THE
LONDON
COMPANY

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To clients and friends of The London Company:

"I cannot forecast to you the action of Russia. It is a riddle, wrapped in a mystery, inside an enigma; but perhaps there is a key. That key is Russian national interest…."

- Winston Churchill

In September of 1939, Great Britain was drawn into war against Nazi Germany and the dawning of what would become World War II. The following month, soon-to-be named Prime Minister Winston Churchill delivered a BBC radio broadcast to rally national support for this undertaking, and from which the above and oft-repeated quote was taken. Churchill's intent was to address Russia's likely motives and actions with respect to the escalating military conflict, the key to which was recognition that Russia's actions would be driven by its pursuit of national interests. Given the headline role that Russia again is playing with the burgeoning investigations into its actions related to our 2016 Presidential election, as well as the myriad of potential entanglements with President Trump and members of his administration and business interests, Churchill's observation has become a politically timely one for the summer of 2017. On another level, it also captures the puzzlement investors are expressing at the seeming dichotomy of a placid and solid first half market advance against a backdrop of global geo-political uncertainty and economic cross-currents. With no additive insights or forecasts as to how Russia's national interests will be served as these political tribulations unfold in the months and years ahead, we will refrain from discussing them further in this letter. Instead, we want to turn our attention and focus to what has transpired within the market over the course of the latest quarter, and the Churchillian enigma of rock-steady capital markets in a decidedly unsteady world.

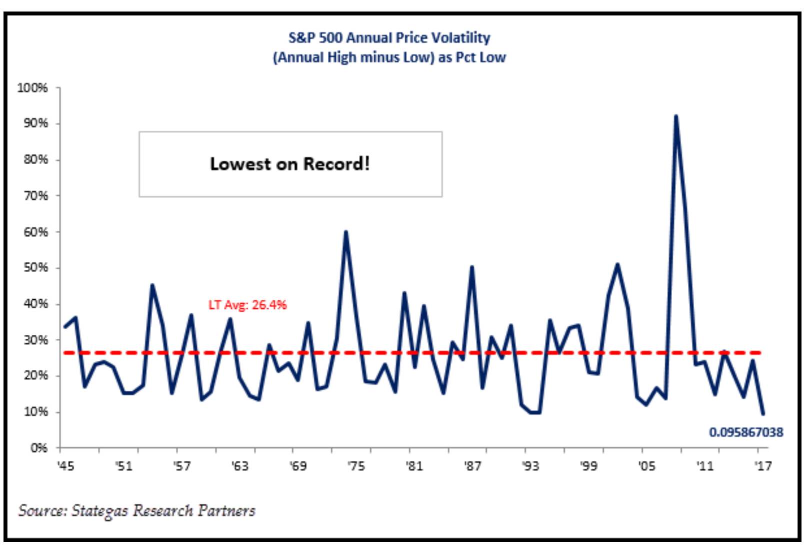
There is an old investing axiom that markets hate uncertainty. There is another axiom that markets climb a proverbial wall of worry. So far this year, elements of both axioms have intersected, weaving a narrative of odd co-existence. Looking around the globe, investors have been subjected to a laundry list of angst-inducing macro challenges. Certainly North Korea and its increasingly bellicose actions have garnered close scrutiny and an intensifying war of words with the United States. Between the two interests sits China, which has yet to defuse the tension and has shown more intent on engineering economic recovery while attempting to shore up a questionable banking system. In the Middle East where instability is a way of life, Syria and Qatar remain hot spots. Western Europe has enjoyed economic recovery but has suffered from an uptick in terrorist-related acts that have put its citizenry on alert. Britain, which has borne the brunt of these recent assaults, faces the added complexity of juggling domestic and regional political backlash as it strives to create an implementation roadmap for "Brexit." And the roadmap for Brazil has been no less smooth, where a nation mired in deep economic recession grapples with its second presidential impeachment trial in less than a year.

804.775.0317 TEL 804.649.9447 FAX www.tlcadvisory.com 1800 Bayberry Court, Suite 301, Richmond, Virginia 23226

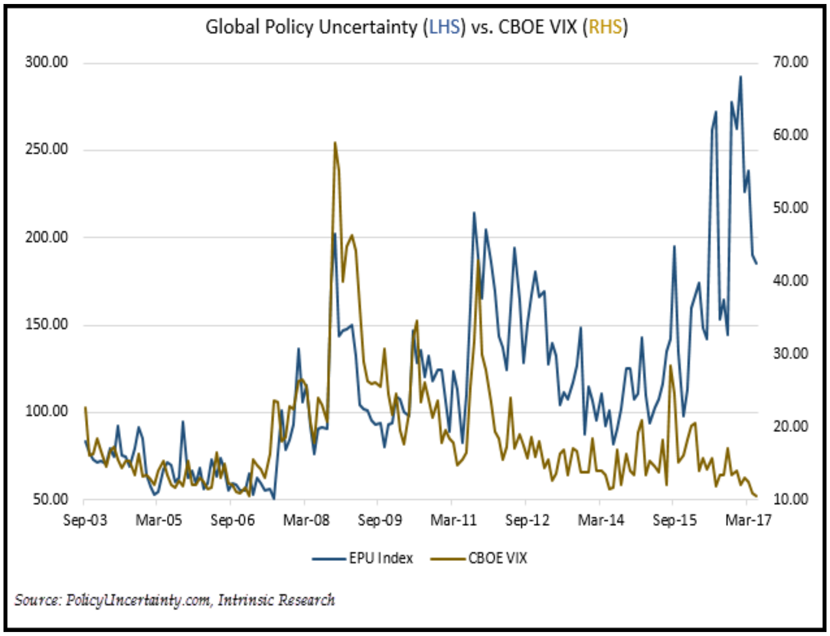
Meanwhile here at home, there has been the aforementioned Russian saga, which has dueled for share of mind with the ongoing debate on ACA repeal/healthcare reform, along with reform initiatives on the budget, trade, personal and corporate taxation, Dodd-Frank, and Department of Labor fiduciary rule, just to name a few. The early months of the Trump administration have been a series of noisy, blunt-force thrusts and parries to drive change without bridging the yawning ideological divide that persists between our elected leaders. While Washington has been immersed in variations of "reformation", the rest of the country has been consumed more with a commercial revolution, as Amazon has led the relentless, accelerating trend of disruption to the traditional retail transaction model. Disruption in Washington and disruption on Main Street have marked the first half of 2017, yet neither has been able to derail the plodding but durable economic expansion we have experienced in the US that has pleased Wall Street. Overall, economic activity as measured by GDP grew at a 1.4% pace in the first quarter, below expectations of 1.9%. Economic reports became mixed, with employment still strong but manufacturing, housing and auto sales softening a tad. Corporate profit comparisons improved. Tame inflation readings did not deter the Federal Reserve from sticking to its script and raising rates for a third consecutive time in June.

Stocks and bonds seemed to interpret the data differently. With moderating inflation, a declining value of the US dollar, and mixed economic signals, long term interest rates fell for most of the quarter and the yield curve flattened out, historically cited as a precursor to a weaker future economy. Conversely, with global inflation and interest rates at such low nominal levels, US fixed income continued to offer competitive yields and narrow spreads, thus comparatively attractive for global capital still in search of incremental basis points of return. As long as central banks remain accommodative in providing liquidity, bonds are likely to find a bid. For stocks, the emphasis leaned on profit improvement and hope for future economic recovery over current growth, reflected by ongoing fund flows into equities and resilient confidence/sentiment measures. Despite all of the uncertainty previously noted, equity investors held to a view that optimists would characterize as sanguine and skeptics might call complacent.

Judging by the macro picture and news flow, one might have expected the recent quarter to have been a volatile and problematic one. However, the actual outcome, as often is the case with expectations, proved otherwise and why here at The London Company we eschew that type of forecasting. During the second quarter, equity indexes advanced to record highs while index volatility, as tracked by Strategas Research Partners, moved to record lows:



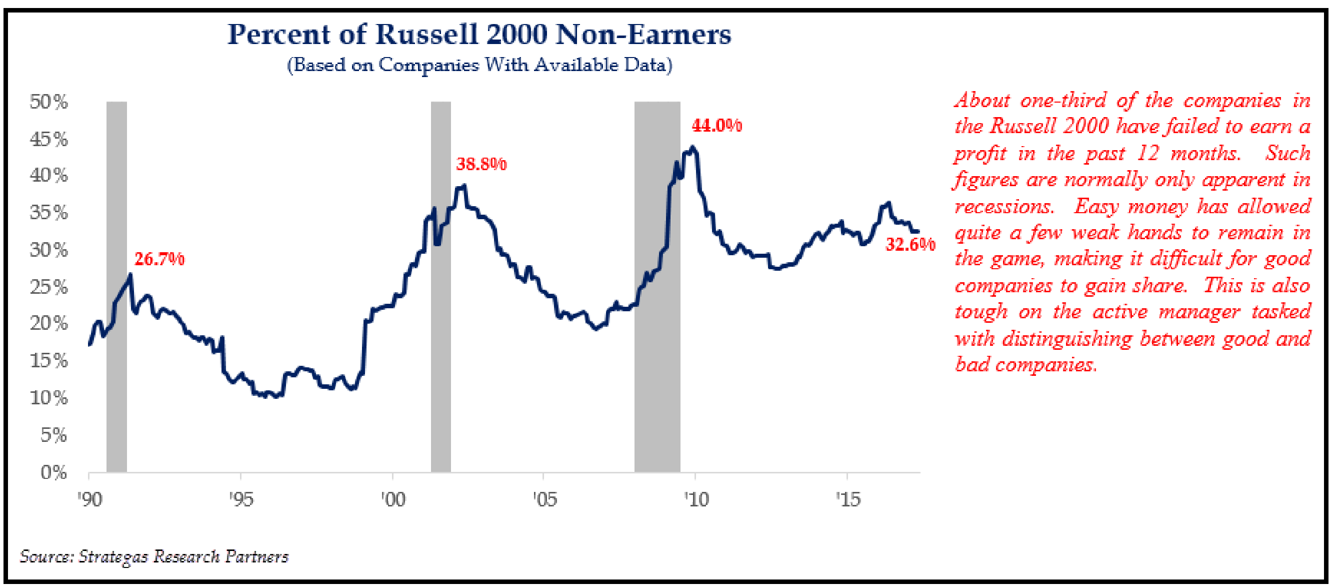
Volatility is commonly used as a measure of market risk, which in turn is viewed as an investor fear gauge. The "VIX," another popular index, was created by the Chicago Board Options Exchange to measure short term market volatility as expressed through S&P 500 options contracts. The embedded expectations in the VIX are that low readings imply low investor fear of current risks, while high readings imply market anxiety. We recently came across an interesting chart that juxtaposed the VIX against a policy or macro uncertainty index. This economic policy uncertainty index (EPU) was created by Northwestern University researchers in academic collaboration with Stanford and the University of Chicago. The visual overlay looks like this:



The upshot here is that while macro policy and market uncertainties have tended to move roughly in sync over time, some divergence began to appear in 2012 and since late 2015 the two indexes have diverged materially. So while global uncertainty remains quite elevated, investor concerns have receded to enigmatic levels that prompt the question of how this divergence ultimately will be resolved, and if low market risk readings truly reflect fearlessness or complacency?

We don't try to outguess the market in these matters, so readers may be disappointed that we will not opine on the question of resolution. We can report how low volatility was manifest in the quarter just ended, and how our portfolios performed in that environment as we reach the mid-point of 2017. During Q2, equity indexes grinded higher by 2-3%, with larger capitalization companies slightly outpacing smaller ones, and growth-oriented benchmarks more noticeably outperforming value-oriented ones. Large capitalization growth has been the leader year to date, with the healthcare and technology sectors consistently strong across the capitalization structure. With the decline in interest rates, utilities also have performed well. Momentum strategies also have tended to work well in this environment. Growth and momentum are two attributes historically ascribed to the "FANG" stocks (Facebook, Amazon, Netflix, and Google), and they have re-emerged as market leaders so far in 2017, though not to the extremes seen during the FANG-exclusive market in 2015 when those stocks drove virtually all of that year's performance. A new wrinkle in the FANG stocks this year, and one shared more broadly by technology stocks is the emergence of measured stability in the names. Investors increasingly believe in the combination of growth and stability in these names, and as more and more money has poured into these positions, those flows have helped anchor stability, which is contributing to the record low market volatility we have described. It remains a very macro-dominated investing landscape, and while market followers point to the drop in inter-sector correlations as a positive development for stock picking, intra-sector correlations remain historically high and not overly discriminating with the relative fundamentals of companies within the sector. Since we pick individual stocks and not sectors, this construct on balance remains a headwind to our approach.

Looking across our portfolios, our large cap strategy finished in-line with its benchmark for the quarter. Income Equity performed ahead of the value benchmark but trailed the broader core benchmarks where the technology and healthcare impacts were far greater. Moving down the market cap spectrum, the quarterly differential of performance shortfall became more significant as the gap between sector leadership and types of businesses we favor and will invest in grew progressively wider. In past commentaries we have highlighted some of the index and stylistic headwinds that are the most exaggerated against our approach. When performance drivers favor growth and momentum that dynamic tends to work against us. When technology and healthcare are atop the leaderboard, we also tend to lag. Last quarter we devoted considerable space to discussing the continued explosion of passive investing and how those fund flows have skewed the playing field for active managers. This past quarter was more of the same, and by example we show the still-growing influence of unprofitable companies on recent benchmark performance as just one glaring trend that is occurring outside our opportunity set of investments that fit our criteria.



We observe the trends and uncertainties of today's market, and we are in continual debate as to what adjustments to make while staying true to our core beliefs. As the market attains each new high water mark, we remind ourselves of the words of French philosopher Pierre Teilhard de Chardin; "remain true to yourself, but move ever upward toward greater consciousness…At the summit you will find yourselves united with all those who, from every direction, have made the same ascent. For everything that rises must converge." For the market, that ascent has followed a winding path of adaptation to the times, which has provided toeholds to scale those walls of worry during difficult periods, resilience to recover from periodic slips and falls, and endurance to rapidly cover a lot of ground when the road is smooth, as has been the case more recently. We have chosen a different path of ascent, one intentionally dissimilar from the market and routed with careful intent to circumvent the most dangerous points in the road. It can be a slower path at times, but we understand that as the market evolves and adapts, there will be periods of divergence. But as long term investors, we also understand the market's tendencies to extend and then revert, and welcome the convergence that we expect will follow.

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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