THE
LONDON
COMPANY

July 13, 2020

To clients and friends of The London Company:

"The only constant in life is change"
– Heraclitus

These simple words are credited to ancient Greek philosopher Heraclitus over 2,500 years ago, but they still resonate today. Change is constant. Its pace may vary, but its inevitability is true. In the first six months of 2020, unfathomable change has happened in nearly every aspect our daily life. The rapidity of it has been unsettling, raising stress and anxiety levels across the world. The global COVID-19 pandemic has changed how we work, how we educate, how we sport, how we travel, how we shop, how we socialize and generally how we think and act when doing everyday things we never had to think about before. It has been surreal and scary. It is our collective hope that this new normal proves to be temporary, yet permanent change is all but certain.

The London Company is relying on our longer-term orientation, helping us process the rapidly changing landscape without feeling the need to have all the immediate answers. The passage of time allows us to digest the impacts the environment is having on our health and well-being, and by extension, its influence over financial markets. It is a bit ironic that the term 20/20 vision means seeing clearly and having acute clarity, while the year 2020 is full of uncertainty and riddled with gross speculation. The COVID-19 pandemic remains a mystery with varying estimates on its lasting duration, ability to mutate, or its eventual curability. With imperfect information, it is natural to see equity prices react to the uncertainty with extreme volatility this year. In fact, we have to go back to the 1930's to find anything like it. So far, in 2020, the S&P 500 Index has returned -20% and +20% in the first two quarters. This odd Jekyll and Hyde symmetry would rank both in the top 10 of best and worst quarters ever. Depending on your disposition, it's either good news or bad news this year is now half over.

In last quarter's commentary, we highlighted all the records being broken, marveling at the speed as we transitioned from the longest bull market ever to the fastest bear market in history. This most recent quarter was just as unusual, with the market discounting current data to look past a COVID-19 economy. Massive monetary and fiscal stimulus have helped offset closed businesses and record unemployment, easing the pain for everyday Americans. The Federal Reserve's heroic efforts (more on this later) have lowered interest rates and increased liquidity, lifting asset prices across the board. The sudden change of pace does

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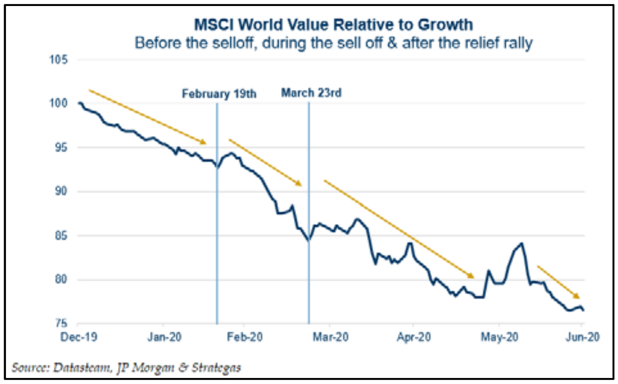
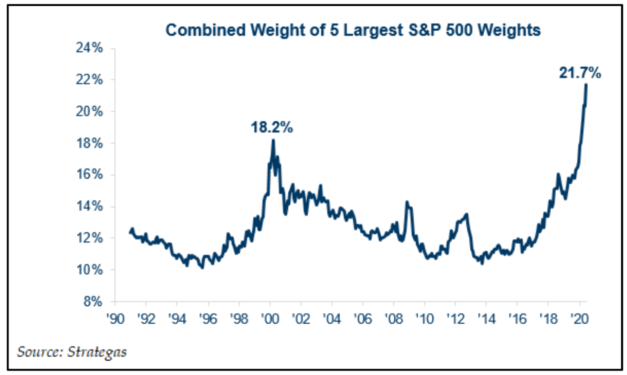
bring some unintended consequences though, and generally more questions than answers, so we will use the rest of this letter to share some of our thoughts and potential fears.

First, let us report on our performance. As long-term owners of great businesses, short-term measurements are not very meaningful whether good or bad, but we want to highlight that we performed as expected. The S&P 500 returned 20.5% this quarter, to be exact. The smaller cap asset classes did even better, with the Russell 2000 Small Cap Index returning 25.4% and the Russell Mid Cap Index increasing 24.6%. We never expect to keep pace in markets that robust, so it is not surprising that all of our strategies lagged the benchmarks this period. For the year-to-date, all indices remain negative with the broad market S&P 500 down 3.1%, providing a textbook example of why capturing less downside is still more important than focusing on the upside. On this measurement, our portfolios remain mixed when compared to their core benchmark, with our SMID and Mid Cap strategies ahead year-to-date but our Large Cap and Small Cap strategies trailing. Our Income Equity portfolio is ahead of its primary benchmark the Russell 1000 Value Index, but is lagging the S&P 500 for reasons discussed below.

Perhaps the only thing that has not changed this year is Growth's dominance over Value. This decade-long trend has accelerated, setting record deviations between the two styles. Even during the downturn in March and across the capitalization spectrum, growth stocks were more defensive and outpaced value stocks significantly (see chart below). For large caps, this quarter's rally was more of the same, as gains were generally concentrated in the biggest, most expensive pockets of the market. The Russell 1000 Growth Index is now up 9.8% for the year through June, while the Russell 1000 Value Index is down 16.3%. This 27% performance delta is astonishing. The London Company portfolios often fall in between the growth and value spectrum so expectedly our performance did the same. The unrelenting demand for growth has concentrated the returns into the largest companies, diminishing the ability to differentiate from the index. The S&P 500 has progressively become more growth oriented and narrow in its results, with the five largest companies (Facebook, Apple, Amazon, Microsoft and Google) now accounting for 21.7% of the index, up four points just since the start of the year (see chart below). Their strength and concentration have weighed significantly on the total index return, so much so that the equal-weighted version is trailing by roughly 8% this year. The biggest gains have been in the Technology sector where it has outperformed in both and up and down periods and has become a larger part of the benchmarks, now representing 28% of the S&P 500 and a substantial 44% of the Russell 1000 Growth Index.

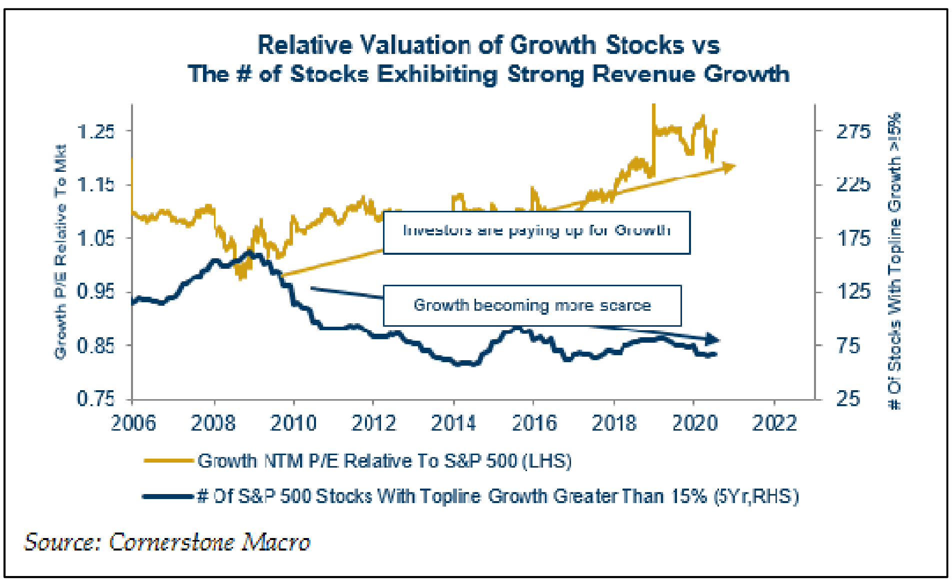


Source: Datastream, JP Morgan & Strategas



Source: Strategas

Extreme deviations are not just happening in the largest five companies but across a wide swath of stocks promising accelerating growth. The preeminent large cap growth index, the Nasdaq 100, has surpassed the peak of the tech bubble in terms of outperformance. For only the second time ever, the Nasdaq 100 to S&P 500 ratio is four standard deviations above its four-year moving average. The question is why. We believe there may be a few reasons, but that mostly the influence of low interest rates and cheap capital has spurred risk taking, increasing the prices (and valuations) investors are willing to pay for growth as it becomes scarce (see chart below).

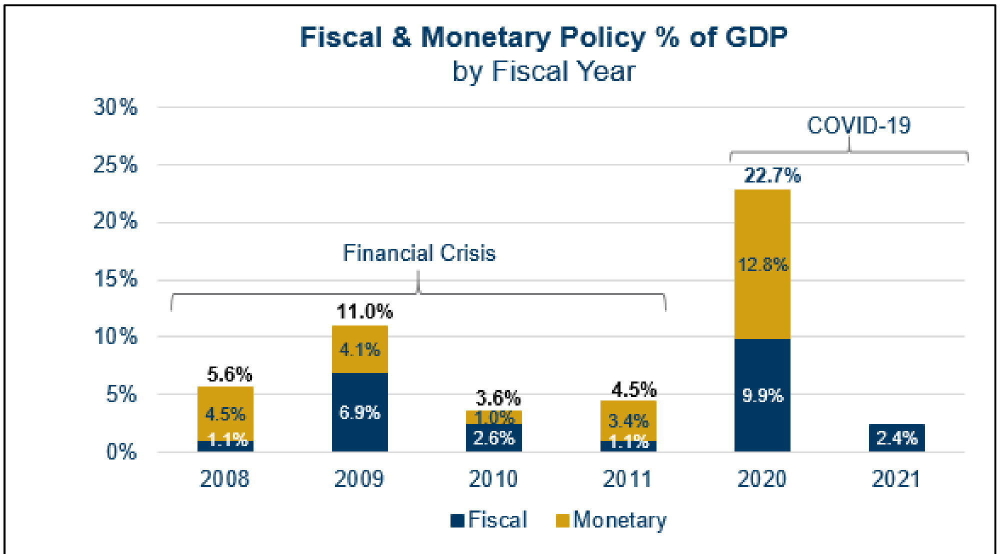


Source: Cornerstone Macro

As a reminder, The London Company does not look at businesses through just a growth or value lens. We frankly look for both. We want high return on capital, cash generating enterprises while trying not to overpay for them. We also acknowledge that the legacy definition often separating a growth versus a value stock, price to book, is a bit antiquated. Many of the leading companies today are no longer capital intensive with large fixed assets, but rather have significant intangible assets that do not appear in tangible book value. These assets are just as real and valuable, but often get unrecognized with that price to book metric. However, when measuring many of these same companies on cash flow, a metric we never believe will go out of favor, we begin to scratch our heads. On this count, the Russell 1000

Growth Index is now twice as expensive as the Russell 1000 Value Index, with the spread widening the most this past quarter. This truth is even more pronounced in small caps, where cheap capital is keeping afloat 'zombie companies' or those not earning enough to meet their annual debt burden. The strength of these loss-making businesses is not new, but ever increasing within the composites, now making up roughly 42% of the total Russell 2000 Index.

We believe reduced risk aversion can be linked to the actions of our Federal Reserve. The balance sheet of the Fed has doubled since the beginning of this pandemic. In just weeks, we have accumulated decades of debt, as nearly $4 trillion in stimulus has been deployed to help stabilize the economy and soothe financial markets. In addition to the interest rate cuts, a slew of programs were initiated, a true alphabet soup of monetary aid to help minimize the pain. As a percentage of GDP, the fiscal and monetary efforts have already surpassed those of the great financial crisis with more likely on the way (see chart below).



Source: Strategas

These efforts have again proven the benevolence of the Fed and put a theoretical floor under asset prices. Our fear is that some companies are remaining solvent longer than they should and the cheap capital is postponing their inevitable failure. There is never a free lunch, but the frenzy of this past quarter is creating all sorts of anomalies and unintended consequences. One curious observation is the reemergence of the retail investor. The market rally has garnered their attention and they are partying like it's 1999. At the largest brokerage platforms, over 2.1 million new accounts have opened this year, the most since the tech bubble. Whether it's the now free commissions offered by these platforms, government stimulus checks, or the lack of sports or other forms of gambling, the interest in speculative stocks is running high. As the kids say, FOMO (fear of missing out) appears to be real. The influence of retail assets are not as significant as institutional but their impact was visible. The most bewildering example was the first of its kind, an attempted equity issuance by a declared bankrupt company. The car rental company Hertz sought to raise over $1bn in stock even though it was worthless, just because they believed retail investors would accept it. Similar to the bubble in cryptocurrencies a couple years ago, there are increasing instances of speculative bets based on little fact or reason. This behavior helps explain why the most hated stocks and lowest quality companies did best in the second quarter, or how a startup like Nikola, a company with zero revenues and no real product yet, amassed over $30bn in market cap just based on hope. These examples fall outside our circle of competence, but they extend to the valuations of other successful, profitable businesses and give us pause when it relates to the risks underlying many equities.

Expectations of a quick economic recovery have boosted the valuations across the board, despite the lack of guidance at most companies. As a manager focused primarily on downside protection, we know valuation matters. Our process reduces speculation and limits forecast risk, so we rely on the strength of the balance sheet and quality of the business to protect us, and over longer periods of time that has proven to serve us well. As we observe the market today, we really do not know how the pandemic will unfold or what long-term impacts will emerge from this crisis. We do not know which businesses will reopen or how many jobs will be lost permanently. Market volatility will likely continue but our temperament will remain the same. We aim to own quality assets that will endure any market environment. We stay fully invested so we don't have to worry about short-term price movements. There is a reason we did not make massive changes during the swoon and recovery. We were comfortable with the businesses we owned entering the year and feel even better about them today. For the few companies that were caught in the crosshairs of COVID-19 and had to mortgage the future with excessive debt, we stress tested them and sold if risk of permanent impairment increased. For the most part, our actions this quarter were on the margin, adding and trimming to some of our existing holdings at attractive prices. We are thankful to have clients that understand our long-term outlook by providing us long term capital. The same alignment of interest is what we seek with our portfolio companies as well.

Looking ahead, our focus remains on the health and well-being of our clients, colleagues and friends. We know the road to recovery is foggy and paved with sharp turns. The uncertainty can be fraught so we reduce anxiety by focusing on the things we can control. We use time to our advantage and rely on our disciplined process to protect and grow your capital. Change can be swift and unnerving, but our response will remain calm and measured. In a year so full of surprises, we can only hope to find some normalcy soon. Thank you again for your trust and support, and please feel free to contact us with any questions or concerns.

Best regards,

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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.

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