Q1 | 2021

Large Cap

THE LONDON COMPANY

Market Observations & Portfolio Commentary

Quarterly Market Update

US equities rallied during Q1 across major indexes and the market cap spectrum. Gains were driven by improving economic data, an accommodative Federal Reserve, recent fiscal stimulus, and continued progress with the rollout of vaccines to fight COVID. Small cap shares led the way with a 12.7% increase in the Russell 2000 Index. The Value indexes significantly outperformed the Growth indexes across the market cap spectrum. Cyclical sectors outperformed the more defensive sectors in the large and mid-cap space, while defensive sectors outperformed in small cap. With regard to factors driving performance during Q1, Value, Yield, and Volatility had a positive influence on relative returns. Growth, Momentum, and Quality factors had a mixed impact.

Key Performance Takeaways for the Quarter

- The London Company Large Cap portfolio returned 9.4% gross (9.2% net) during the quarter vs. a 11.3% increase in the Russell 1000 Value Index. Both stock selection and sector exposure were headwinds to relative performance.
- We are bottom-up stock pickers, but sector exposures influenced relative performance as follows:
  - *What Helped*: Underweight Healthcare & Utilities (two weaker performing sectors)
  - *What Hurt*: Underweight Energy & Financials (the two best performing sectors)
- Expectations for strong real GDP growth in 2021 led to a rally in higher beta and traditional value (older businesses most leveraged to the overall economy) companies. The Large Cap portfolio lagged the double-digit returns of the Value index. As in Q4'20, our lower beta, high Quality positioning was out of favor in this risk-on, pro-cyclical environment.

Top 3 Contributors to Relative Performance

- **CarMax (KMX)** – KMX shares rallied during Q1, as it's omni-channel business, digital enhancements and strategic initiatives have been paying dividends. KMX is generating higher incremental sales with a lower cost structure, and its lending business is generating strong returns.
- **Altria (MO)** – MO outperformed the broader market as cigarette volumes were better than expected through the pandemic. Recent fiscal stimulus has aided lower income consumer spending and MO may have benefited from its persistent pricing power as investors focus on the potential for rising inflation.
- **Charles Schwab (SCHW)** – SCHW, along with banks, experienced a sharp rise in its stock price during Q1 as interest rates began to rebound and the yield curve steepened. During Q1, SCHW's management alluded to its intent to increase pricing charged to third-party funds and gave favorable commentary around new client acquisition.

Top 3 Detractors from Relative Performance

- **Apple (AAPL)** – AAPL underperformed during Q1 as several mega-cap technology stocks fell out of favor. AAPL's fundamentals remain strong.
- **Visa (V)** – V underperformed in Q1 as it faced heightened regulatory oversight. We remain attracted to the oligopoly in the global payments market and potential for future growth.
- **Nestle (NSRGY)** – NSRGY underperformed the broader market during Q1 as investors favored companies with greater economic sensitivity. This despite the fact that NSRGY boasted the highest level of organic growth in five years.

Trades During the Quarter

- **Increased: Altria (MO)** – We believe MO is a compelling total return opportunity with a ~8% dividend yield and an attractive valuation. Sales & profits have continued to improve as well.
- **Exited: Fox Corp. (FOXA)** – Sale reflects concerns around cord cutting, greater competition for Fox News, and our desire to reduce the portfolios exposure to advertising.
- **Initiated: Facebook (FB)** – FB is the leader in social media, owning four of the most prominent networks. The properties are used by 3.3B people globally ex-China on a monthly basis, and it has consistently grown users every year. Digital advertising is a duopoly, with Google and FB controlling 80%, and it continues to take share from traditional advertising. Within the 'Social' category (Google not included), FB has a ~65% share. FB has consistently generated double-digit returns on capital and free cash flow, plus it has many strategies to continue monetizing its user base. It has a very strong balance sheet with a net cash position. In 2021, for the first time, FB began trading at a discount to the broader market, based on EV/EBITDA, plus its board authorized its largest share repurchase ever.
- **Decreased: Apple (AAPL), Alphabet (GOOG) & Blackrock (BLK)** – Given recent strength and elevated valuations, we felt it was prudent to reduce position size of the holdings.
- **Initiated: Old Dominion Freight Line (ODFL)** – We've owned ODFL for many years in other London Company portfolios. We view ODFL as the best in class less than full truckload (LTL) provider. Barriers to enter the industry are high as it is difficult to replicate ODFL's national distribution network. The current economic environment is positive for ODFL, and we believe it can compound strong earnings growth for years.
- **Exited: Dollar Tree (DLTR) –** Exit follows a large sale from the CEO as well as some concerns around new store openings.
- **Initiated: Church & Dwight (CHD)** – CHD develops and manufactures a variety of household, personal care, and specialty products. Its largest brand is Arm & Hammer, but also manages 12 other core household name brands. CHD has acquired most of its brands, targeting the #1 or #2 brands in niche or fragmented categories, and has been efficient at capturing acquisition synergies overtime. Their portfolio is diversified among categories and price points, creating stable demand in various economic environments. CHD has a flexible balance sheet, and its asset-light nature allows for strong free cash flow generation and attractive returns on capital.

Looking Ahead

We maintain a positive view on the economy and expect strong real GDP growth in 2021. The reopening of parts of the economy, continued success with the rollout of vaccines to help eliminate the coronavirus, additional fiscal stimulus, and accommodative policies from the Federal Reserve are all positives. However, the coronavirus remains an issue, especially the threat of new variants. In terms of the equity market, we recognize valuations are on the rich side, while interest rates will likely remain low vs. history. At current valuations along with various short term risks to the economic outlook, we expect greater volatility in share prices and possibly more muted returns in the near term.

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Performance

As of March 31, 2021

	QTD	YTD	One Year	Three Years	Five Years	Ten Years	Inception to Date
Large Cap (Gross)	9.4	9.4	55.8	13.2	13.9	13.4	11.9
Large Cap (Net)	9.2	9.2	55.1	12.6	13.4	12.9	11.3
Russell 1000 Value	11.3	11.3	56.1	11.0	11.7	11.0	10.0

Inception date: 06/30/1994

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Disclosure notes

The London Company's performances are size weighted and annualized based on calculations for the period ending March 31, 2021. The characteristics discussed herein relate to a representative account, and not every client's account will have these exact characteristics. As London manages its client portfolios according to each client's specific investment needs and circumstances, London cannot affirm that the characteristics of the account shown are similar to all accounts participating in the strategy. This is due in part to the timing of trades by the Adviser, market conditions, cash availability, and the timing of client deposits and withdrawals. Therefore, prospective clients should not assume that similar performance results to those shown would have been achieved for their accounts had they been invested in the strategy during the period. None of the information contained herein should be construed as an offer to buy or sell securities, or as investment recommendations. An investment in a London Company strategy is subject to risks, including the loss of principal.

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Composite Creation/ Inception Date: June 30, 1994

Composite Definition: The Large Cap strategy invests mainly in conservative, low-beta, large cap equities with a focus on above-average downside protection. Primarily we seek profitable, financially stable, quality large cap companies which consistently generate free cash flow, high returns on unleveraged operating capital, trade at rational valuations, and are run by shareholder-oriented management. Positions are generally in the market capitalization range of the major domestic large cap indices. Accounts included in this product composite are fully discretionary taxable and tax-exempt portfolios with a minimum of $1 million in assets. The product is measured against the Russell 1000 Index and has a creation and inception date of June 30, 1994. There is no use of leverage, derivatives or short positions. All actual fee-paying discretionary portfolios are included in one or more composites that have been managed for a full calendar quarter with limited restrictions and similar objectives. Composite may include accounts under dual contract.

Benchmark Description: Russell 1000 Index measures the performance of the large-cap segment of the U.S. equity universe. The Russell 1000 is a subset of the Russell 3000 Index and includes approximately 1,000 of the largest securities based on a combination of their market cap and current index membership. The Russell 1000 represents approximately 92% of the U.S. market. Benchmark returns are not covered by the report of independent verifiers. Large Cap product is typically compared to the Russell 1000 Index. Any comparison to the Russell 1000 Value, S&P 500, or their corresponding ETFs, is for illustrative purposes only.

Performance and Fees: Gross of fee returns are calculated gross of management and custodian fees and net of transaction costs. Net of fee returns are calculated net of actual management fees and transaction costs and gross of custodian and other fees. Returns may be net of miscellaneous fund expenses. The gross figures do not reflect the deduction of investment advisory fees. For example, an account that earned 15% per year for 10 years would have an accumulated return of 305% before fees and 270% after fees, assuming a 1% fee. Returns are calculated and stated in US dollars. Returns are calculated gross of withholding taxes on foreign dividends and interest. Dividends are reinvested. Policies for valuing investments, calculating performance, and preparing GIPS Reports are available upon request.

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