

THE LONDON COMPANY

INVESTMENT COUNSEL

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Dear Client,

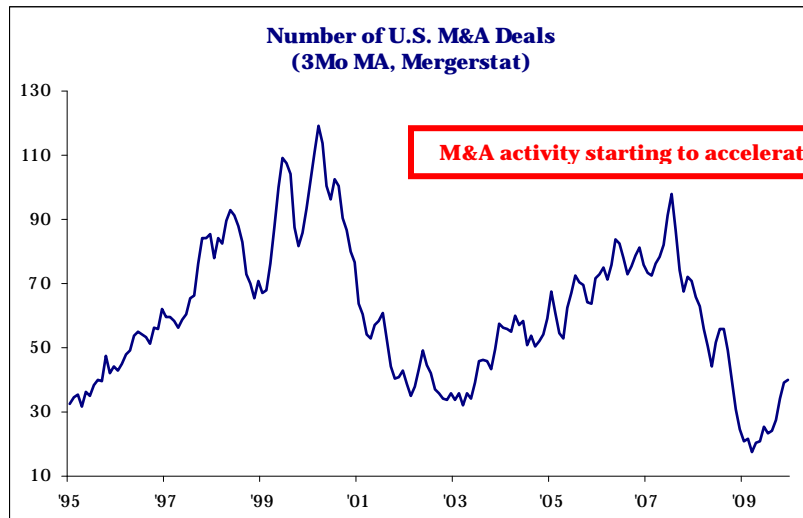
After falling 35% at the beginning of the year, stocks staged an amazing come back in 2009. The rally which began in March continued in the fourth quarter and the S&P 500 ended up returning 26.5% for the year. Few expected it and many fear the rally isn't sustainable. Strategas Research Partners has dubbed it the "bull market no one loves," citing how little of the \$3.8 trillion parked in money market funds at the beginning of 2009 has been earmarked toward equities. In an environment where money market funds were paying virtually nothing, investors sought higher returns by investing \$351 billion in bond funds in 2009, more than fifty times the measly (by comparison) \$6.2 billion that flowed into equity mutual funds. Perhaps it is not surprising that retail investors are gunshy towards stocks after suffering through two major bear markets in ten years, and it is certainly true that much remains to worry about; however, we believe an improving economy, moderately higher interest rates, ample liquidity, and increased merger and acquisition activity set the stage for equity investments to again outperform both bonds and cash in 2010.

We expect the economy to continue to improve, though the recovery will be less than that typically experienced after such a severe recession. Restocking of depleted inventories, capital spending by companies on equipment and software, and government expenditures should contribute to growth. Of the \$787 billion stimulus bill enacted in early 2009, only 25% of it has actually been spent and with 2010 being an election year and with the unemployment rate hovering at 10%, the drumbeat from Washington is likely to be for more spending, not less. On the other hand, consumer spending will remain subdued as the unemployment rate stays stubbornly high and households continue to repair their balance sheets by saving more and paying down debt. This will place a ceiling on the economic rebound and prevent a sharp, "v-shaped" recovery.

The large amount of excess labor and industrial capacity created by the recession remains and makes inflation a non-issue in 2010. This, plus a fear that it tightens too early and short-circuits the recovery, implies the Federal Reserve will maintain an accommodative interest rate policy by keeping the Fed Funds rate at or near zero. Meanwhile, the Fed has signaled it will unwind some of its "quantitative easing" programs, beginning in March when it will no longer buy agency mortgage-backed securities, proof that the

financial crisis is largely behind us. In short, the economic recovery will be strong enough for the Fed to begin to take liquidity out of the system, but not strong enough for it to raise rates.

P/E multiples for the broader stock market are still low relative to interest rates and private market values; therefore, we see room for continued P/E expansion in 2010. Companies are challenged to grow their top lines and with margins at peak levels, they will be increasingly pressured to buy growth through acquisitions. With record levels of cash, underlevered / debt free balance sheets and ample free cash flow, most companies have the capacity and flexibility to finance acquisitions. With valuations for acquisition candidates still lower than several years ago, M&A activity, which picked up in the latter half of 2009, will continue to accelerate in 2010 and provide further support for the market. Additionally, companies may choose to return excess cash to shareholders with above average dividend increases and share repurchases, which will provide added return and earnings growth. Through a combination of intelligent acquisitions, dividends, and repurchases, shareholder-oriented cash utilization should support above average returns for the foreseeable future.



Source: Strategas Research Partners, LLC



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

Best regards,



Stephen M. Goddard, CFA



Jonathan T. Moody, CFA



J. Wade Stinnette, Jr.