Q1 | 2021

Income Equity

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 Income Equity portfolio returned 7.0% gross (6.9% net) during the quarter vs. a 11.3% increase in the Russell 1000 Value. 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*: Underweight Healthcare & Utilities (two weaker performing sectors)
  - *What Hurt*: Underweight Financials & Energy (two best performing sectors)
- Equity risk-taking continued to follow stronger economic data & positive vaccination news in Q1, with investors bidding up beta and cyclicality while shedding profitability. The Income Equity portfolio outperformed the core indexes but did not keep pace with the double digit returns for the Russell 1000 Value index. Similar to Q4'20, our Quality focus with defensive, lower beta positioning was out of favor in this risk-on, pro-cyclical environment. Being underweight banks & energy, in particular, was an obstacle. Given our conservative positioning, we would not expect to outperform in a strong market, driven by high beta and low quality.

Top 3 Contributors to Relative Performance

- **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.
- **Lowe's (LOW)** – Much of LOW's outperformance came after it reported strong 4Q results. Same store sales were driven by both the DIY and Pro customers with ticket size and number of transactions growing. Home improvement demand continues and the outlook remains positive, despite difficult comps and margin pressure. LOW's transformational program has delivered strong operating income growth and margin expansion. We continue to believe management is taking the correct approach to improve the business for the long term.
- **Intel (INTC)** – INTC shares performed very well in 1Q21 due to continued strong demand for semiconductors in applications such as laptops for mobile workers. However, most of the improvement in the stock can be attributed to the presence of the company's new CEO, who has brought a renewed sense of energy to INTC and a turnaround plan.

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, but the stock gave back some of its strong relative outperformance in recent years.
- **Nintendo (NTDOY)** – NTDOY reported stronger than expected F3Q results and issued solid FY2021 guidance. However, the stock underperformed the broader market during Q1 following a greater than 60% increase in the shares in 2020. In addition, investors favored companies more leveraged to upside in the economic data with greater domestic exposure. Fundamentals remain strong and the Switch continued to be a bestselling hardware platform. NTDOY is elongating the hardware cycle and focusing on higher-margin software sales.
- **Merck (MRK)** – MRK shares underperformed the broader market in Q1. Investors were disappointed with weaker earnings and the news that the MRK's two COVID-19 vaccine candidates had been discontinued. MRK announced a new CEO succession plan as the current CFO will be stepping into the role. Investor sentiment seems to be weighed down by lingering COVID-19 impacts on the business and skepticism on how the new CEO will spur growth. We are optimistic they can navigate these short-term headwinds. We think MRK can generate durable earnings growth over time and believe it is well-positioned in key products and franchises.

Trades During the Quarter

- **Increased: Dominion Energy (D) –** Added to the name on weakness reflecting improvement in the business as well as signs of conviction from management. After recently selling some of its transmission assets to Berkshire Hathaway, D now has a greater focus on the utility business in states with a more favorable regulatory framework. Recent large stock purchases by the CEO and a board member gave us added confidence.

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. Long term, we remain optimistic about the prospects for the US economy and expect real GDP growth in the 2-3% range. 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 and possibly more muted returns in the near term. Longer term, we continue to believe that quality attributes and solid company fundamentals will lead to strong risk adjusted returns over time. The companies in London Company portfolios generate much higher returns on capital with stronger balance sheets at reasonable valuations relative to the broader market, which we believe bodes well for future returns. Our goal remains to outperform the broader market over full market cycles with less volatility.

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Performance

As of March 31, 2021

	QTD	YTD	One Year	Three Years	Five Years	Ten Years	Inception to Date
Income Equity (Gross)	7.0	7.0	46.0	14.5	12.7	13.2	9.6
Income Equity (Net)	6.9	6.9	45.4	14.0	12.3	12.7	9.0
Russell 1000 Value	11.3	11.3	56.1	11.0	11.7	11.0	7.3

Inception date: 12/31/1999

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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: December 31,1999

Composite Definition: The Income Equity strategy invests mainly in common equities with a focus on higher overall dividend yield orientation, which may be supplemented with primarily investment grade, preferred equities. This strategy has a more conservative orientation, with a focus on capital preservation, income and growth, in order to provide greater yield and downside protection relative to our Large and Mid Cap strategies. Our Income Equity strategy is designed to generate above-average, absolute returns over full market cycles. Accounts in this product composite are fully discretionary taxable and tax-exempt portfolios with no minimum dollar amount of assets. The product is measured against the Russell 1000 Value Index and has a creation and inception date of December 31, 1999. 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: The Russell 1000 Value Index measures the performance of the large-cap value segment of the U.S. equity universe. It includes those Russell 1000 Index companies with lower price-to-book ratios and lower expected growth values. 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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