THE
LONDON
COMPANY

July 7, 2016

To clients and friends of The London Company:

*"**Kris Kringle**: You think I'm a fraud, don't you?*
***Dorey Walker**: Fraud is a bit too strong of a word.*
***Kris Kringle**: But you don't believe in me.*
***Dorey Walker**: I believe that Christmas is for children.*
***Kris Kringle**: Well your daughter doesn't believe in me, either.*
***Dorey Walker**: I don't think that there's any harm in not believing in a figure that many do acknowledge to be a fiction.*
***Kris Kringle**: Oh, but there is. I'm not just a whimsical figure who wears a charming suit and affects a jolly demeanor. You know, I'm a symbol. I'm a symbol of the human ability to be able to suppress the selfish and hateful tendencies that rule the major part of our lives. If you can't believe, if you can't accept anything on faith, then you're doomed for a life dominated by doubt."*

\- *Valentine Davies*

Mid-20th Century screenwriter Valentine Davies created the enduring and endearing story *Miracle on 34th Street*, a holiday classic that uses the Santa Claus persona to affirm the triumph of belief over the entrenched stigma of crass commercialism and personal doubt in post-World War II New York City. Dorey Walker is a divorced mother raising a young and ultra-pragmatic daughter, while juggling her high-pressure role as the Macy's employee responsible for recruiting the iconic department store's annual Santa Claus. She runs into and hires Kris Kringle, and her disbelief in his self-proclaimed "true" identity is converted to belief through a magical series of events and literal trials and tribulations. Besides the obvious seasonal incongruity in pairing this vignette to the mid-year point on the calendar and the advent of the hottest months of a Richmond Summer, Davies old-school and romanticized perspectives serve as a dramatic contrast to the hard-edged views and glib style of last quarter's quoted author Hunter S. Thompson. Why any of that is pertinent to an update of the financial markets and recent results and views from The London Company is the subject of this quarter's letter.

In the first six months of 2016, the investment backdrop has been a bit analogous to a classic summer visit to a theme park where a variety of attention-grabbing attractions await. For thrill-seeking investors, there has been the equity market rollercoaster ride offering heart-stopping plunges from the peak, both early in the year and briefly post-"Brexit", interspersed with whipsaw reversals and rebounding climbs of equal breath-taking magnitude. And like a good rollercoaster ride, the market roughly ended June 30th not far from where it started its journey on January 1. Meanwhile, over in the staged entertainment zone, investors have witnessed the Presidential primary mudwrestling and tap dancing reality contests that have winnowed the candidate field down to hugely unpopular Democratic and Republican presumptive survivors,

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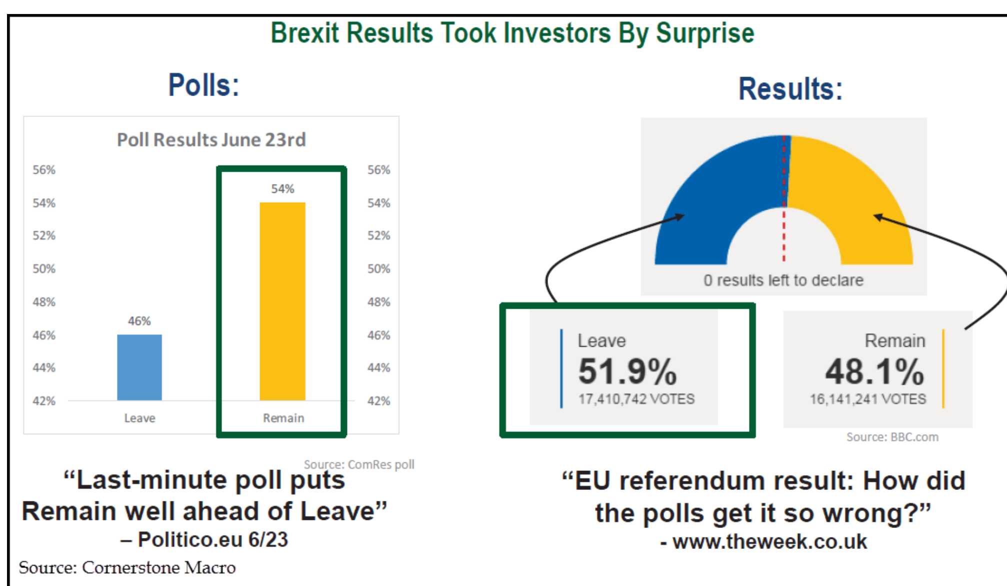
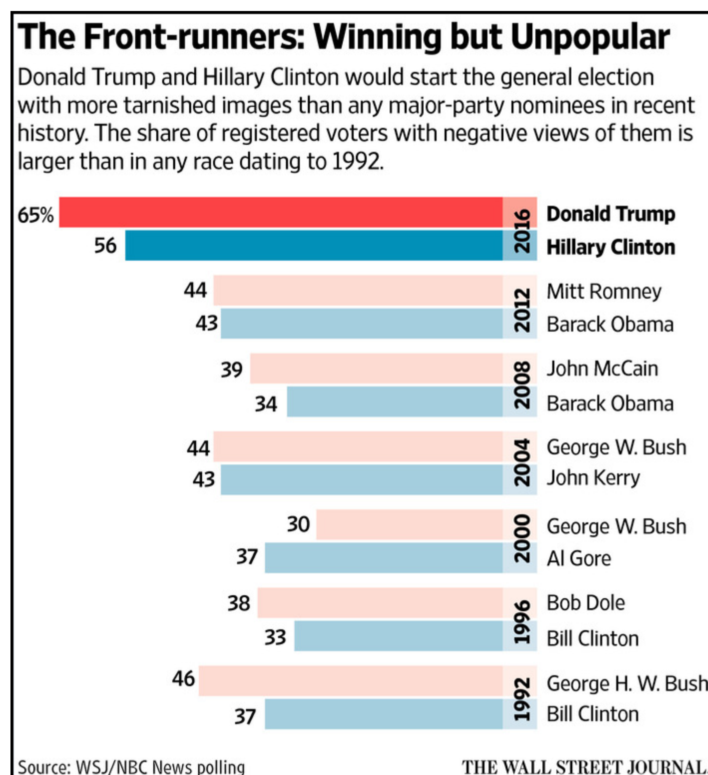
one of whom is most likely to be elected our next President. Alongside this spectacle, the mystifying Federal Reserve show has been playing, with deft sleight of hand policy shifts toward and away from the status quo and a fluid narrative on the future path of interest rates, all intended to convey greater "transparency" to the befuddled crowd. Finally, over in the fun house, the maze of mirrors leading investors on the path to "Brexit" has provided illusory outcomes, dead ends, backtracking, and distortions of all kinds with no clear way out. Each attraction will be looked at in how it has shaped the latest quarter and year to date, and collectively how they link a common market theme that the continuing inability to convert broad-based disbelief into belief and hope for the future overhangs the investment landscape.

Certainly exiting the quarter, the hottest topic has been the UK vote to leave the European Union (EU), the now universally over-saturated term "Brexit". Opinion and speculation as to the outcome of this closely-contested referendum veered back and forth in the weeks and days leading up to the actual vote and ended in a surprise decision to leave. As the graphic below shows, the final polling versus the vote stunned the markets and the anticipatory pre-vote rally in equities quickly reversed into a vicious two-day swoon:



What is apparent is that pundits under-estimated the British citizens' deep-seated concerns about immigration policy and a lack of belief in the future benefits of remaining a part of the EU. What is equally apparent in the aftermath is the total uncertainty on how exit will proceed, if at all. While Prime Minister David Cameron immediately stepped down, in the days following the vote it was reported that over 3 million voters requested that the referendum be put to a second vote, showing widespread doubt both about the decision to remain AND to leave the EU. The allure of the "none of the above" option revived a sense of optimism that a different and less painful course might be forged, although at this early juncture that course is buried within the funhouse maze of mirrors with throngs of prognosticators anxiously bumping into them. Nevertheless, it provided enough impetus to fuel a strong reflex rally in the markets, which erased the two-day bungee and snapped market levels back to where they had been going into the vote. For the quarter it essentially ended as no harm, no foul, and going forward the market will continue to absorb, digest and adapt to whatever occurs.

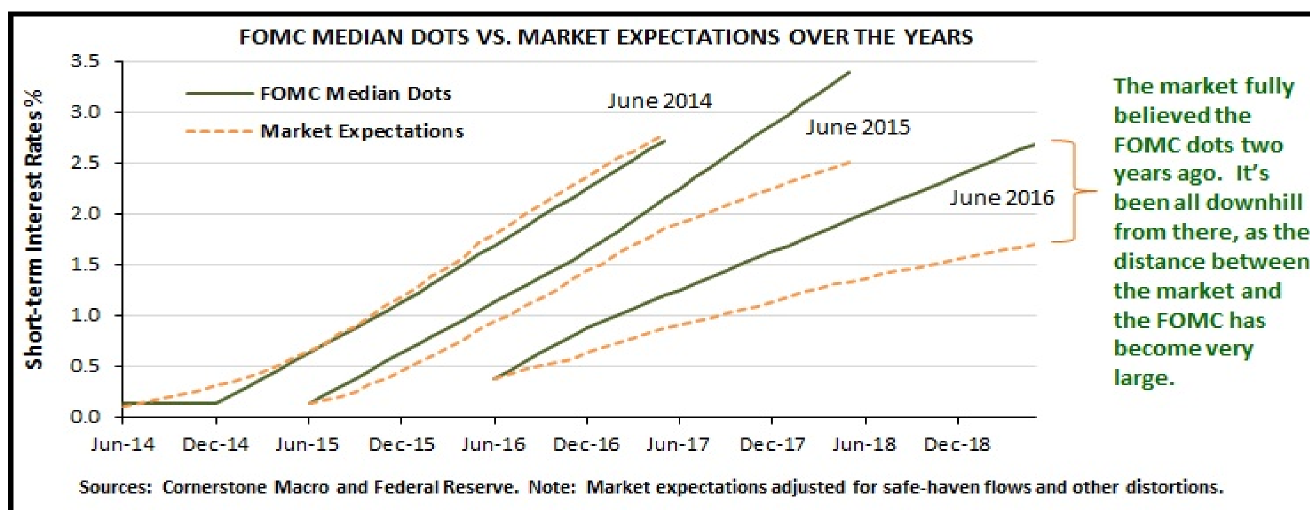
The allure of a "none of the above" option resonated here at home as well, with the quadrennial Presidential election campaign grinding through a discordant primary season, and with disheartening acrimony both within and between the Democratic and Republican parties. Although the national conventions have yet to formalize the party candidates, the clear frontrunners Clinton and Trump and their disparate agendas already have brought a perverse sense of commonality among voters as to how disaffected and disenfranchised so many of them feel about their choices to lead the US. National surveys suggest a wide range of possible outcomes to the November vote that have vacillated in response to unfolding news developments. However, more consistent has been the unprecedented level of disfavor the candidates themselves garner among survey respondents. A *Wall Street Journal* poll from earlier in the year paints a gloomy picture of this year's election race and underscores tepid endorsement of whoever will become the 45th President of the United States:



While such a low bar of expectations could ultimately lead to upside surprise in how the next four years play out - one more future event we are not willing to forecast - voter pessimism and the broad range of uncertainty about governance will continue to overhang the markets for the balance of the year. And in the wake of the "Brexit" experience, investors should be wary of predictive surveys and be mindful that a discontented and doubting public with low belief in this year's electoral undertaking is capable of reaching any number of unexpected decisions.

With such a rocky political landscape, investors have focused attention on the Federal Reserve and trying to interpret the "transparent" messaging on how the Fed is navigating domestic monetary and interest rate policies in a world of entrenched low nominal growth and zero to negative real interest rates. One of the communications/forecasting tools that the Yellen-led Fed has attempted to use is the "dot system" of interest rate targeting. Each of the 17 members of the FOMC anonymously provides their predictions for the target fed funds rate at the end of this

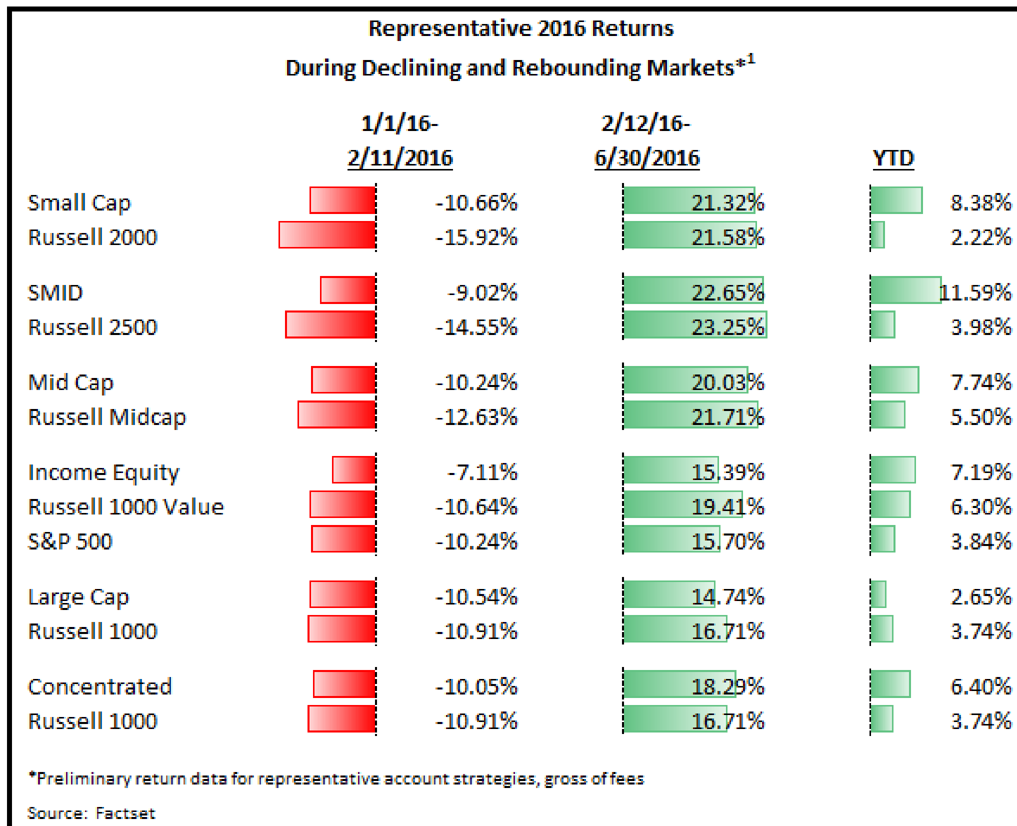
year, each of the next few years, and in the longer term. The Fed releases those consolidated predictions in a chart that includes a dot for each of the members at their target interest rate level for each time period. While conceptually appealing, over time what has ensued have been frequent revisions to the dots as a data-dependent Fed was forced to recalibrate to economic and market fragility buffeted by weakness and financial stress in emerging markets, notably China, a collapse in the shale oil boom, and persistent strength in the US dollar which has exacerbated international trade issues. Not surprisingly, over time investors and Fed followers have demonstrated diminishing belief in the utility of this communications tool, so that the goal of providing greater transparency has only built a higher financial Tower of Babel:



With so much uncertainty and so little credible macro data upon which investors can anchor their fundamental conviction, a little Kris Kringle might go a long way right now - although he does not appear to be a bona fide candidate for elected office. Here at The London Company, we do not rely upon miracles or benevolent mythical figures or forward interpretation of macro data to guide our decisions. The pervasive lack of belief, the persistent overhang of doubt, and the wildly gyrating daily markets only reinforce our core beliefs about eschewing the short term reactionary approach and trying to steer a steady longer term course. Our unwavering conviction in the power of downside protection as the means to achieving superior full cycle returns can be observed even in the recent window of what has transpired over the first 6 months of 2016. Coming off a 2015 year that hugely favored a narrow group of stocks with growth and momentum attributes, 2016 could hardly have shifted gears more forcefully. Value-oriented styles of investment have bounced back smartly, although not in the way seen in previous value-driven markets. Whereas value traditionally has outperformed in more economically pro-cyclical periods, the unusual combination of low and falling interest rates and the ongoing quest for yield, along with a rebound in the over-sold commodities complex produced a leadership profile of strange bedfellows that included utilities, telecommunications, energy, and basic materials while leaving value-stalwart financials in the dust.

There are two sub-periods worth reviewing in the six month results, the approximate 10-16% declines in the equity indices that occurred in January to the mid-February lows, and the approximate 16-23% rallies in those indices from the lows to quarter end. Our belief is that focusing on downside protection generally digs a shallower hole from which to recover, and consequently does not require keeping up with markets during the most robust phases of upside.

Looking at the preliminary data on how our representative accounts performed versus their respective benchmarks over these two contrasting snapshots validate these core beliefs:



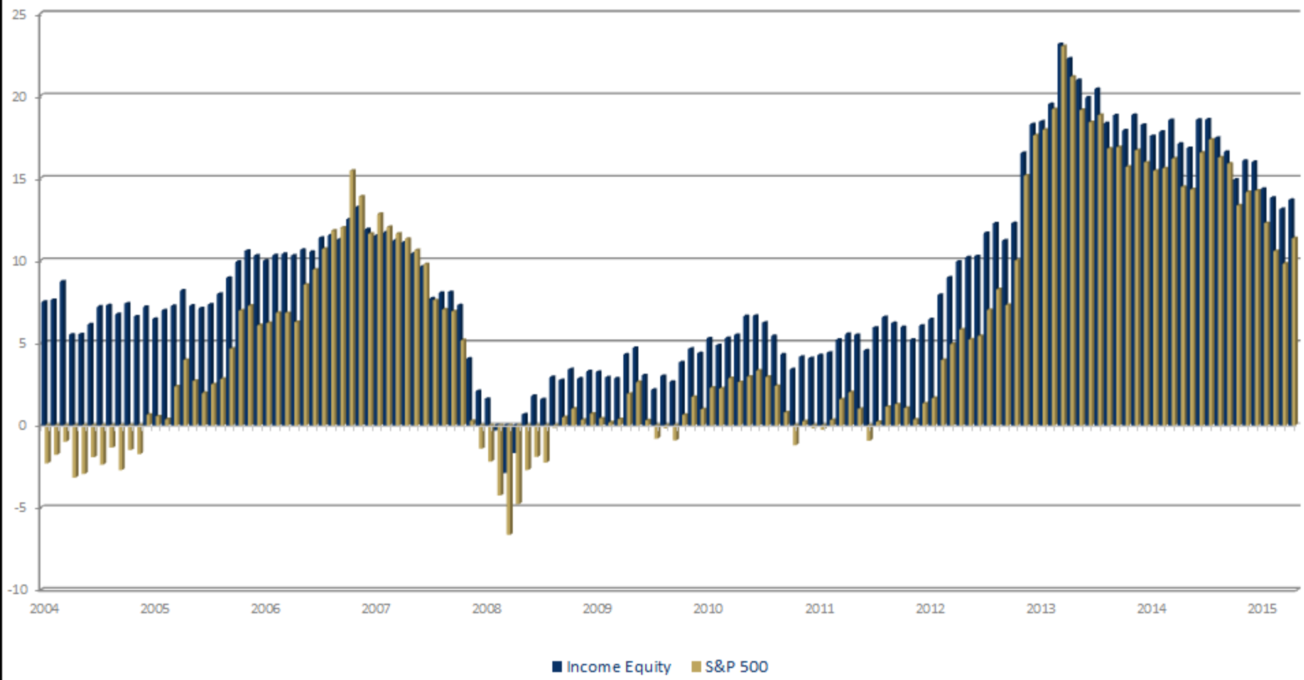
Representative 2016 Returns
During Declining and Rebounding Markets*[1]

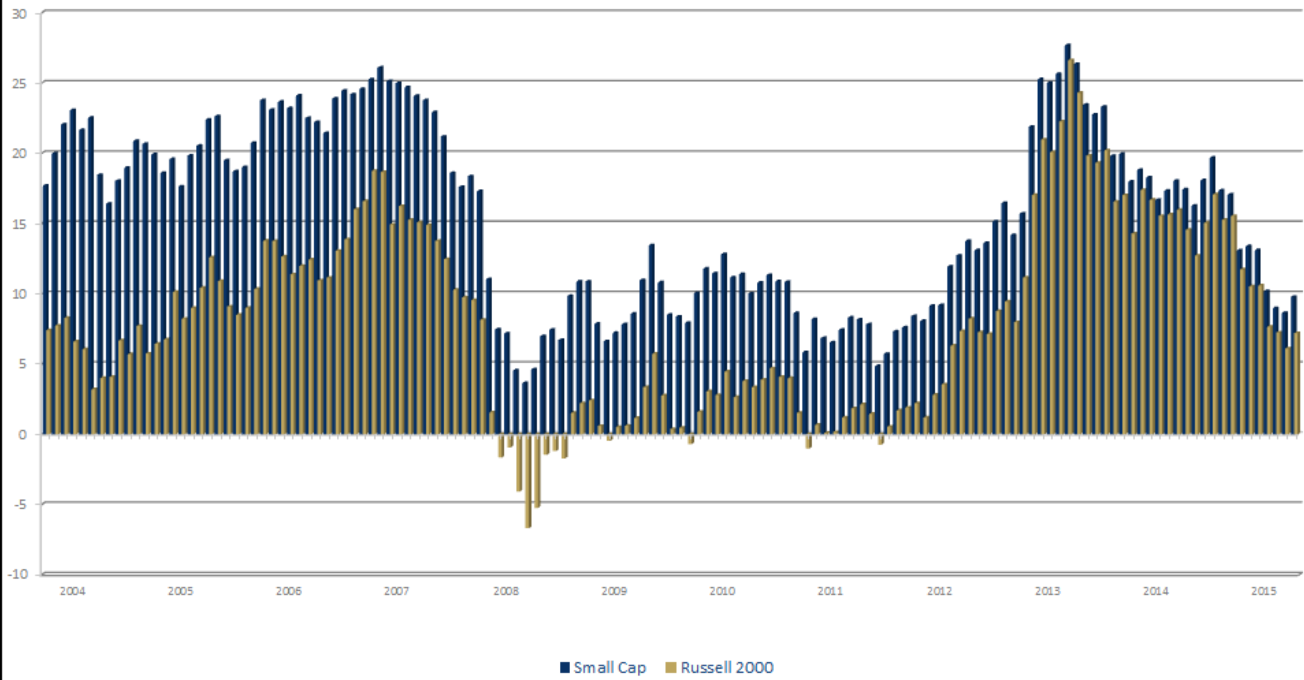
	1/1/16-2/11/2016	2/12/16-6/30/2016	YTD
Small Cap	-10.66%	21.32%	8.38%
Russell 2000	-15.92%	21.58%	2.22%
SMID	-9.02%	22.65%	11.59%
Russell 2500	-14.55%	23.25%	3.98%
Mid Cap	-10.24%	20.03%	7.74%
Russell Midcap	-12.63%	21.71%	5.50%
Income Equity	-7.11%	15.39%	7.19%
Russell 1000 Value	-10.64%	19.41%	6.30%
S&P 500	-10.24%	15.70%	3.84%
Large Cap	-10.54%	14.74%	2.65%
Russell 1000	-10.91%	16.71%	3.74%
Concentrated	-10.05%	18.29%	6.40%
Russell 1000	-10.91%	16.71%	3.74%

*Preliminary return data for representative account strategies, gross of fees

Source: Factset

In the downswing, all six of our strategies accomplished the goal of delivering relative downside protection to the benchmark, some by a greater degree than others. In the subsequent powerful reversal, five out of six strategies did not keep pace in an environment in which we would have expected to lag. More importantly, the combination of those two sub-periods resulted in five out of the six strategies finishing the first half ahead of their benchmarks. The one strategy that did not play out consistent with the others, Large Cap, reflects a greater impact of the unusual bar belled sector leadership cited above, along with a trio of stock-specific issues that detracted from our short term performance. The point here is not to highlight short term performance - as we do not put much credence in short term outcomes and encourage our readers to do the same - rather to illustrate pretty much how we expect our portfolios to perform over the vagaries of the market continuum. Bottom line, we prefer our equity rollercoaster to offer fewer thrills and chills than the market one. A much better validation of the full cycle approach employed here at The London Company can be seen in the 5 year rolling return charts that we often share with our clients and prospects. For reference we are including two of those in this letter to portray the since-inception experience of small cap and income equity, two very seasoned strategies. What these graphics depict is the long term benefits of digging shallower holes by owning more concentrated portfolios constructed on a bottom up basis. We know that all of our strategies have and will encounter periods of underperformance for myriad causal factors, and sometimes these factors can extend into multiple year windows. However, for the true long term investor, the effects of riding the "kiddie rollercoaster" seem to create less angst and distress more of the time, and deliver the most favorable results during those periods of more angst and more distress:


5 Year Rolling Returns¹ Income Equity March 2016
25
20
15
10
5
0
-5
-10
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014
2015
Income Equity
S&P 500
¹ Returns are gross of advisory fees. Each data point reflects the past 5 year annualized return for each month of the stated year.


5 Year Rolling Returns¹ Small Cap March 2016
30
25
20
15
10
5
0
-5
-10
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014
2015
Small Cap
Russell 2000
¹ Returns are gross of advisory fees. Each data point reflects the past 5 year annualized return for each month of the stated year.

As we look ahead, we see all the factors noted previously remaining in the picture over the foreseeable future. The domestic economy remains tethered to ropes of global economic malaise, although it continues to perform relatively better and reveals pockets of improvement in the labor markets, housing, and regional manufacturing production and some nascent recovery in the energy complex. None of these pockets seem to pack enough punch to sustainably pressure overall inflation, thus the long period of low interest rates seems likely to extend further into the future. China remains a huge wild card and potential game changer depending on how it chooses to manage through its precarious financial and economic position. The equity markets are likely to use their "season's pass" to ride the rollercoaster over and over, which is not a promising antidote to the doubt and disbelief that have infected the psyche of many investors. Acknowledging that we have entered our eighth year of recovery, overall equity market levels appear to be more elevated and in the control of short term and algorithmic traders with transient time horizons. However, we invest in companies not markets and for the long term and not the next quarter or next data point, and continue to find opportunities across sectors and market capitalizations. So while we do not believe we have any great insights as to how future events play out from here nor how long the market could be held hostage to its theme park type experience, we do maintain high confidence in how we manage portfolios for our clients and for ourselves.

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.

[1] The performance is GROSS of investment advisory fees and includes the reinvestment of all income. Gross returns will be reduced by investment advisory fees and other expenses that may be incurred in the management of the account. For example, a 0.50% annual fee deducted quarterly (0.125%) from an account with a ten-year annualized growth rate of 5% will produce a net result of 4.4%. Actual performance results will vary from this example.

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.