Q2 | 2021

Large Cap

THE LONDON COMPANY

Market Observations & Portfolio Commentary

Quarterly Market Update

US stocks posted mid to high single digit gains during Q2. Solid economic data and improving corporate earnings were positives, partially offset by concerns about rising inflation, the timing of potential changes to monetary policy from the Fed, and the possibility of future tax increases. Growth outperformed Value across the market cap spectrum except in the Small Cap space. For the most part, cyclical sectors outperformed defensive, though it was mixed among mid and Large Cap stocks. With regard to factors driving performance during Q2, the dynamics weren't linear down the market cap spectrum. Amid Large Cap stocks, Growth and Quality factors had the most positive impact on relative performance, while Value factors had a negative impact. Amid Mid and Small Cap stocks, Volatility and Yield had the most positive impact, while the remaining factors produced mixed results.

Key Performance Takeaways for the Quarter

- The London Company Large Cap portfolio returned 5.3% gross (5.2% net) during the quarter vs. a 8.5% increase in the Russell 1000 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 Utilities (a weaker performing sector) & overweight Real Estate (a better performing sector)
  - *What Hurt*: Underweight Info. Technology (a better performing sector) & overweight Cons. Staples (a weaker performing sector)
- After a strong first quarter of relative performance, the Large Cap portfolio gave back some of its relative gains during Q2 amid a resurgence in growth factors. For the year, the portfolio is still ahead of the index, which is exceeding expectations, especially given the double digit returns for the market overall.
- In our view, quality appears poised for relative strength, especially if volatility levels increase. As recoveries mature and approach mid-cycle, market breadth typically narrows and quality factors tend to shine. Further, as a result of the outlier underperformance in this recovery, quality stocks are now trading at the biggest discount to the broader market in the past 20 years.

Top 3 Contributors to Relative Performance

- **Alphabet (GOOG)** – GOOG was up 21% in the quarter and 43% YTD. GOOG is benefiting from a reacceleration in ad spending in e-commerce and is seeing very strong performance across all of its businesses. During Q2, GOOG repurchased $11.4B in stock and has repurchased over $19B in the last 2 quarters. GOOG remains a juggernaut in the e-commerce ad business and it generates high returns on capital that have averaged 16%. GOOG's competitive advantages include network effects, brand equity, economies of scale, and intangibles such as search algorithms and its vast collection of user data. We believe valuation remains attractive.
- **BlackRock (BLK)** – BLK continues to benefit from positive equity market performance and is executing well internally. BLK reported Q1 earnings above expectations with strong base fee growth and margin expansion. We view BLK as a very well-run company with a widening moat, and we remain confident in the long-term compounding potential of the business.
- **Nestle (NSRGY)** – NSRGY delivered strong quarterly sales results and is now expecting mid-single digit organic growth and moderate margin expansion for the full year. NSRGY's strong balance sheet has allowed management to invest (both capex and M&A) in the highest growth and margin areas of the business such as coffee, pet, and health science. The growth and margin guidance for 2021 suggest that this strategy is yielding success.

Top 3 Detractors from Relative Performance

- **Citrix (CTXS)** – CTXS underperformed the broader market after reporting quarterly results that disappointed investors. Supply chain shortages were a challenge, plus renewal rates fell short of expectations for some of its limited-use short-term contracts signed at the beginning of COVID. CTXS' transition to a subscription model is complete, which should provide more consistency in results going forward. We remain attracted to the CTXS' strong positioning in an environment that will likely value more flexible work solutions in the future.
- **NewMarket (NEU) –** NEU underperformed following a weak earnings report driven by rising oil and base oil prices combined with growing concerns over the ramp of hybrid and electric vehicles. NEU's margins tend to suffer in periods of rising base oil prices until they roll over and the company can capture the lag in spreads. We remain attracted to NEU's positioning in the consolidated market for fuel additives and lubricants.
- **Altria (MO)** – MO declined 5% during Q2 after a strong performance during Q1. Greater spending behind risk reduced products like on! and iQOS may negatively impact margins in the near term. Pricing power is evident with revenue growth despite volume declines. We remain attracted to the strong brands, pricing power, significant cash flow generation, and attractive dividend yield.

Trades During the Quarter

There were no trades during the quarter.

Looking Ahead

We maintain a positive view on the US economy and expect strong real GDP growth in 2021. Nearly half of the population has been vaccinated, and most of the economy has re-opened. The US consumer is in great shape and labor markets continue to improve. Separately, the manufacturing and services segments of the economy are firmly in expansionary territory. Fiscal and monetary policy should continue to be accommodative in the near-term. Despite the positives, we recognize that risks remain. Inflation concerns, talk of tax hikes, elevated equity valuations, some fiscal stimulus rolling off, and a more reactive Fed are noteworthy factors looming over markets. While we believe fundamental conditions remain positive, we note a confluence of market concerns could lead to increased volatility and more muted returns for equities in the near term. As we look at the characteristics of our portfolios today, the positioning is the best it's been in a number of years. Returns on capital and balance sheet strength continue to be very healthy. Given the level of quality, it is abnormal to see our portfolios trade at such attractive valuations relative to the respective benchmarks. We believe this will serve us well for both near-term volatility and long-term durability.

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Performance

As of June 30, 2021

	QTD	YTD	One Year	Three Years	Five Years	Ten Years	Inception to Date
Large Cap (Gross)	5.3	15.1	39.8	14.8	14.6	13.6	12.0
Large Cap (Net)	5.2	14.9	39.2	14.3	14.1	13.1	11.4
Russell 1000	8.5	15.0	43.1	19.2	18.0	14.9	11.1

Inception date: 06/30/1994

Contact information

The London Company
of Virginia, LLC
1800 Bayberry Court, Suite 301
Richmond, VA 23226

T 804.709.1244
F 804.649.9447
info@TLCAdvisory.com
www.TLCAdvisory.com

Disclosure notes

The London Company's performances are size weighted and annualized based on calculations for the period ending June 30, 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.

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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