

THE LONDON COMPANY

INVESTMENT COUNSEL

Stephen M. Goddard, CFA
Managing Director

1801 Bayberry Court, Suite 301
Richmond, Virginia 23226

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

April 10, 2009

Dear Client,

The U.S. economy has, "fallen off a cliff," said Warren Buffett in an interview with CNBC's Becky Quick on March 9th; a little over a week after Buffett released his annual letter to shareholders in which he described the worst of his forty-four years at the helm of Berkshire Hathaway. Indeed the economy had fallen off a cliff; Gross Domestic Product shrunk by over 6% in the fourth quarter of 2008, the worst decline since the painful recession of the early 1980's, and it is likely to have done just as poorly in the quarter just ended. Fearful of the impact on corporate earnings and with no end in sight, investors sold stocks down to prices not seen in twelve years. By the time the bottom was reached on March 9, ironically the same day Buffett gave his interview, the major indexes were down almost 25% year-to-date and on top of the 37% decline suffered in all of 2008.

Then, news spread that Citigroup, in an internal communication to its employees, stated that January and February were profitable. Hope began to swell that maybe, just maybe, the worst of the banking crisis was behind us. Likewise, some economic news began to improve. Stocks rebounded strongly and gained back much of what had been lost, ending the quarter down 11%. As we go to press, the stock market is up over 20% from the bottom.

So, was that it? Will March 9th prove to have been the bottom of this bear market cycle? The truth is nobody knows, nor will anyone know until we are way past it. Certainly things have been far worse than we predicted and there have been a number of false dawns during this bear market, beginning with the rescue of Bear Stearns a year ago. Yet, some things seem to be getting better or at least less bad, on the economic front. Retail sales improved in January and February as did consumer confidence. Small business confidence also jumped to its highest level since August. Durable goods orders were up in February, the first advance in seven months and surprising economists who were expecting another drop. Perhaps the most surprising and welcome was positive news on the housing front where new home sales rose in February and inventories declined, though the median price also fell. With mortgage rates at forty year lows and house prices falling, housing affordability is the highest it has been in three decades.

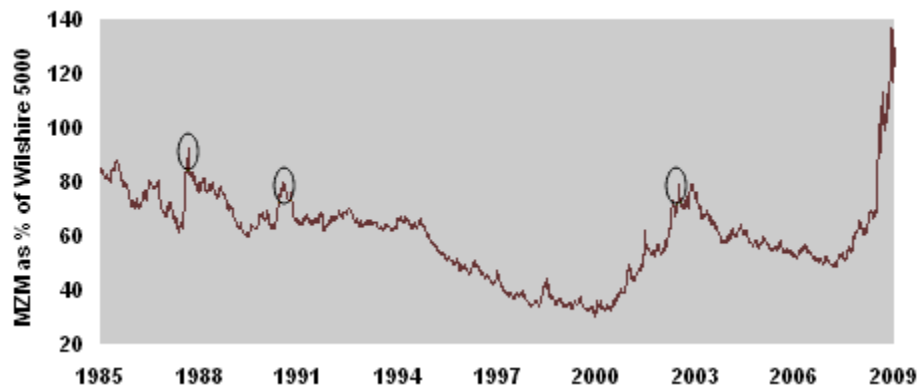
While all of this is welcome news, we must warn that the economy remains fragile. Going into this recession, consumer spending was 70% of economic activity and the

consumer has been badly damaged. Unemployment is high and rising and there has been a plunge in household net worth due to plummeting house and stock prices. Consumers were caught with too much debt and too little savings. Consequently, consumption will continue to suffer as households repair their balance sheets by spending less, saving more, and paying down debt. Meanwhile, the massive amounts of fiscal and monetary stimulus being poured into the global economy by governments around the world will help stem some of the decline.

Getting back to the earlier question, we cannot say with certainty that we have seen the lows in the stock market because we cannot predict the behavior of investors, who often act irrationally in both good and bad times. We can say with confidence that many companies are a bargain at today's prices. We are seeing companies with positive cash flows trading below their net cash, which is not rational and a clear sign their stocks are oversold. These valuations would appear to be anticipating a prolonged economic depression, dismissing any prospect for government fiscal and monetary stimulus to support the economy later this year or early next. By setting the bar so low for future earnings, stocks are poised to benefit from earnings surprises. Future earnings reports do not need to be good, they just need to be better than expected and earnings expectations are the lowest we have ever seen.

We are not the only ones who see value in today's stock prices. Many companies we have heard from have announced intentions to use excess capital to acquire competitors. The improved credit markets have given strong companies access to capital at reasonable cost and over \$100 billion of acquisitions have been announced in recent months. Merger and acquisition activity will provide key support for the stock market as acquisition premiums propel stock prices higher.

Furthermore, there is a massive amount of cash sitting on the sidelines as illustrated in the following chart, courtesy of Liz Ann Sonders at Charles Schwab, which shows the amount of cash as a percent of the value of the stock market:



With cash yields so low, investors will at some point begin to seek a higher rate of return and much of this money will be invested in stocks once it becomes clear the worst of this

bear market is behind us. It has happened before. The circles on the chart represent prior bear market ends which have come when cash levels were elevated.

The only way investors are going to recover the value lost from the bear market is to stay invested in stocks. Bonds and cash are not going to do it. The stock market will remain volatile and we may give back some of the gains made since March 9th. New lows may be experienced. However, we believe an improving economy, compelling stock valuations, increased M & A activity, and massive amounts of liquidity are a recipe for generous returns to patient, long-term investors over the next five years.

Thank you for your continued confidence and trust. Please feel free to call with questions.

Best regards,



Stephen M. Goddard, CFA



Jonathan T. Moody



J. Wade Stinnette, Jr.