Q3 | 2020

Large Cap

THE LONDON COMPANY

Market Observations & Portfolio Commentary

Quarterly Market Update

US stocks traded higher during the quarter driven by improving economic data, monetary and fiscal stimulus, and optimism around the eventual availability of vaccines and treatments to fight COVID-19. Stocks traded higher during July and August, but declined a bit in September. For the quarter, stocks posted gains across the market cap spectrum led by Large Caps. The Growth indexes continued their outperformance over the Value. Though Cyclical sectors outperformed Defensive in the Small Cap space, there was little difference among Large Caps. At the individual stock level, exposure to Growth, Volatility, Size, and Momentum factors had a positive impact on relative performance, while Value, Yield, and Quality had a negative impact.

Key Performance Takeaways for the Quarter

- The London Company Large Cap portfolio returned 10.9% gross (10.8% net) during the quarter vs. a 9.5% increase in the Russell 1000 Index. Relative outperformance was driven by positive stock selection and sector allocation, partially offset by our minimal allocation to cash.
- We are bottom-up stock pickers, but sector exposures influenced relative performance as follows:
  - *What Helped*: Overweight Cons. Discretionary (the best performing sector) and underweight Healthcare (a weaker performing sector)
  - *What Hurt*: Overweight Financials (a weaker performing sector) and underweight Info. Technology (a better performing sector)
- Greater participation by some of the more economically-sensitive sectors and less headwind from the mega-cap tech stocks benefitted our Large Cap strategy. In a period when large cap benchmark returns were strong but also punctuated by a September setback, we were pleased to have delivered good comparative results.

Top 3 Contributors to Relative Performance

- **FedEx (FDX)** – FDX responded favorably during Q3 with e-commerce volumes aided tremendously by the pandemic with more people shopping from home and rising prices/fees. Additionally, the stock likely saw improved sentiment from UPS' plans to be more supportive with capital spending and pricing.
- **Apple (AAPL)** – AAPL was strong during the quarter in a continued flight to quality, despite selling off with other large cap tech stocks near the end of the quarter. Excitement and sentiment built during the quarter following the launch of several new products and the nearing of the launch of a 5G iPhone.
- **Air Products & Chemicals (APD)** – APD performed strongly during 3Q after reporting results that highlighted the defensive nature of its business model and announcing a partnership to build/operate a world-scale green hydrogen production facility.

Top 3 Detractors from Relative Performance

- **NewMarket (NEU) –** Despite a rebound in the economy, NEU declined during Q3 due to its nearly 100% exposure to the automotive industry and miles driven by motor vehicles, which is currently weak due to COVID. NEU's 2Q20 earnings were weaker than expected, as management highlighted that the global transportation market came to a near halt during the early 2020 which greatly affected the consumption of NEU's products.
- **Citrix (CTXS)** – CTXS has been a major beneficiary of the COVID induced work-from-home conditions. The stock performed quite well earlier in the year; however, as the economy moved toward reopening and workers returned to the office, CTXS generated positive absolute performance but lagged on a relative basis.
- **Cisco (CSCO)** – CSCO declined after announcing 2Q results that were better than feared, but lackluster guidance combined with the CFO's resignation, lack of buybacks (first time since 2003), and a restructuring plan raised concerns about management's strategic shift and execution abilities.

Trades During the Quarter

- **Reduced: Apple (AAPL)** – Reduced on strength reflecting the recent rally and large position size. We remain attracted to the fundamentals, but felt a smaller position was warranted given elevated valuation—now over 20x EV/EBITDA
- **Increased: Charles Schwab (SCHW)** – Addition reflects strength of its platform as well as increased assets and cost synergies from the pending acquisition of TD Ameritrade.
- **Increased: STORE Capital (STOR)** – Addition reflects the stability of the business at an attractive valuation. Tenants continue to pay rent even through the pandemic, showing the strength of its client base.
- **Increased: Altria (MO)** – Addition reflects improving cigarette volume, pricing power, potential upside from iQOS, as well as an 8% dividend yield.
- **Exited: Wells Fargo (WFC)** – Exit reflects concerns about weaker earnings due to low interest rates and a flat yield curve along with weaker non-interest income.
- **Exited: Chevron (CVX)** – Sale reflects declining cash flow and the risk of a dividend reduction.
- **Initiated: Johnson & Johnson (JNJ)** – JNJ is a global healthcare company that operates in consumer, pharmaceutical and medical device segments. Initiation reflects JNJ's diverse business with three stable divisions, strong pharma pipeline with great track record of R&D investments, its healthy balance sheet, and attractive operating margins.

Looking Ahead

We are encouraged by the improvement in the economic data, but risks remain. In the near term, the US economy faces the dual risks of a possible spike in the virus potentially leading to delayed openings or business closings, and reduced unemployment benefits possibly limiting consumer income and consumer spending. In that environment, combined with relatively high valuations for stocks (20x P/E and 16x EV/EBITDA), we expect significant share price volatility. Longer term, we remain optimistic about the prospects for the economy. While we believe the risks and rewards are somewhat balanced as they relate to stocks overall, we always remain cautious and focus on limiting downside in each holding. Fortunately, we are still finding high conviction investment ideas with quality attributes to populate the portfolios.

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Performance

As of September 30, 2020

Composite	QTD	YTD	Annualized One Year	Three Years	Five Years	Ten Years	Inception to Date
Gross	**10.9**	**1.8**	**8.9**	**8.9**	**11.2**	**13.0**	**11.3**
Net	**10.8**	**1.4**	**8.4**	**8.4**	**10.7**	**12.5**	**10.7**
Russell 1000	9.5	6.4	16.0	12.4	14.1	13.8	10.3

Inception Date: 06/30/1994

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Disclosure notes

The London Company's performances are size weighted and annualized based on calculations for the period ending September 30, 2020. 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: June 30, 1994

Composite Definition: The Large Cap strategy invests mainly in conservative, low-beta, large cap equities with a focus on above-average downside protection. Primarily we seek profitable, financially stable, quality large cap companies which consistently generate free cash flow, high returns on unleveraged operating capital, trade at rational valuations, and are run by shareholder-oriented management. Positions are generally in the market capitalization range of the major domestic large cap indices. Accounts included in this product composite are fully discretionary taxable and tax-exempt portfolios with a minimum of $1 million in assets. The product is measured against the Russell 1000 Index and has a creation and inception date of June 30, 1994. 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: Russell 1000 Index measures the performance of the large-cap segment of the U.S. equity universe. The Russell 1000 is a subset of the Russell 3000 Index and includes approximately 1,000 of the largest securities based on a combination of their market cap and current index membership. The Russell 1000 represents approximately 92% of the U.S. market. 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 portfolios, calculating performance, and preparing compliant presentations are available upon request.

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