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To clients and friends of The London Company:

Chance the Gardener - "There will be growth in the spring!"

Benjamin Rand - "I think what our insightful young friend is saying is that we welcome the inevitable seasons of nature, but we're upset by the seasons of our economy."

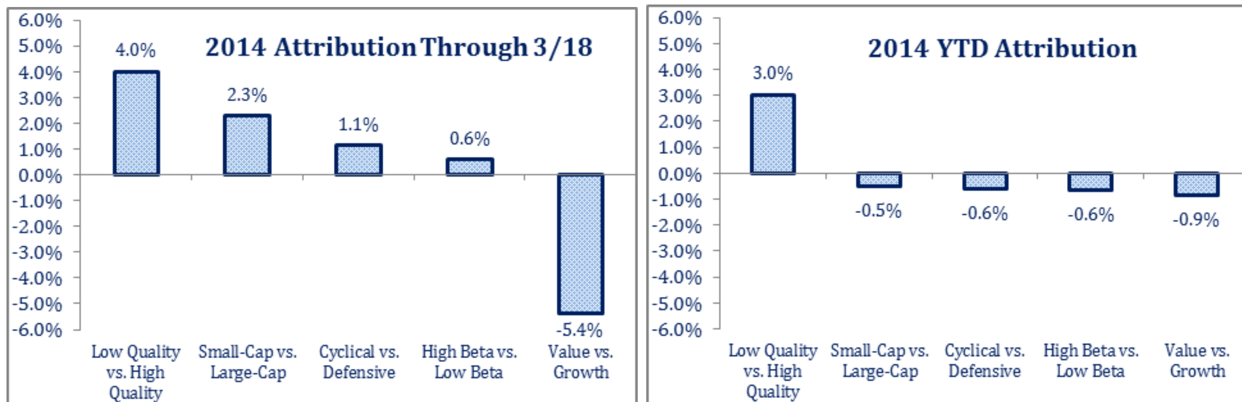
President Bobby - "Well, Mr. Gardner [SIC], I must admit that is one of the most refreshing and optimistic statements I've heard in a very, very long time. I admire your good, solid sense. That's precisely what we lack on Capitol Hill."

Actor Peter Seller's final movie appearance in "Being There" was a tour de force role, playing a simple-minded gardener named Chance whose thoughts and speech were formed totally by what he experienced gardening and watching on television. Through an improbable series of events and mistaken identity, Chance's naïve "wisdom" catapulted him into prominence as the President's most influential economic advisor and eventual heir-apparent. The excerpted dialogue is from 1979, but hauntingly echoes today's national mood, frames the political landscape, and captures a place where many investors find themselves at the end of 2014's first quarter. The year started out with relentlessly harsh weather and pervasive fears of negative economic consequence, but we finished March with improving weather and rising optimism that indeed there will be growth in the spring. The equity markets dutifully shadowed this economic "script" as if still under the Svengali-like direction of our protagonist, Chance. In short, it was a Hollywood quarter with plot twists and a dramatic finish, driven first by the absence of growth both in the US and globally (notably China and the other BRIC countries), only to be supplanted later by budding optimism that the season of growth, at least in the U.S., was at hand.

Decomposing the market's returns in the quarter is a two stage exercise. Up until the March 19th press conference at which newly-installed Fed Chair Yellen introduced the possibility of initiating interest rate increases in the up-coming 6 month time window, snow-weary investors showed a clear but bifurcated preference both toward growth over value but also toward the higher yielding utilities, symptomatic of prevailing economic concerns and a narrowing perceived list of alternatives capable of sustaining earnings growth into such a fallow environment. Other significant market drivers included a bias

toward low quality over high quality, and smaller capitalization issues over larger ones. The poster-children for this growth invulnerability were biotechnology and internet stocks, which embody those attributes along with higher beta and a more cyclical element, all of which drove those stocks to outsized short term returns. Historically these are not the type of names found populating London Company portfolios. Also not well-represented are the utilities, where it has become difficult for us to discern compelling opportunities for long term investment. Unsurprisingly, most of Q1 proved to be highly unfavorable for our discipline and relative returns, particularly in our Small Cap, SMID, and Mid Cap portfolios.

Then, in a moment similar to what Former Fed Chair Bernanke accomplished with his tapering comments last June, Yellen's remarks became pivotal to how the rest of the first quarter played out. In a span of less than two weeks, Chance the Gardener's prophetic words were endorsed by the Fed, buttressed by various economic reports, and embraced by investors who aggressively reversed course. Value, which has tended to outperform during periods of anticipated or accelerating economic growth, quickly came back into vogue, and investors upshifted into larger cap issues with lower beta and modestly higher quality. The two quarterly attribution charts that follow graphically depict the intra-quarter swing that occurred:



Source: Strategas Research Partners

It is noteworthy that in these charts, style reflects the pure growth and pure value indexes; for the more popular Russell and S&P style indexes, value actually outperformed across the board for the full quarter, albeit all of that outperformance coming post-Yellen. At the sector level, the growth-to-value rotation was equally striking, and to us offers yet more convincing evidence of the futility of investing based on short term trends and forecasts:

Sector Performance Before Yellen Speech

Russell 2000		Russell Midcap		Russell 1000	
Sector	Return	Sector	Return	Sector	Return
Health Care	11.69	Health Care	10.75	Utilities	8.04
Information Technology	5.01	Utilities	7.69	Health Care	7.99
Financials	2.65	Information Technology	5.16	Materials	3.32
Industrials	2.49	Telecommunication Services	4.45	Information Technology	3.22
Utilities	5.53	Consumer Staples	4.27	Financials	1.95
Energy	2.45	Materials	3.40	Consumer Discretionary	0.44
Consumer Staples	3.77	Financials	3.37	Industrials	0.06
Materials	2.04	Industrials	2.90	Consumer Staples	-0.28
Telecommunication Services	3.66	Consumer Discretionary	2.01	Energy	-0.82
Consumer Discretionary	-1.16	Energy	1.78	Telecommunication Services	-3.75

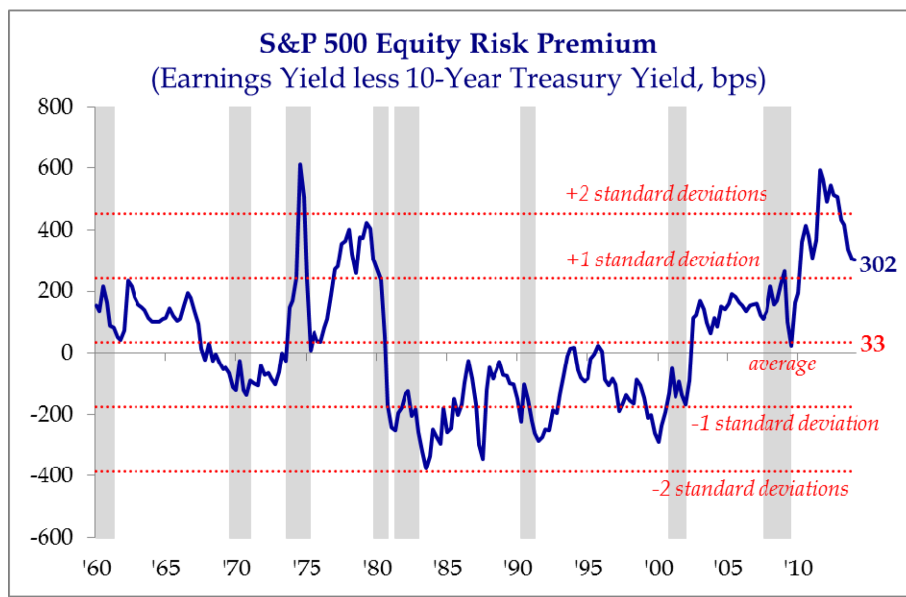
Sector Performance After Yellen Speech

Russell 2000		Russell Midcap		Russell 1000	
Sector	Return	Sector	Return	Sector	Return
Energy	2.65	Telecommunication Services	1.72	Telecommunication Services	3.84
Utilities	0.20	Energy	1.57	Energy	2.29
Telecommunication Services	-1.23	Utilities	1.48	Utilities	1.53
Materials	-1.25	Financials	0.44	Financials	1.01
Consumer Staples	-1.58	Materials	0.28	Consumer Staples	0.86
Industrials	-1.76	Consumer Staples	0.11	Industrials	0.37
Consumer Discretionary	-2.13	Industrials	-0.33	Materials	-0.10
Financials	-2.19	Information Technology	-1.73	Information Technology	-0.87
Information Technology	-4.35	Consumer Discretionary	-1.92	Health Care	-1.97
Health Care	-7.11	Health Care	-3.84	Consumer Discretionary	-2.42

Source: Factset

Taken together, it was a whipsaw quarter that transcended bad weather, fears of a Chinese financial implosion, and the Russian incursion into Crimea as a resilient market pushed on to nominal new highs. For our portfolios, results were mixed, with favorable results in larger market caps and lagging results in the mid and smaller market caps. Returns were constrained, ranging from 3.5% for the Russell Mid Cap to 1.1% for the Russell 2000. As always, for The London Company it is about the individual holdings and what has transpired at the stock level in the latest 90 day marking period. Among a number of our sizeable, top performing positions from 2013, particularly in the consumer discretionary space, we saw profit-taking and a rotation away from last year's winners create significant negative performance drag early in the quarter. We view this as a transient event and one not based on fundamental deterioration, thus we are unfazed by the latest results and continue to feel confident in the positions we hold. Because our portfolios intentionally do not resemble benchmarks, we expect short term results to deviate, sometimes measurably, from market returns both for better and for worse. However we also expect our portfolios to exceed benchmark returns, with better downside protection, over the full market cycle.

With the markets moving ever-higher, we often are asked where the market is headed next, whether or not stocks are becoming over-valued, and if we are encountering difficulty in uncovering fresh investment opportunities. We are neither prognosticators nor seers, and have no informed opinion as to the market's next move or direction. For us, one critical determinant is the equity risk premium, which measures the spread between the cost of debt and the cost of equity. The amount of that spread defines the degree of opportunity that corporate managements have to optimize capital structure for the benefit of shareholders. As seen below, at quarter end the spread remained historically wide, suggesting ongoing value in equities relative to bonds. From our vantage point, the backdrop remains advantageous and we are finding no dearth of fresh ideas across sectors and the market cap spectrum.



Source: Strategas Research Partners

Many of the long running themes that we have highlighted in past letters appear intact. Globally, economic growth is struggling, especially in emerging markets. The lack of growth and the lack of policy direction out of Washington have shackled corporate America, so that the prodigious amounts of cash-flow still being generated continue to accumulate on company balance sheets. Moody's Investor Service reported that at yearend 2013, cash reserves held by corporate America increased 12% YOY or $180billion to $1.64trillion, of which $947billion was sheltered overseas. Despite rising dividends, rising share repurchases, and rising investor activism to prod greater deployment of this cash gusher, the piggy bank keeps growing larger. Among the recent economic reports is data suggesting some potential shift in capital deployment strategy, as capital spending is starting to tick up, which could benefit forward economic activity. We do not see a recovery in capital spending and continued return of capital via dividends and share repurchases as mutually-exclusive decisions. There are abundant reserves to accomplish "all of the above." With respect to M&A, the trickles of activity and announcements have picked up but hardly constitute a boom that we and others long have been expecting. Before the current cycle has run its course, we would be surprised not to have seen a surge in deal-making that ultimately transitions into some hint of speculative frenzy. We are far from those conditions today.

For now, we are into spring and indeed there appears to be growth both in nature and in the economy. Returning one last time to the sagacious Chance, who boldly predicted that "…summer will follow spring, and then we will have fall and winter. And then we will get spring and summer again." We feel pretty confident about that part of his forecast, but it remains to be seen how future growth plays out. Were he not merely a figment of biting social commentary, Chance might have found a place in Washington, where he could bring his wisdom and advice to help clear the entanglement of weeds and undergrowth that defines the current state of political inertia. At movie's end, he literally walks on water and off into the misty distance while the final credits roll. For the markets and the economy and for all of us, the movie plays on and the outcome is yet to be determined.

Thank you again for your trust and support, and please feel free to contact us with any questions or concerns.

Best regards,

The London Company

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