Q3 | 2021

Large Cap

THE LONDON COMPANY

Market Observations & Portfolio Commentary

Quarterly Market Update

US stocks posted roughly flat returns during Q3. Despite the spread of the COVID-19 Delta variant, the market rallied for the first two months of the quarter, following solid economic data. However, September was a difficult month for stocks reflecting concerns around potential changes in monetary policy, persistent supply chain issues resulting in higher inflation, and some political drama. The weak September resulted in slightly negative returns for much of the market for Q3. Large Cap indexes held up better than Small Cap. Growth modestly outperformed Value in the Large and Mid Cap space, while Value outperformed in the Small Cap arena. Defensive stocks outperformed the more cyclical shares across the board. Turning to factors, Growth, Quality, and Momentum factors had the most positive impact on relative performance, while Value and Volatility factors had a negative impact.

Key Performance Takeaways for the Quarter

- The London Company Large Cap portfolio declined -1.7% gross (-1.8% net) during the quarter vs. a 0.2% increase in the Russell 1000 Index. Both sector exposure and stock selection were headwinds to relative performance.
- We are bottom-up stock pickers, but sector exposures influenced relative performance as follows:
  - *What Helped*: Overweight Financials (the best performing sector) & underweight Energy (a weaker performing sector)
  - *What Hurt*: Overweight Materials (a weaker performing sector) & underweight Info. Technology (a better performing sector)
- While Quality factors outperformed during Q3, the impact was somewhat masked in the large cap space. Higher quality stocks actually saw much of their Q3 relative performance gains erased in September. The atypical September selloff was unlike normal pullbacks in that riskier equities (higher beta & lower quality) outperformed in the final weeks. Additionally, index returns were mostly driven by some of the largest mega-cap holdings and banks. The five largest companies in the Russell 1000 represent roughly 20% of the index, which diminished our ability to differentiate. While we're overweight Financials, we currently have limited banking exposure. The atypical selloff, concentration of returns and limited banking exposure were headwinds to relative performance. Importantly, the Large Cap portfolio's characteristics are very attractive vs. the broader market and we remain very confident in each holding.

Top 3 Contributors to Relative Performance

- **O'Reilly Auto Parts (ORLY)** – ORLY reported strong results with comps up nearly double digits. The strong comps were driven by government stimulus, strength of the DIY customer, and harsher weather. Management raised full year guidance despite difficult comps and margin pressure. Robust used car sales and average age of vehicles on the road are tailwinds.
- **Old Dominion Freight Line (ODFL)** – ODFL performed very well in Q3. Industry capacity for both drivers and trucking equipment is currently tight while demand is very strong for freight services as the economy reopens, which is producing extraordinary pricing and yields. As a premium and reliable carrier in the industry, ODFL has been posting both record results and taking market share. ODFL has also been expanding its network to accommodate future growth.
- **Alphabet (GOOG)** – GOOG continues to experience strong momentum in all business units. The business accelerated sequentially and the core ad business was stronger than expected. GOOG continues to reinvest in its ecosystem.

Top 3 Detractors from Relative Performance

- **FedEx (FDX)** – FDX shares were weak after issuing higher guidance for capital spending. Investors remain concerned FDX's network cannot support the incredibly high package and freight volumes seen across the industry. Yields at FDX have been trending upwards but margin leverage has been elusive.
- **Norfolk Southern (NSC)** – Shares of NSC took a breather after solid gains in the rail group. Concerns arose during Q3 that rising demand could not be effectively met with high service levels as NSC. Additionally, investors remain concerned over the longevity of the positive results NSC is reporting in its coal transportation business, and in the face of rising fuel costs.
- **Air Products & Chemicals (APD)** – Recent results were a bit weaker than expected reflecting moderation in the overall US economy. However, volume growth is healthy and pricing continues to be a positive contributor to growth. Additionally, the recent financial close of Jazan (large gasification project in Saudi Arabia) should remove an overhang on the stock.

Trades During the Quarter

- **Exited: Bristol-Myers Squibb (BMY)** – Exit reflects recent insider sales, and concerns around drugs coming off patent.
- **Reduced: Charles Schwab (SCHW)** – Reduced the large weight in SCHW reflecting strength in the stock earlier in the year and near term risk around pay for order flow.
- **Reduced: CarMax (KMX)** – Reduced the large weight in KMX reflecting strength in the stock and concern that used car market will revert to a more normalized environment.
- **Initiated: Fiserv (FISV)** – FISV is a leading provider of merchant acquiring services, outsourced banking solutions, and payment networks in the US. The majority of its revenue is very stable, and its business segments have sticky products, high retention, and low customer concentration. FISV is well-positioned with massive scale and a new slate of product offerings that are taking share. Valuation looks compelling and is further supported by insider buying. We're attracted to its fundamentals and believe it has a favorable growth outlook.

Looking Ahead

We maintain a positive view on the US economy and expect strong real GDP growth in 2021, but note the rate of growth in the second half of the year will likely decelerate vs. the first half. 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. That said, the Delta variant remains a potential risk. Further, fiscal stimulus will likely start to wane and the Fed will likely begin to reverse some of its accommodative monetary policies later this year and into 2022. This could lead to slower growth in 2022. In terms of equities, we recognize valuations are on the rich side. At current valuations along with various short-term risks to the economic outlook (e.g. rising inflation & potential tax increases), we expect greater volatility and possibly more muted returns in the near term. Longer term, we continue to believe quality attributes and solid company fundamentals will lead to strong risk adjusted returns over time.

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Performance

As of September 30, 2021

	QTD	YTD	One Year	Three Years	Five Years	Ten Years	Inception to Date
Large Cap (Gross)	-1.7	13.2	23.9	10.9	14.1	14.3	11.8
Large Cap (Net)	-1.8	12.8	23.4	10.5	13.6	13.8	11.2
Russell 1000	0.2	15.2	31.0	16.4	17.1	16.8	11.0

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 September 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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