

THE LONDON COMPANY

INVESTMENT COUNSEL

Stephen M. Goddard, CFA
Managing Director

One James Center, Suite 1501
Richmond, Virginia 23219

Telephone: 804-775-0317
Facsimile: 804-649-9447

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As the first quarter closes, a quick review of the performance of the publicly traded asset classes reveals that stocks have experienced one of their best first quarters in many years. While the S&P 500 returned over 4%, mid and small cap issues continued their strong performance of recent years and rose 6%-11%, respectively. Large cap value (+5%) outperformed large cap growth (+2%). International markets remained strong and rose 9% in the aggregate.

The first quarter saw the individual investor return to the stock market. After focusing their investing in the real estate market since 2000, the individual resumed buying stocks in late 2005 and this past quarter. Some of the strength in mid-small caps and international markets can be attributed to this buying.

Fundamentally, little has changed since year-end. Corporate profits remain strong, dividends are rising, mergers continue to be announced and hope remains that the Fed will soon cease raising interest rates. All of these factors have contributed to higher stock prices recently.

Nonetheless, the factors that have constrained the market remain in place: relatively high energy costs, rising interest rates (more recently on the long end as well as the short end of the yield curve), the prospect of profit margins peaking and profit growth slowing, and ample valuation in view of the aforementioned points.

More than likely, aggregate economic growth will slow to 2.5%-3.0% in the quarters ahead, reflecting slowing housing and the probability that capital spending may not accelerate as it has late in the business cycle. Profit growth, too, should be less than 10% for the year, down from double-digit increases in recent years. Nonetheless, growth in the economy may not slow sufficiently to encourage the Fed to lower rates.

Given this outlook, the stock market should favor, as it has in the past, higher quality companies, typically large caps, with relatively consistent 10% earnings growth plus another 1%-2% for dividends. As corporate profits subside to less than 10%, the large cap stock universe usually becomes more appealing, especially on a total return basis. Keep in mind that most of these companies are over-capitalized, and consequently they can sustain both share buy-backs and dividend increases. This flexibility in cash flow management should capture more interest as the pace of the overall economy and profit growth subside, especially in the latter half of 2006.

Further increasing the interest in the big cap stocks is the growing likelihood for some decline in the dollar, especially when U.S. interest rates peak. Typically, U.S.

multinational companies benefit from a declining dollar. In fact, some of these multinationals are beginning to trade below the valuations paid for many overseas stocks, just the opposite of their respective valuations several years ago, when overseas markets were much cheaper than the U.S. Consequently, we expect a convergence in performance between the large cap and small cap stocks over the next 12 months.

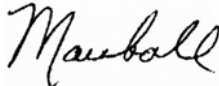
Our conservative, low beta style will excel in this environment as “mega caps” regain momentum. While we will moderately lag in up markets, like the past three years, we significantly outperform in slower economic growth and a benign market which, we believe, is likely over the next few years.

Please feel free to call us if you would like to discuss. Thanks you for your continued confidence.

Sincerely,



Stephen M. Goddard, CFA



A. Marshall Acuff, Jr., CFA

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