sup>(2)</sup> Historical 1-year weighted median, <sup>(3)</sup> Forward 1-year weighted median

<sup>(4)</sup> Weighted median (\$B)

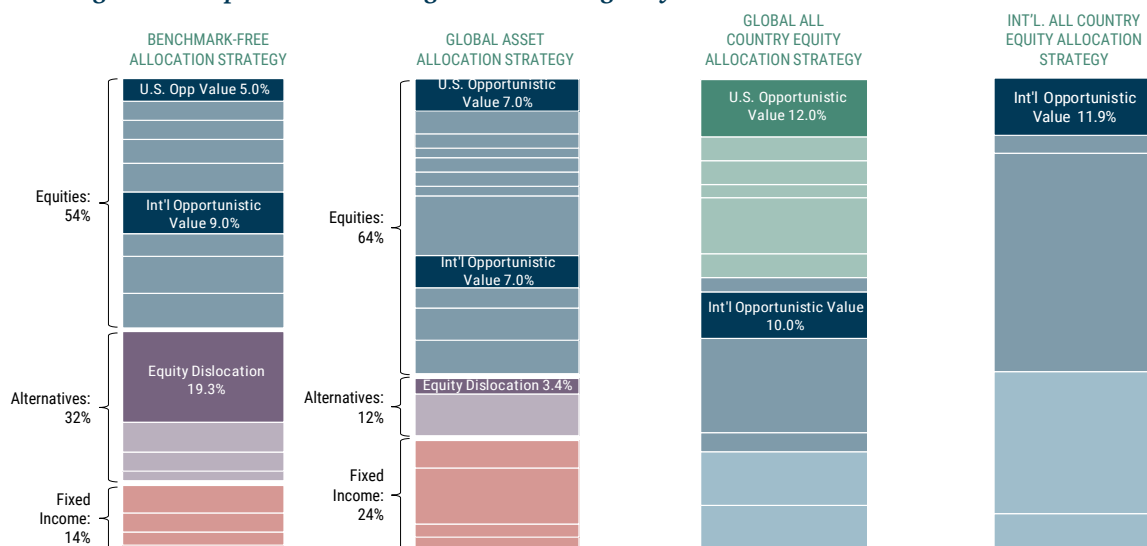
Further, our analysis suggests that while value companies typically undergrow the market, that undergrowth has not been any worse than normal in recent years. The combination of cheap valuations and no sign of relative fundamental decay has created a compelling opportunity in value equities.

### Asset Allocation Conviction: Deep value is the biggest active position across portfolios

Given the attractiveness of the deep value opportunity in the U.S., we have added U.S. Opportunistic Value across our Asset Allocation multi-asset class and equity allocation strategies, with exposures ranging from 5-15% of portfolios depending on the mandate. In addition to U.S. Opportunistic Value, we are further expressing our enthusiasm for deep value with positions in International Opportunistic Value (developed ex-U.S. deep value stocks are similarly dislocated, at a 7<sup>th</sup> percentile discount relative to history) and Equity Dislocation, a long-short implementation, which is 100% long the cheapest value stocks globally and 100% short the most expensive growth stocks globally. **In combination, deep value is the biggest active position across all of GMO's asset allocation portfolios.**

## ASSET ALLOCATION PORTFOLIOS

Investing in the Deep Value thesis long-short and long-only



As of 12/31/2023 | Source: GMO

The above information is based on a representative account in the Strategy selected because it has the fewest restrictions and best represents the implementation of the Strategy. Weightings are as of the date indicated and are subject to change. The groups indicated above represent exposures determined pursuant to proprietary methodologies and are subject to change over time.

We believe deep value is the most attractive part of the U.S. equity market today, offering a compelling 7.3% real return forecast. With the rest of the market trading expensively, allocators should lean equity exposures toward value. However, given the significant disconnect between deep and shallow value, traditional value implementations are not dialed into this unusual opportunity – the chance to buy very cheap companies without wading into junk. By applying quality views in the construction process, investors have a rare opportunity to own many large cap and other companies with better quality characteristics (balance sheet strength, level and consistency of ROEs, etc.) than broad value while still trading at attractive valuations.

Thank you for your trust and partnership. We look forward to engaging with you in the year ahead.

Yours sincerely,



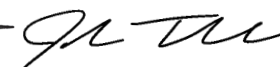
Warren Chiang  
Portfolio Manager



Simon Harris  
Head of Systematic Equity



Tara Oliver  
Portfolio Manager



John Thorndike  
Co-Head of Asset Allocation

<i>Annualized Returns as of 12/31/2023 (Net, USD)</i>	<i>Inception</i>	<i>1-Year</i>	<i>3-Year</i>	<i>5-Year</i>	<i>10-Year</i>	<i>ITD</i>
<b>GMO U.S. Opportunistic Value Strategy</b>	6/30/2022	16.16	N/A	N/A	N/A	14.87
<b>S&amp;P Composite 1500 Index</b>		25.47	N/A	N/A	N/A	18.34
<b>S&amp;P Composite 1500 Value Index</b>		21.64	N/A	N/A	N/A	19.15

***Performance data quoted represents past performance and is not predictive of future performance.***

Net returns are presented after the deduction of a model advisory fee and incentive fee if applicable. These returns include transaction costs, commissions and withholding taxes on foreign income and capital gains and include the reinvestment of dividends and other income, as applicable. Fees paid by accounts within the composite may be higher or lower than the model fees used. **GMO LLC claims compliance with the Global Investment Performance Standards (GIPS®).** A Global Investment Performance Standards (GIPS®) Composite Report is available on [GMO.com](http://GMO.com) by clicking the GIPS® Composite Report link in the documents section of the strategy page. GIPS® is a registered trademark owned by CFA Institute. CFA Institute does not endorse or promote this organization, nor does it warrant the accuracy or quality of the content contained herein. Actual fees are disclosed in Part 2 of GMO's Form ADV and are also available in each strategy's Composite Report. The portfolio is not managed relative to a benchmark. References to an index are for informational purposes only.

***Disclaimer***

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