THE LONDON COMPANY

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

1801 Bayberry Court, Suite 301
Richmond, Virginia 23226

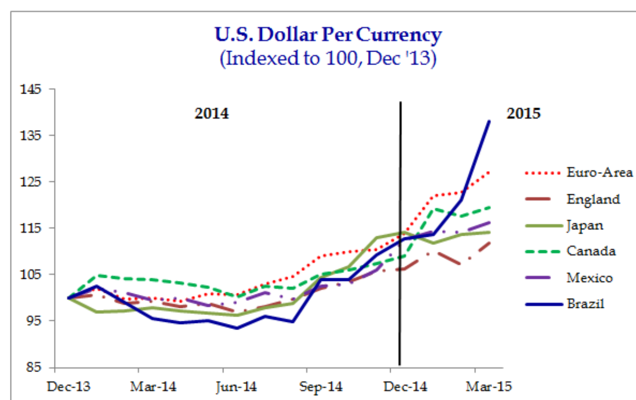
April 6, 2015

To clients and friends of The London Company:

My mind is made up. Don't confuse me with the facts.
– Roy S. Durstine

While many people both within and outside of the investing arena are guided by this simple expression of certainty, its origin has been attributed to a mid-20th Century advertising specialist writing an article "Don't Confuse Me with the Facts!" for the 1945 periodical *Advertising & Selling.* This quip resonates here at The London Company (London) where we seek to minimize confusion and gain a clear sense of conviction in our investments based on facts and factors that drive long-term returns. At the same time, we strive to remain cognizant of the need to balance that conviction with the dynamic and changeable nature of the facts themselves, which can create a smokescreen of confusion and challenge or even change conviction. We often write and talk about the inherent difficulties in divining short-term cause and effect impacts of macro events in the marketplace. We feel equally ill-equipped in adding portfolio value through our reliance upon predictive reasoning and forecasting of material future events. It is our belief that opportunity is created because the consensus investor tends to gravitate to ever-changing points of view based upon the facts du jour, and too often repositions portfolios to reflect that fluid thinking. In the short term, it can be easy to confuse facts with factual noise, and even harder to decide how to respond to it. In the long term we all are dead, and the facts become irrelevant. So the trick is to find the happy medium of time horizon between those two goal posts.

We can look no further than the most recent quarter as yet another installment in this long-running market saga of myopic certainty. Heading into 2015, there was a widely held view that US$ strength would continue to drive strong domestic market returns as had been witnessed for most of 2014. The prevailing view called for the continued leadership by US equities, buttressed by a solid collection of data points. As the chart below depicts, the consensus got half of the call right in 1Q- the US$ indeed continued to outperform most global currencies. Getting the other half of the call proved to be a bit more elusive however, as we did not get the expected market response. Rather, the US market trailed many of the world markets both in local-market terms as well as dollar-dominated terms.



Source: Strategas Research Partners

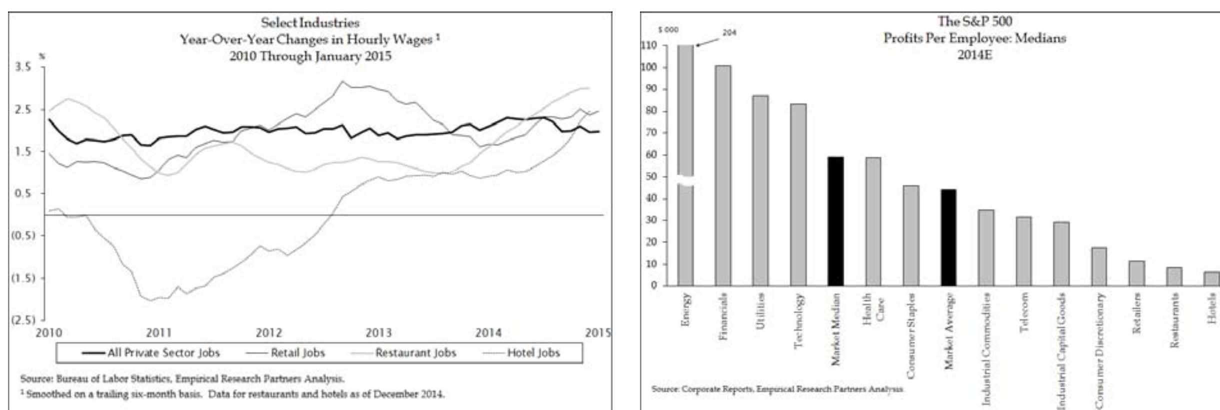
Global Equity Market Performance
(Price Return; 1Q '15)

Country	Index	Local (sorted)	USD	EUR	GBP
Germany	DAX	22.0%	8.3%	22.0%	13.8%
Hungary	BUX	18.4%	10.6%	24.6%	16.2%
France	CAC 40	17.8%	4.6%	17.8%	9.8%
Russia	MICEX	16.4%	20.2%	35.4%	26.2%
Europe	STOXX 600	16.0%	2.9%	16.0%	8.1%
China	Shanghai	15.9%	15.9%	30.6%	21.8%
Israel	General	10.4%	8.1%	21.8%	13.5%
Japan	Nikkei 225	10.1%	10.0%	24.0%	15.6%
Philippines	PSE PSEi	9.8%	9.9%	23.8%	15.4%
Czech	PX - 50	9.2%	-2.5%	9.8%	2.4%
Australia	ASX All Ord.	8.8%	1.6%	14.4%	6.7%
South Africa	FTSE S. Africa	6.9%	2.1%	15.0%	7.2%
South Korea	KOSPI	6.5%	5.6%	18.9%	10.9%
Indonesia	SE Composite	5.6%	0.0%	12.7%	5.0%
Hong Kong	Hang Seng	5.5%	5.5%	18.9%	10.8%
Poland	WIG	5.2%	-1.4%	11.0%	3.5%
E.M.	MSCI EM	4.6%	1.9%	14.8%	7.0%
Malaysia	FTSE Malaysia	3.4%	-2.4%	10.0%	2.5%
U.K.	FTSE 100	3.2%	-1.8%	10.6%	3.2%
Taiwan	TAIEX	3.0%	4.0%	17.2%	9.3%
New Zealand	NZX All	2.8%	-1.4%	11.1%	3.5%
Brazil	Bovespa	2.3%	-14.9%	-4.2%	-10.6%
Canada	TSX Composite	1.8%	-6.9%	4.9%	-2.2%
Chile	IPSA	1.7%	-1.0%	11.6%	4.0%
India	BSE SENSEX	1.7%	2.5%	15.5%	7.7%
Switzerland	SMI	1.6%	4.0%	17.1%	9.2%
Mexico	IPC	1.3%	-1.9%	10.5%	3.0%
U.S.A.	S&P 500	0.4%	0.4%	13.2%	5.5%
Turkey	ISE 100	-5.7%	-15.1%	-4.3%	-10.8%
Colombia	IGBC	-14.1%	-21.4%	-11.4%	-17.4%
Peru	LSE General	-15.8%	-19.1%	-8.8%	-15.0%

Source: Strategas Research Partners

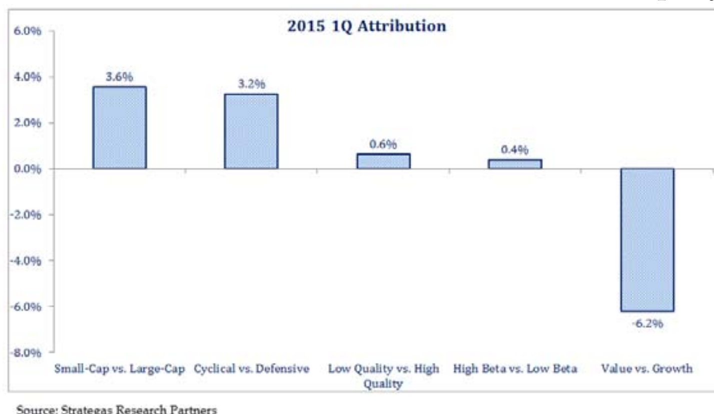
Now, this is only one quarter, and perhaps the markets will reverse course as the year progresses and validate this prognostication, but the early results clearly were not as expected. In similar vein, announced 1Q changes to the minimum wage and a spate of reactionary headlines from WalMart and others boosting employee wages generated consternation that the US economy was entering the front edge of a new cycle of wage inflation that could help ignite the long-feared rise in interest rates and depress record corporate profit margins. While not an unreasonable premise, these fears did not reflect the

current distribution of wages and relative impact upon corporate profitability, as seen on the charts below:



Retailers, restaurants, and hotels are highly visible service industries that comprise 28% of the employment in the SP500. However, those industries combined contribute only 6% to SP500 earnings. Meanwhile, high profit-contributors like energy, financials, and utilities continue to shed jobs, providing a powerful offset to wage inflation, resulting in an overall flat-to-benign trend line to total private sector hourly wages. While the labor market continues to strengthen and some wage pressures should become apparent over time, the recent trends do not imply an imminent demise to the extended period of low inflation, record high corporate profitability, and slow economic growth. Putting the headlines aside, 1Q economic activity undershot expectations, again being hampered by bad weather and logistical problems stemming from the contentious West Coast port labor disruptions.

We use these two anecdotes as preamble to our narrative on how The London Company fared in the latest quarter. Based on some of the key characteristic drivers at work during 1Q, the profile of outperformance would have favored smaller cap stocks that were more cyclical than defensive, and had marginally lower quality and higher betas. Furthermore, growth significantly outpaced value. We show our customary scorecard on these factors in the chart on the right.



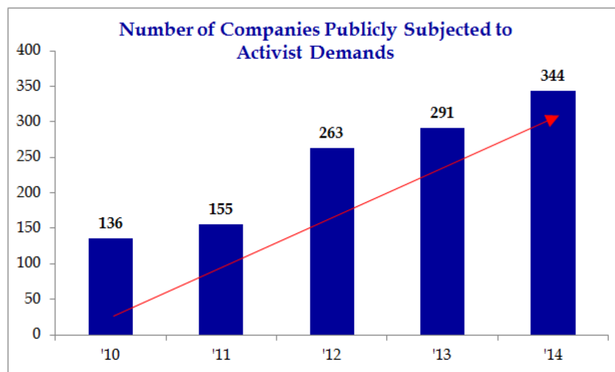
Source: Strategas Research Partners

At a sector level, being overweight in healthcare, consumer discretionary and telecom and being light in utilities, energy and financials would have boosted returns. Taking all the factual data points together, those readers familiar with our investment approach might initially surmise that London likely endured a pretty difficult quarter. However, on balance, our portfolios actually performed relatively well during 1Q, with the strongest outperformance in Small Cap, solid outperformance in SMID, Income Equity, and Concentrated, in-line performance in MidCap, and trailing performance in Large Cap. Certainly our outsized and enduring affinity for consumer discretionary companies across

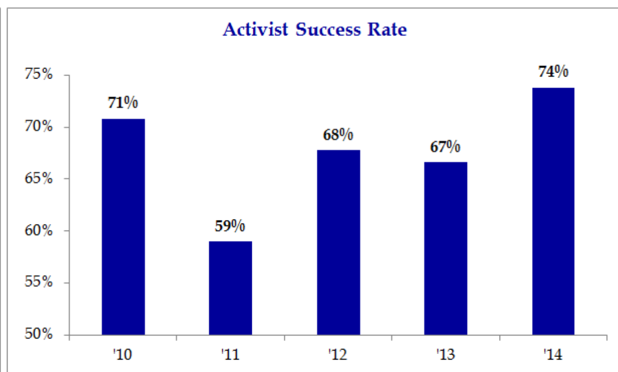
the entire market capitalization spectrum benefitted all portfolios. In a period of strong US$ performance and falling energy prices, domestically focused consumer businesses with little to no adverse impact from currency translation served as profitable safe havens. In Small Cap and SMID particularly, this benefit was compounded by the snapback of several of the outdoor sporting names that had been under extreme pressure and detracted greatly from performance during the fourth quarter of 2014. We recouped performance somewhat commensurate with the degree of previous quarter lag. Conversely, in Large Cap where we enjoyed a robust 2014, we saw the opposite effect and some give back that went against us. It is not uncommon for our portfolios to experience this type of quarter to quarter reversion in performance as we hold positions for the long term and not 90 day snapshots, and do not attempt to adjust our positions due to short term crosscurrents or headwinds.

The market now has entered its seventh year of its impressive bull run with a lot of help from Fed policy, but without much help from traditional economic expansion either home or abroad, and even less from governmental leadership and policy. Corporate managements by and large continue to face a "high class problem" of record profitability and too short a list of projects in which to invest for future growth. Investors have been the prime beneficiary of this situation, as corporations have returned copious amounts of capital to shareholders in the form of dividends and share repurchases. After a brief pause in 2014, share repurchases have ramped back up to record levels and increasing dividend payouts continue down a long runway before they approach historically normalized levels. Investment in capital spending clearly is on the rise, but remains reasonably constrained by the low economic gear and embedded pessimism about the potential for an acceleration in growth to justify capital expansion. M&A activity also remains a popular and value-accretive use of corporate cash flow. Our portfolios have participated in this step up in restructurings, destructurings, and various business combinations that are occurring across corporate America.

Overarching this backdrop of putting capital to work lurks the growing shadow of investor activism, a development we have commented on in previous letters. Capital available to corporations is matched by capital available to investors who have recognized a lucrative opportunity to utilize that capital to influence, redirect, and even seize control of the public corporation agenda. Managements from the very smallest entities up to $700B market cap Apple have experienced the growing intrusion of what once was referred to as the "barbarians at the gate." Activists are imposing change at a spiraling rate of increase, and in the process unlocking value for themselves and for other shareholders as well. Successful activist outcomes only serve to attract more involvement to levels not previously seen in the US market. The following two charts highlight the extent to which activism has become a primary dial-moving force in the current investment landscape.



Source: Strategas Research Partners



Source: Strategas Research Partners

While London has not taken a lead role in activist skirmishes, we are finding the battleground spilling over into our portfolios and see an unavoidable consequence of becoming involved in some of these frays going forward. Our position will always come down on the side of what we believe is in the best economic interests of our clients, whether that be on the side of management or on the side of the activist. Activism, like M&A, IPOs, and LBOs, all are cyclical phenomenoms that are products of circumstances in play at a point in time. These cycles generally move from opportunity to excess over some period of time, and it is the ultimate excess and change in circumstances that make them end badly. While we see that scenario as a possible risk here as well, we do not have any clairvoyant sense of when that might be and what gets us to that point. We will continue to monitor events and expect to benefit from the activism cycle in the meantime.

In closing, we enter the second quarter with a new and evolving set of consensus expectations about when the Fed will embark upon its tightening policy, how world economies will grapple with their own set of growth challenges, what will happen to the global commodities complex, and where the resilient bull market will take investors in the months ahead. Substantial intellectual firepower goes into these forecasts based upon careful analysis of the facts, yet there is a tendency for subsequent events not to transpire as logically anticipated. These are the facts that London would most likely find confusing, thus we will stick to our knitting and focus at the company level where we feel we can add value.

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

Important Disclosures:

*Past performance is no guarantee of future results. This report is for informational purposes only. The statements contained herein are solely based upon the opinions of The London Company and the data available at the time of publication of this report, and there is no assurance that any predicted results will actually occur. Information was obtained from third party sources which we believe to be reliable but are not guaranteed as to their accuracy or completeness. This report contains no recommendations to buy or sell any specific securities and should not be considered investment advice of any kind. In making an investment decision individuals should utilize other information sources and the advice of their investment advisor.

The London Company of Virginia is a registered investment advisor. More information about the advisor, including its investment strategies and objectives, are fully described in the firm's Form ADV Part 2, which is available by calling (804) 775-0317, or can be found by visiting www.TLCadvisory.com.