THE
LONDON
COMPANY

January 5, 2017

To clients and friends of The London Company:

"What we anticipate seldom occurs; what we least expected generally happens."

-Benjamin Disraeli, Henrietta Temple

Disraeli, a two-time Prime Minister in Victorian England, is better remembered for his distinguished political legacy as leader/defender of Britain's conservative party than for his contributions to its literature. And while his novel *Henrietta Temple* is unlikely to be found on any "Top 10" lists of Victorian prose, the excerpted quote captures perfectly the house view here at The London Company with respect to the year just ended and the one that has just begun. As we were putting together last year's missive, we were trying to provide context around a year dominated by growth, momentum and narrow market leadership set against a backdrop of a collapse in the global energy and commodity complexes and a China teetering on the brink of economic implosion. The future seemed daunting, and the market consensus was decidedly negative. Our concluding comment in that letter may have proved the most prescient: "Entering an election year, change might be a word that the weary American citizenry will embrace as it votes to select its next President and confront an incumbency of stagnated governance."

Change proved to be the operative word in recapping the key events of 2016. The equity markets started the year as feared, with China and commodities jointly responsible for engendering one of the worst 1Q starts in history. However neither oil nor China spiraled into the anticipated disaster scenarios weighing upon equities. Instead, as leading economic data began to suggest that a positive inflection point had been reached, a dramatic "V"-bottom for commodities and equities occurred in mid-February, beginning a significant change for the better. As has been the case in such previous gut-wrenching swoons, the industries/sectors under the most stress - in this case energy, materials, and banks - enjoyed the largest degree of subsequent rebound over the balance of the year, defying the expectations of most prognosticators and those investors positioned for doom and gloom.

The fear of China and commodities derailing the equity markets next was supplanted by equally-dire expectations when the "Brexit" vote shockingly sided with change, contrary to the prevailing "wisdom" that British voters would support the status quo. We got neither the expected outcome with the vote nor with the market's response, as the FTSE 100 powered to an almost 19% recovery in the vote aftermath low point through yearend. While the true impact of the "Brexit" decision is yet to be known and should come into play during 2017, in 2016 it perversely punished those investors who attempted to position portfolios both defensively and/or in favor of the status quo.

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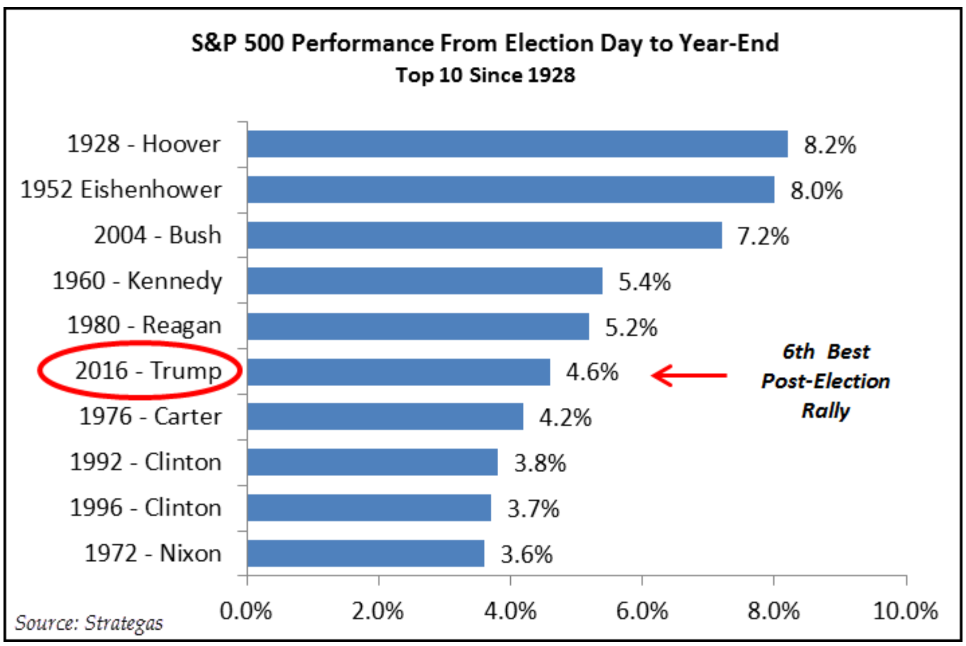
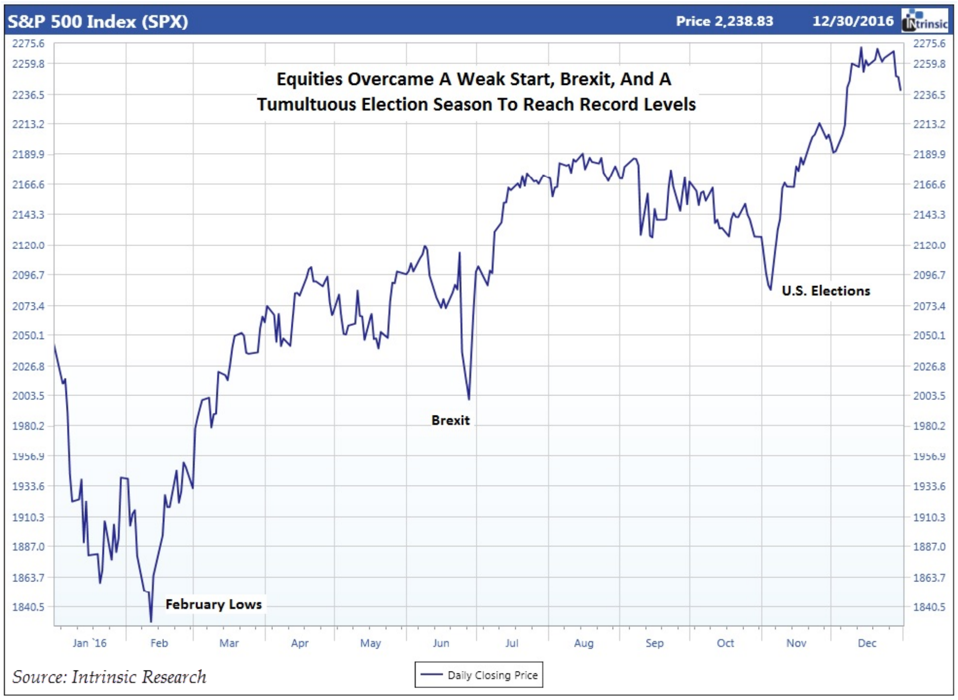
The upheaval to start the year and with the June "Brexit" proved to be harbingers for 2016's main event, the US Presidential election. We have little insight to add to the copious public narrative of how it came to pass that a reputedly unelectable candidate, who had alienated much of the mainstream leadership of his own party, managed to snatch victory out of the jaws of defeat. While we certainly were neither bold enough nor clairvoyant to predict a Trump victory, we were not surprised at how strongly the national undercurrent for change was running in this election year and ultimately how that was made manifest. Initially, the market response was a short-lived but harrowing 5%+ after-hours plunge in the S&P 500 Futures on election night (and not down more due to market-imposed circuit breakers that halted trading), as the Trump victory became cemented and as some worst market fears became an unimaginable reality. However, investors quickly pivoted to embrace change and the perceived future potential that it could unlock a number of intractable fiscal and intransigent governance and regulatory issues that have trapped the US in a long-running, Rod Serling-esque episode of "The Twilight Zone".

A primary catalyst for the markets during the fourth quarter clearly was the election, with that outcome driving the 6th best post-election rally since the Great Depression:

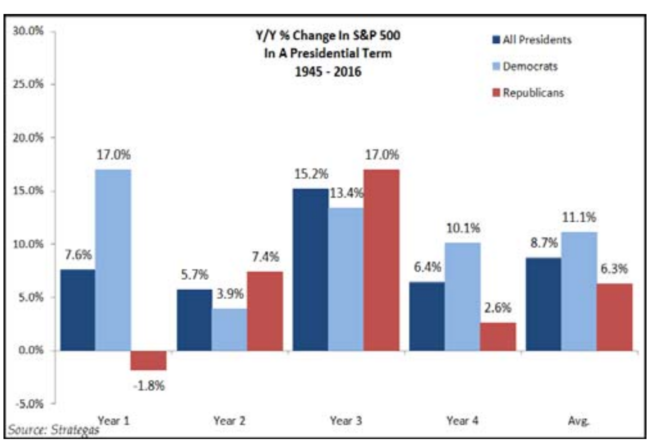


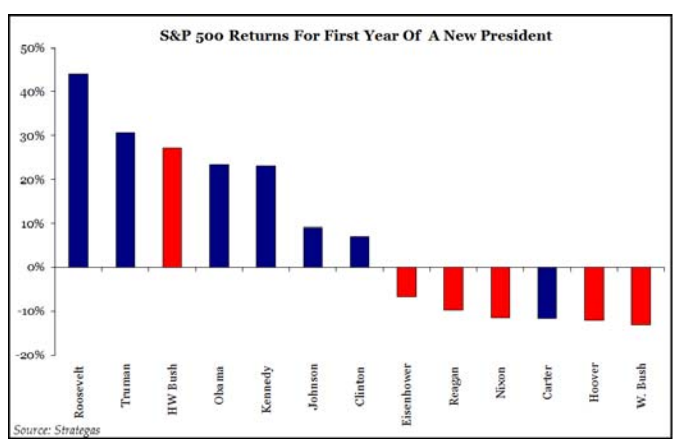
Along with the election, a pickup in economic growth, led domestically by a stronger labor market and wage growth and signs of broader improvement, further underpinned the rally. A surge in confidence both by consumers and corporate leaders also contributed to gains and fortified the resilience of an already-firm US dollar. All of these factors extended a maligned but durable period of slow but steady economic recovery, that now has reached the 7.5 year mark since the end of the 2008-2009 Great Recession, thus making it the fourth longest interval between recessions in United States' history. Even December's Federal Reserve action to boost interest rates and recalibrate upward its forward trajectory of future interest rate increases did little to blunt market optimism, as the re-energized focus on fiscal policy trumped the long-standing dominance of monetary policy.

Revisiting the 2016 roadmap below, each of the three key unexpected events discussed previously resulted in upward-biased responses in the stock market that defied the prevailing consensus opinion:

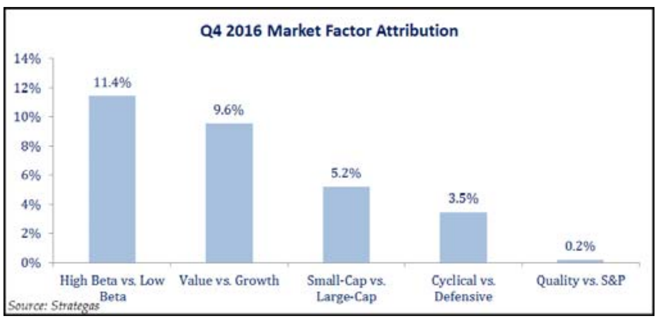


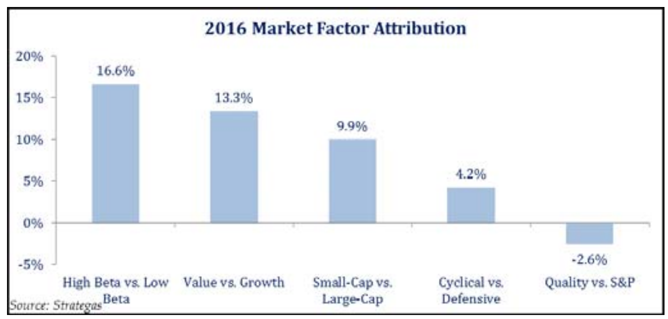
In spite of these serial speedbumps and recurring admonitions of likely negative market impacts, the fourth quarter and full year actually played out in line with past outcomes in the final years of the Post-World War II Presidential cycle, where the S&P 500 has averaged about a 10% advance with an incumbent Democrat. The real anomoly of 2016 might have been the Chicago Cubs finally winning a World Series after a 108 year drought. Of course, using this history as a guide, looking at the same cycle data would infer the possibility of a more difficult first year ahead for President-elect Trump, as past markets have struggled early on to digest the changes brought about by an incoming Republican administration. Whether 2017 follows the historical cycle playbook or forges a more distinct and positive course is beyond our predictive purview, but given 2016 returns and bouyant sentiment, we are keenly aware that the expectations bar has been set far higher entering 2017 than it was set entering 2016.





Turning to the performance of The London Company strategies for the quarter and the full year, we turned in satisfactory absolute and mixed comparative results for both periods. During 4q, our Large Cap, Mid Cap, and Concentrated strategies outperformed benchmarks, while Small Cap, SMID, and Income Equity trailed benchmarks. Income Equity did however perform roughly in line with the S&P500. For the full year, Mid Cap and Concentrated outperformed while our other strategies did not. Benchmark returns ranged from 12% for large cap to 21.3% for the Russell 2000 Small Cap Index. In examining the environment and drivers of return for 2016, it should not be hugely shocking to report that we lagged in most of our strategies and particularly so from the market lows in February. As a reminder, in the rocky, early weeks of the year when the benchmarks declined over 10% for large caps and nearly 16% for small caps, our portfolios provided good relative downside protection as we would and you should have expected. On the other hand, marked from the February lows, equity returns exploded, with the large cap indices spiking 24-25% (and with the Russell Value Index up over 29%), while the Russell 2000 skyrocketed over 43%. We do not expect to capture rapid gains of that magnitude and in fact did not. Unlike 2015, a year paced by a narrow set of growth/momentum stocks, 2016 rewarded high beta, value (notably banks, energy, and global industrials), and cyclically-oriented and smaller capitalization issues. As the two tables that follow show, both for 4Q and for the year, these attributes generally were "the right stuff" for generating outperformance, up and down the capitalization spectrum:





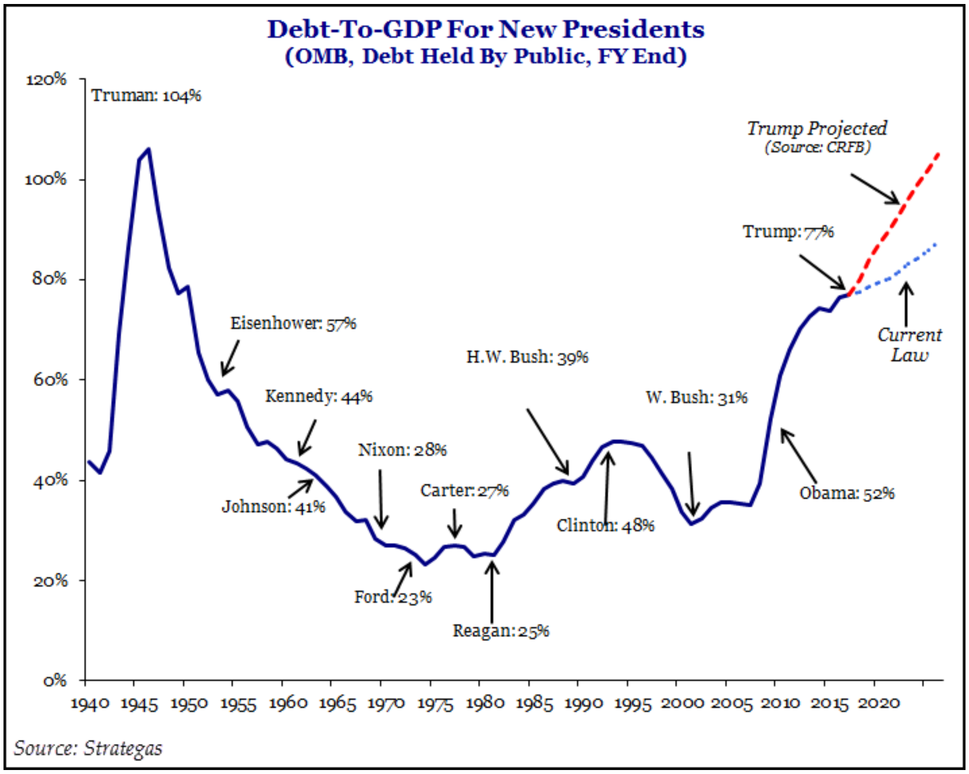
Value benchmarks were most positively impacted by this confluence of "risk-on" factors given the heavy representation in banks and energy/commodities, two areas that tend to connect poorly with our process. The inabilities of these businesses to consistently generate good returns on invested capital, and the absence of other identifiable elements that can shelter the businesses from significant market decline have made them problematic investment candidates for us, so over the years we have tended to be less exposed to these pockets of the market. Conversely, high return on capital, an attribute that long has been coveted here at The London Company as one of the long term cornerstones of downside protection, was a weaker contributor to return last year. As the following exhibits clearly show, when economic data inflected positively and investors became more willing to embrace risk and future potential, more offensively-minded strategies sprang to the forefront at the expense of defensively-minded ones:

The degree of difficulty within the market has been compounded by the ongoing flow of funds that has continued unabated out of active equity strategies and into ETF and other passive strategies. As we discussed in our last letter, this shift to passive investing has dramatically impacted and distorted the landscape and liquidity profile particularly for the smaller and riskier constituents in the smaller cap indices as more and more dollars seek to emulate the index, buying and exerting upward pressure on issues often for non-fundamental reasons. Active management has struggled against this dynamic, since the meteoric rise and lopsided tipping in favor of passive investing appears to be reaching levels of popularity and a conventional wisdom and conviction that it can only continue unabated. As this becomes an embedded future expectation, caution is warranted in our opinion. Trends such as these always carry longer and further than most people will believe, but ultimately fall victim to a change that undermines the status quo. Overall, status quo did not have a good year in 2016.

Overall we did not have our best comparative year either. We have discussed some market headwinds that did not play in our favor. As always though, our results are most impacted by the names we chose to own, and to maintain more concentrated portfolios that tend not to follow the market's beat. For better and sometimes for worse, we march more to our own beat. We held positions in some names that performed extremely well last year and preserved value when conditions were most stressed. We were also disappointed in how a handful of our names veered off track, in a few instances necessitating removal from the portfolios. Recognizing occasional error and decisively moving on from it can be one of the more difficult aspects of what we do. Staying the course for the long term when the immediate term challenges conviction also tests intestinal fortitude and certainly can even appear wrongheaded when viewed within the confines of a 12 month yardstick of measurement. We like to use these letters to remind ourselves and our clients and followers that sucessful long term investing is not a straight-line journey on the quarterly installment plan, nor one absent a few bouts of pain along the way. The old maxim "no pain, no gain" helps keep us focused on our longer term goals.

Another hallmark of The London Company is to not make economic, market or other forward-based forecasts, though we often are asked for them. Given our empathy for Disraeli's mantra, it would seem more than a little disenguous for us to join the legions of bright, articulate prognosticators who generally have proven better with a turn of phrase than with a turn of the calendar. Of course, we do not operate in a vacuum either, and monitor closely how the future seems to be taking shape, while maintaining a healthy dose of skepticism about the consensus views of how things should play out. As we noted earlier in this letter, the mood and economic underpinnings for the market are vastly improved versus a year ago. Besides the prospect of change, a Trump Presidency has revived both hopes and fears about the path to "Making

America Great Again." There are some historical echoes and parallels that have been drawn to where we found ourselves at the inception of the Reagan Presidency entering 1981. One distinct difference is where the US economy stands in relation to its debt to GDP, where Trump inherits a huge can that has been kicked far down the road since Reagan took office:



Tax reform and fiscal stimulus are twin objectives of a Republican-controlled government. Implementing required changes while dragging along the debt burden here (as well as globally) will require a degree of political finesse that remains to be seen. Aggressive trade reform, another key initiative of the new administration, also could complicate the translation of today's hope into 2017's actions and must be viewed as a potential risk. Emerging market economies remain vulnerable and dependent upon exports so trade and a long list of geopolitical tensions will test our resolve for consequences of change. Finally, there is the dimension of unpredictability that Trump and his adminstration should bring to the next four years. The market abhors uncertainty, which may not mesh well with Trump's peripatetic agenda and volatile nature. Trump's volatility is likely to become the market's volatility as we move ahead and should provide ample support for the venerable Chinese fortune or curse: "may you live in interesting times."

Disraeli's words rang true in the year just ended, as they have repeatedly over time. One cannot confidently predict that 2017 and beyond will not unfold as the consensus currently is forecasting, but we would advocate healthy respect for the likelihood of more intrusion of the unexpected.

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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