Q1 | 2022

Income Equity

THE LONDON COMPANY

Market Observations & Portfolio Commentary

Quarterly Market Update

US equities traded lower during Q1 reflecting concerns about higher inflation, a shift toward tighter monetary policy, and the war in Ukraine. There are increasing signs of decelerating growth as high inflation is limiting purchasing power. The Federal Reserve increased the fed funds rate and plans to begin tapering its balance sheet; moreover, it is expected to be more aggressive with monetary policy, given elevated inflation and low unemployment. All of the major indexes traded lower, but Large Cap held up best. The Value indexes significantly outperformed the Growth. In general, cyclical sectors outperformed the more defensive. In terms of market factors that drove performance, Value, Yield, and Momentum had a positive impact on relative returns. Growth and Quality were mixed, and Volatility factors had a negative impact.

Key Performance Takeaways for the Quarter

- The London Company Income Equity portfolio declined -2.2% gross (-2.3% net) during the quarter vs. a -0.7% decrease in the Russell 1000 Value. Sector exposure was a headwind to performance, partially offset by positive stock selection.
- We are bottom-up stock pickers, but sector exposures influenced relative performance as follows:
  - *What Helped*: Underweight Financials & Healthcare (two weaker performing sectors)
  - *What Hurt*: Overweight Info. Technology (the worst performing sector) & Underweight Energy (the best performing sector)
- The Income Equity portfolio lagged our expectations during Q1. Limited Energy exposure as well as few deep value holdings led to the underperformance. Our tilt toward Quality also didn't help despite the market trading lower.

Top 3 Contributors to Relative Performance

- **Chevron (CVX)** – CVX rallied during Q1 along with the rising price of oil. We continue to view CVX as best of breed in oil and gas, with its low leverage, focus on capital discipline and returns, and dedication to a growing dividend.
- **Cincinnati Financial (CINF)** – CINF reported a solid quarter and, like other insurers, received a significant boost from pricing gains as it was able to price ahead of inflation.
- **Progressive (PGR)** – PGR's strong Q1 performance was due to better than expected loss ratios and successful rate increases. All auto insurers are facing headwinds from higher frequencies, but PGR's segmentation and risk selection should translate to a more profitable book coming out of this cycle.

Top 3 Detractors from Relative Performance

- **Lowe's (LOW)** – Despite strong results and sequential same-store sales acceleration, concerns around future consumer discretionary spending and inflation pressured the stock in Q1. LOW's increased its 2022 outlook due to positive macro indicators and company-wide initiatives.
- **Blackrock (BLK)** – We recognize that BLK fees should correlate to AUM and therefore to market performance, so the recent downturn is a negative in the near-term. That said, we believe BLK is a competitively advantaged long-term winner that is well positioned to gain client assets in the future.
- **Air Products & Chemicals (APD)** – APD was under pressure in Q1 reflecting increasing natural gas costs, which negatively impacts the half of their business that isn't protected by energy pass through agreements. Given its oligopolistic nature, we believe APD should be able to raise prices but with a lag.

Trades During the Quarter

- **Exited: Franklin Resources (BEN)** – Reflects concerns about M&A strategy to counter slowing growth and fee pressures.
- **Initiated: Fidelity National Information Services (FIS)** – FIS is a well-diversified conglomerate provider of technology services for global financial institutions. Its three distinct segments include: Merchant Solutions (merchant acceptance of digital payments), Banking Solutions (outsourced central account processing & technology infrastructure for banks) and Capital Markets (transaction processing, software licensing & professional services). It has durable fundamentals, attractive margins, limited capital spending needs, industry leading share across each segment, and shareholder oriented capital allocation plans. Most of its revenues are recurring with long-term contracts and high retention. We believe FIS' impressive characteristics are not reflected in its attractive valuation.
- **Exited: Intel (INTC)** – Reflects uncertainty around INTC's turnaround plans and weak free cash flow generation over the next few years due to elevated capital spending needs.
- **Increased: Verizon (VZ)** – Reflects the strength of network, stability of the business, attractive valuation & >4% yield.
- **Reduced: Lowe's (LOW), Norfolk Southern (NSC), Chevron (CVX) & Berkshire Hathaway (BRK.B)** – We remain attracted to each company, but felt it was prudent to reduce each holding. LOW continues to post solid sales growth, but we recognize that LOW will likely face increasing headwinds from rising interest rates. NSC may also face headwinds from high energy prices and the potential for slower economic growth. CVX has benefitted from rising oil prices, but we recognize the inherent volatility in any commodity price, so we elected to trim on strength. We also trimmed BRK.B on strength.
- **Initiated: Starbucks (SBUX)** – SBUX is a retailer of specialty coffee with 33K stores across 83 markets, with 2/3s of its stores located in the US & China. The coffee industry has favorable tailwinds, and SBUX is very well positioned given its leading share (~60% US & ~40% globally), strong loyalty program, and pricing power. SBUX has extremely attractive unit economics and reinvestment opportunities with its owned stores, and it has additional high quality royalty income streams via partnerships with Pepsi and Nestle. SBUX has high margins, excellent returns on capital, and a very flexible balance sheet.

Looking Ahead

We expect greater volatility driven by higher than normal inflation, a more aggressive shift in monetary policy, and the war in Ukraine. Despite these headwinds, noteworthy tailwinds include solid corporate earnings, rising GDP, as well as low unemployment and higher wages for consumers. Separately, as the effects of COVID continue to fade, we could experience faster than expected global supply chain improvements, which could lead to lower inflation. Monetary policy will likely remain in focus. The big question is can the Fed get inflation expectations under control without causing a recession. In terms of equities, we note that multiple compression is likely given rising interest rates and higher than normal inflation. Given the unique risk backdrop, equity returns may be more modest and volatile going forward.

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Performance

As of March 31, 2022

	QTD	One Year	Three Years	Five Years	Ten Years	Inception to Date
Income Equity (Gross)	-2.2	15.5	15.0	13.1	13.1	9.9
Income Equity (Net)	-2.3	15.0	14.5	12.6	12.6	9.2
Russell 1000 Value	-0.7	11.7	13.0	10.3	11.7	7.5

Inception date: 12/31/1999

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Disclosure notes

The London Company's performances are size weighted and annualized based on calculations for the period ending March 31, 2022. The characteristics discussed herein relate to a representative account, and not every client's account will have these exact characteristics. As London manages its client portfolios according to each client's specific investment needs and circumstances, London cannot affirm that the characteristics of the account shown are similar to all accounts participating in the strategy. This is due in part to the timing of trades by the Adviser, market conditions, cash availability, and the timing of client deposits and withdrawals. Therefore, prospective clients should not assume that similar performance results to those shown would have been achieved for their accounts had they been invested in the strategy during the period. None of the information contained herein should be construed as an offer to buy or sell securities, or as investment recommendations. An investment in a London Company strategy is subject to risks, including the loss of principal.

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Composite Creation/ Inception Date: December 31,1999

Composite Definition: The Income Equity strategy invests mainly in common equities with a focus on higher overall dividend yield orientation, which may be supplemented with primarily investment grade, preferred equities. This strategy has a more conservative orientation, with a focus on capital preservation, income and growth, in order to provide greater yield and downside protection relative to our Large and Mid Cap strategies. Our Income Equity strategy is designed to generate above-average, absolute returns over full market cycles. Accounts in this product composite are fully discretionary taxable and tax-exempt portfolios with no minimum dollar amount of assets. The product is measured against the Russell 1000 Value Index and has a creation and inception date of December 31, 1999. There is no use of leverage, derivatives or short positions. All actual fee-paying discretionary portfolios are included in one or more composites that have been managed for a full calendar quarter with limited restrictions and similar objectives. Composite may include accounts under dual contract.

Benchmark Description: The Russell 1000 Value Index measures the performance of the large-cap value segment of the U.S. equity universe. It includes those Russell 1000 Index companies with lower price-to-book ratios and lower expected growth values. Benchmark returns are not covered by the report of independent verifiers.

Performance and Fees: Gross of fee returns are calculated gross of management and custodian fees and net of transaction costs. Net of fee returns are calculated net of actual management fees and transaction costs and gross of custodian and other fees. Returns may be net of miscellaneous fund expenses. The gross figures do not reflect the deduction of investment advisory fees. For example, an account that earned 15% per year for 10 years would have an accumulated return of 305% before fees and 270% after fees, assuming a 1% fee. Returns are calculated and stated in US dollars. Returns are calculated gross of withholding taxes on foreign dividends and interest. Dividends are reinvested. Policies for valuing investments, calculating performance, and preparing GIPS Reports are available upon request.

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