April 13, 2021

To clients and friends of The London Company:

> *"Let us not look back in anger, nor forward in fear, but around in awareness."*
> *-James Thurber*

James Thurber was a humorist, cartoonist, author, playwright, and journalist known for his quirky and relatable characters and themes. One of the foremost American humorists of the 20th century, his inimitable wit and pithy prose spanned a breadth of mediums and genres, including short stories, illustrations, modern commentary, fables, children's fantasy, and letters (source: Thurber House). Although Thurber was an accomplished writer in various genres, financial market pundit is not generally included among them. Still, as we come upon the anniversary of the 2020 pandemic and market meltdown, his words serve as fitting encapsulation of where investors find themselves at the end of the first quarter.

Looking back over the past 12 months, much has occurred that could incite an angry response. COVID has inflicted total disruption across the entirety of the global economy, shuttering whole industries, derailing supply chains and our normal routines, and transforming daily life in the blink of an eye. The loss of human life has been staggering, and the shutdowns and other response measures enacted have torn at the basic fabric of society. Add to this bleak retrospective the surge in social unrest and the election year vitriol that exposed how vast a divide that exists between our political parties and how Americans view governance. It is not hard to see why we live in angry times, and why many people are fearful of the future.

Yet, the past 12 months also have demonstrated that the will and adaptability of people, and the resiliency of our capital markets are powerful antidotes to anger and fear. Helped by the rapid advancement and deployment of effective COVID vaccines, and the injections of massive fiscal stimulus and monetary accommodation to revive the economy, the fog that prevailed this time last year has begun to lift, and with it a complete recovery to new all-time highs in the equity markets. Over the past 12 months, large capitalization stocks have gained over 50%, midcap stocks have advanced over 70%, while small cap stocks have soared over 90%. These heady returns were not in the forecast last March. There are myriad causes and factors at work here, we want to focus our market awareness on a few key considerations that frame the environment and how our strategies are performing.

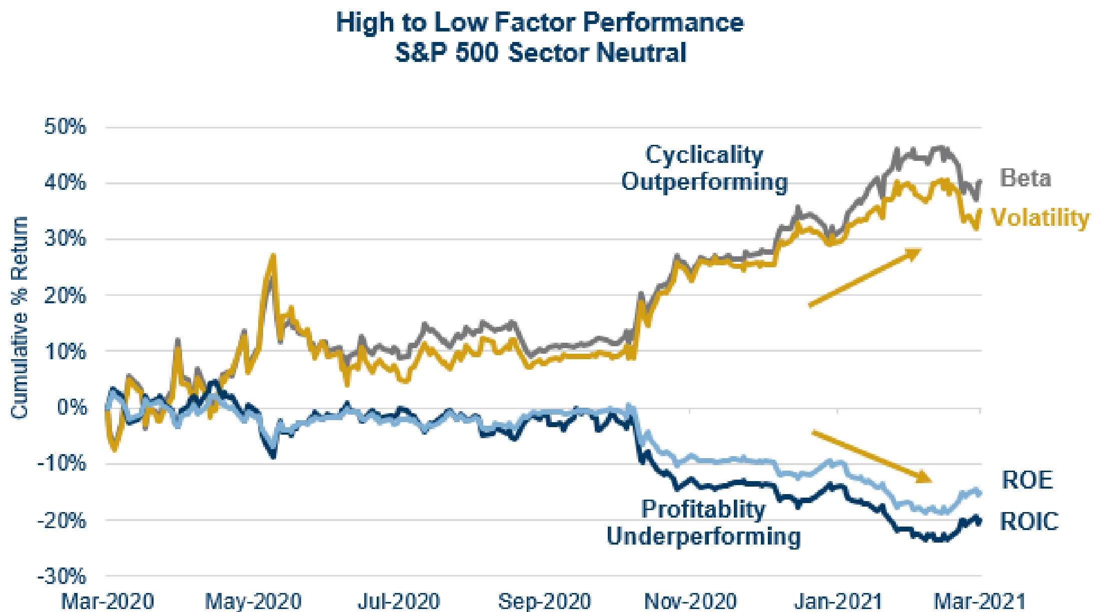
Market leadership continued to favor smaller capitalization stocks, and higher beta, deeper value stocks most leveraged to economic recovery.

An inflection point of the entrenched leadership of growth stocks was reached in 4q 2020. Aggressive fiscal and monetary stimulus, fast tracking approvals of multiple COVID vaccines, and an election outcome that suggested pursuit of more rapid expansionary economic policies shifted investor focus to the downtrodden and most economically sensitive areas of the market. Small cap stocks, and value oriented stocks across the capitalization spectrum snapped back and materially outperformed to close out the year.

This pattern continued during the latest quarter. Small cap stocks posted double the returns of large cap stocks, with the Russell 2000 gaining 12.7% vs. 5.9% for the Russell 1000. The value style materially outperformed across the board in Q1, helping close the gap versus growth over the last 12 months. Attributes that were in vogue included higher beta, weaker financial quality, stocks that had performed poorly during 2020, and stocks that had been subject to elevated shorting. With growing evidence that economic growth was reaccelerating at a pace not seen in decades, cyclical growth beneficiaries-energy, financials (notably banks), industrials, and materials- led the way.

Our portfolios favor lower beta and higher quality/profitability-attributes that are trailing in the current environment.

Attributes that did not perform well over the past two quarters include lower beta and volatility, stronger financial quality and higher profitability. This chart examining how cyclicality vs profitability has performed is a striking visual of the current dichotomy at work:



Source: Cornerstone Macro

As we look across all of our strategies, we have no exposure to the highest quintiles of beta nor lowest quintiles of profitability. We do not find these types of investments attractive in

any environment, but acknowledge that this void resulted in a significantly negative short term performance impact.

Conversely, what we do covet and seek to populate across all of our strategies are durable businesses with superior returns on invested capital, strong balance sheets, and valuations that we believe offer us an acceptable margin of safety. To us, this is the better measure of value, rather than a stylistic definition that relies upon low and unstable multiples on sales, earnings, and book value. We are value investors, not investors in value stocks.

Despite the pronounced headwinds working against us the past two quarters, our performance in the first quarter was mixed. In our Large Cap and Income Equity strategies we outperformed the core benchmarks (gross of fees) but trailed the value benchmarks. Investors pared exposures to the most crowded and concentrated areas of the market—that small handful of mega capitalization growth stocks that had been dominant for several years running—causing a measurable drag on the benchmarks. Besides being over owned and over loved, these stocks also sport valuations with very high sensitivity to changes in long term interest rates. As bond yields began to move higher during the quarter, these stocks suffered multiple compression. What had propelled the benchmarks to a degree that we and others judged to have reached extremes, finally started to revert back again, turning a long term headwind into a tailwind for active managers. It remains to be seen how far and for how long this reversal will carry.

Moving downstream on market capitalization, there were more cyclical headwinds building against us with fewer compensating tailwinds being created. Our Mid Cap, Small/Mid Cap, and Small Cap strategies all lagged the benchmarks (gross of fees), but we were able to capture 75% or better of the upside. Although our upside capture was a little less than our 85-90% full cycle objective, we recognize that the last six months have been an anomalous period, evidenced by the Russell 2000 Value's near 62% gain, its best two back to back quarters on record. While we own many businesses that we believe can thrive in an economic boom, our unwillingness to embrace higher risk, cyclically dependent businesses that traditionally have proven to be shorter duration opportunities will temper relative performance in the current environment. Also it is not necessary to sacrifice quality to participate in a reopening of the economy. For example, less obvious but positioned to capitalize upon this notion are staples companies that cater to the restaurant industry, or pharmaceutical companies that serve in patient care hospital care where reduced utilization has blunted sales during the COVID shut down.

Accelerating economic growth has boosted investor risk appetite and more speculative behaviors.

Over the last 12 months the mood of investors clearly has shifted from "get me out" to "get me in." While obstacles are still hampering efforts to reopen the economy, and COVID risks remain a lurking threat, confidence is on the upswing. A cornerstone of healthy functioning capital markets, confidence and a willingness to take risk are vital ingredients.

There are expressions of risk appetite that raise yellow flags to us and bear monitoring as we move ahead. Option activity and margin interest have picked up, both obvious risk taking

actions. The increasing presence of retail investors on daily trading and stock specific activity is another area of interest. Retail investors have been much more active in very low priced, often dubious stocks, and they have put unusual upward pressure on that cohort as they have banded together through non-conventional trading platforms to exert real influence.

The emerging popularity of SPACs (Special Purpose Acquisition Company), which are shell companies with no operating businesses, is further evidence that animal spirits are on the rise to more tenuous levels.

Sustained value leadership requires durable economic and earnings recoveries.

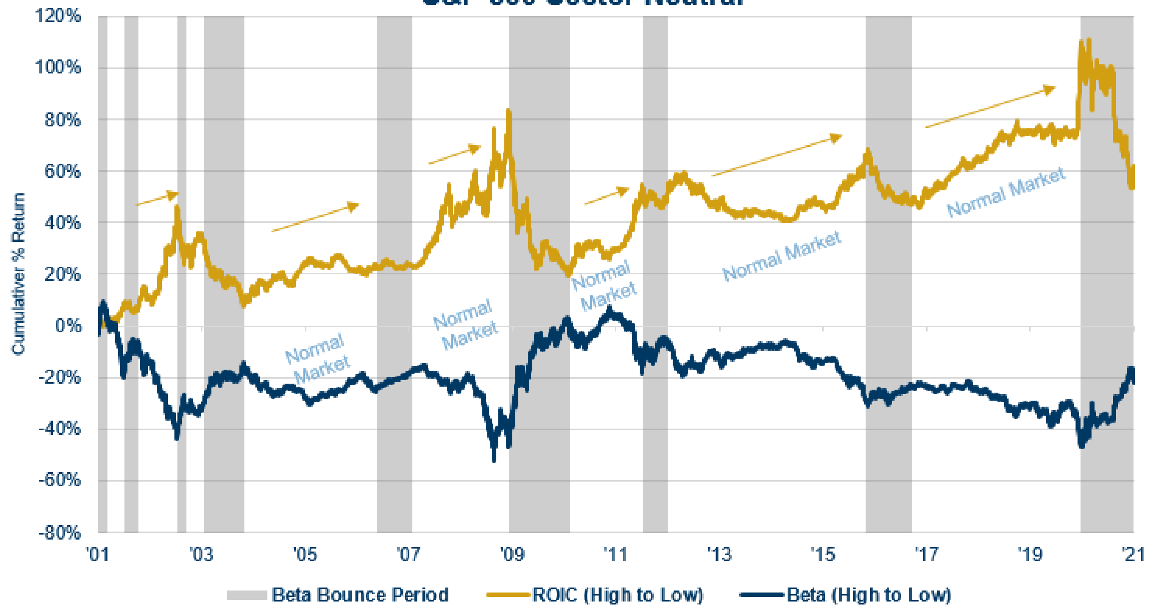
At this juncture, 2021 is pointing to a robust economic recovery. While market valuations are steep, the expected rebound in corporate profits will serve to reduce P/E ratios as investors pursue an earnings-driven market. Earnings are expected grow 40% for large cap stocks and nearly 100% for small cap stocks this year. Fiscal stimulus, equivalent to 10.8% of GDP already moving through the pipeline exceeds both 2020's pandemic response peak and that employed during the 2008-2009 Great Financial Crisis-an unsustainable rate.

Deficit spending and resulting economic growth of this magnitude ignites concerns about the potential to drive inflation and interest rates higher. So far we have experienced a modest backup in rates, albeit historically low levels. The Federal Reserve has vowed to use its considerable arsenal of tools to contain inflationary effects and cushion an upward spiral in interest rates in order to facilitate a full reopening in the economy. This mission will face severe challenges were the economy to maintain the pace we expect to see this year.

While an earnings-driven market equates to a value-driven market, a key consideration becomes how much of this development already has been priced into stocks? Value has enjoyed a conspicuous return to favor in the past six months, and can certainly build upon recent gains. The market will anticipate a peak well before the economy peaks, which puts this recovery on a shot clock.

We are not prognosticators here at The London Company, so we are not prepared to offer a forecast of how long value's return to favor can persist. Duration could be contingent upon how long investors are willing to hold high beta and maintain a high appetite for risk, particularly when fiscal stimulus and cyclical growth wane and interest rates and inflation potentially start to enter the picture. While there clearly is short term opportunity here, it also requires a nimble timing strategy to stay ahead of the market's forward discounting tendencies. We do not believe market timing is a core competency that we possess.

Rather, as long term investors, we try to be aware of what surrounds us and focus on company-specific opportunities as they evolve. As this final exhibit clearly shows, historical reliance on high ROIC investments has proven to be a strategy that can lose battles along the way but tends to win the war over time.



Source: Cornerstone Macro

As always, we appreciate and value highly the trust you have placed in us.

Best regards,

The London Company

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The London Company of Virginia is a registered investment advisor. More information about the advisor, including its investment strategies, fees 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.

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