Portfolio Commentary

Full Year Market Update

For the year, the broader market posted solid gains, with the Russell 3000 up 26.0%. At the start of 2023, interest rates were rising, inflation was stubbornly high, and investors were bracing for a recession. Instead, inflation continued falling, consumers kept spending, and the unemployment rate fell to its lowest level since 1969. With slowing inflation, signs of better balance in the labor market, and normalized GDP growth expectations, the Federal Reserve indicated that it would pivot to rate cuts later in 2024. Huge rallies by the mega-cap Magnificent 7 (Apple, Microsoft, Amazon, NVIDIA, Alphabet, Tesla, & Meta Platforms) were a big driver of overall index performance, and narrow market leadership remained a nagging concern for much of the year.

It was a year of bifurcated performance, led by the mega-cap stocks. Enthusiasm over artificial intelligence and robust gains by the Magnificent 7 led to significant outperformance of the Growth Indices and helped mask weakness in other corners of the market. Non-dividend paying companies significantly outperformed companies that pay a regular dividend, especially in the large cap space. Turning to market factors for the year, Volatility and Growth factors posted the strongest results. Value, Yield, and Momentum factors presented headwinds; while Quality and Momentum factors delivered mixed results.

Key Performance Takeaways

The London Company Income Equity portfolio gained 5.9% (5.5% net) for the year vs. a 26.5% increase in the Russell 1000 Index. Sector exposure and stock selection were both headwinds to relative performance.

The Income Equity portfolio lagged the Russell 1000 in 2023 and came up short of our 85-90% upside capture expectations. Growth & Volatility factors dominated the large-cap indices in 2023. The concentrated strength and skew from the Magnificent 7 diminished the relative impact of our Quality orientation. Moreover, higher yielding stocks had a historically bad year versus non-dividend payers. Nearly 40% of the Russell 1000's return came from non-dividend payers.

Historically, a reliance on high Quality factors and dividend investing has proven to be a strategy that can lose battles along the way but tends to win the war over time. It's difficult to predict when a cycle will turn, but we believe we're approaching an inflection point with the dominance of the mega-cap stocks. Moreover, relative valuations for dividend-paying stocks have drifted toward multi-decade lows. While the full benefits of quality & dividend investing have been delayed at the large cap level, we don't think they'll be denied in the long term. In our view, the characteristics of the Income Equity portfolio remain attractive, and we believe we're well positioned for an uncertain future.

Top 3 Contributors to Relative Performance

Charles Schwab (SCHW) – SCHW posted growth in net assets, with some of the headwinds around the TD integration clearing. We believe SCHW is well positioned to show a sharp rebound in 2024 and 2025 earnings as near-term issues resolve naturally. We continue to like SCHW's strong competitive position, growth outlook, high incremental margins, and excellent management team.

Fastenal (FAST) - FAST outperformed in 2023 as management continued to execute on expanding onsite locations and increasing sales through its digital footprint. With low leverage, strong cash generation, and ongoing business investments, we believe FAST is well-positioned to strengthen its already robust set of competitive advantages.

Comcast (CMCSA) - CMCSA outperformed in 2023 as connectivity headwinds are less of a concern to investors at current valuations. Visibility into broadband revenue growth is improving with expectations of modest customer additions and solid pricing power going forward. CMCSA is well positioned to defend against competing broadband technologies, and we remain confident in their ability to drive sustainable top line growth and margin expansion.

Top 3 Detractors from Relative Performance

Diageo (DEO) – DEO's underperformance in 2023 was primarily the result of demand normalization and a weaker macro environment. The critical U.S. market continues to be soft as retailers worked through excess inventory. Management lowered its financial outlook due to weaker regional trends and higher reinvestment needs to support growth. Overall, we remain confident in DEO's leading portfolio of brands across key categories and regions, which gives it an entrenched market position in the attractive spirits industry.

Air Products (APD) – APD's stock came under pressure in 2023 due to weakening global industrial production and fears of inflation affecting the cost of megaprojects. At this point, the majority of APD's project pipeline has been de-risked with updated project costs and these investments are all expected to achieve return thresholds >10%. CEO Seifi Ghasemi purchased >$5M worth of stock in November on a pullback in the stock price.

Pfizer (PFE) – We exited our position in PFE in 3Q reflecting concerns about recent M&A activity and weaker-than-expected sales of COVID related drugs. While PFE's drug pipeline could lead to solid sales in the future, we felt more confident in other holdings.

Sector Influence

We are bottom-up stock pickers, but sector exposures influenced relative performance as follows:

- What Helped: Underweight both Health Care & Energy (two weaker performing sectors)
- What Hurt: Underweight Info. Technology (a better performing sector) & overweight Cons. Staples (a weaker performing sector)

Portfolio Characteristics & Positioning

We believe the Income Equity portfolio is positioned for long-term durability and possesses the fundamental ingredients that stand the test of time: wide moats, sustainably high returns on capital, strong cash flow generation, low leverage ratios, a premium shareholder yield (dividends + net buybacks), and trading at an attractive discount to the Russell 1000. As access to capital becomes more difficult and the cost of that capital is more expensive, we believe companies with strong balance sheets and the ability to self-fund their operations could have a structural advantage in 2024 and beyond. In an environment of possibly lower returns and greater volatility, we believe the Income Equity portfolio offers a compelling option for equity investors.

Portfolio Characteristics	Income Equity	Russell 1000
Pre-tax ROC (3 Yr. Avg.%)	25.1%	14.8%
Net Debt/EBITDA	1.7x	1.7x
Enterprise Value/EBITDA	14.9x	15.8x

Source: FactSet

Looking Ahead

After such a strong 2023, we believe investors should temper expectations for 2024. Stocks defied rate hikes, wars, collapsed banks, and recession fears in 2023. Now, calls for a soft landing are consensus; sentiment is overly optimistic; and markets are priced for very little risk. Predicting the future direction of the economy is always challenging. While we do agree the odds of a recession have come down, they are still elevated. A soft landing remains in reach, but much of that hinges on whether the Fed eases soon enough to avoid an employment problem. Perhaps this time it will be different, but historically the odds of sticking the landing have been very low. Even though we have greater clarity over the Fed's path from here, there still remains a long list of items creating uncertainty that could lead to greater volatility in 2024.

In terms of the equity market, we believe returns in the near term may be modest, with shareholder yield (dividends, share repurchase, debt reduction) comprising a significant percentage of the total return. Economic growth is likely to slow; earnings estimates appear optimistic; and valuations are somewhat elevated. Moreover, investors continue to expect a faster pace of rate cuts than members of the FOMC currently suggest. The difference in the pace of rate reductions could lead to greater levels of volatility in 2024. Markets are impossible to outguess in the short run, but we believe the antidote to uncertainty is quality and that solid company fundamentals will lead to strong risk-adjusted returns in the long run. With that in mind, the characteristics of our portfolios remain attractive, and we believe we're well positioned for an uncertain future.

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Annualized Returns
As of 12/31/2023

	QTD	1Y	3Y	5Y	10Y	ITD
Income Equity (Gross)	8.2%	5.9%	6.0%	10.7%	9.4%	9.0%
Income Equity (Net)	8.1%	5.5%	5.6%	10.3%	8.9%	8.3%
Russell 1000	12.0%	26.5%	9.0%	15.5%	11.8%	7.2%

Inception date: 12/31/1999. Past performance should not be taken as a guarantee of future results. Performance is preliminary. Subject to change.

Disclosure Notes

The London Company's performances are size weighted and annualized based on calculations for the period ending December 31, 2023. 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.

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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. As of July 1, 2022 The London Company redefined the composites to exclude all dual contract relationships and any potentially bundled fee scenarios. This policy is not retroactive, but will continue to apply going forward.

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. The Income Equity product is typically compared to the Russell 1000 Value Index. Any comparison to the Russell 1000, 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. Returns are calculated and stated in U.S. 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.

Past performance should not be taken as a guarantee of future results. The report is for informational purposes only. Data, while obtained from sources we believe to be reliable, cannot be guaranteed and all statistics are subject to change. The statements contained herein are solely based upon the opinions of The London Company and the data available at the time of publication of this report, and there is no assurance that any predicted results will actually occur. Information was obtained from third party sources which we believe to be reliable but are not guaranteed as to their accuracy or completeness. This report contains no recommendations to buy or sell any specific securities and should not be considered investment advice of any kind. An investment in a London Company strategy is subject to risks, including the loss of principal. Referenced strategies may not be suitable for all investors. The appropriateness of a particular strategy will depend on individual circumstances and objectives. In making an investment decision, individuals should utilize other information sources and the advice of their investment advisor.

The London Company of Virginia, LLC

1800 Bayberry Court, Suite 301
Richmond, VA 23226

Tel: 804.775.0317
info@TLCadvisory.com

www.TLCadvisory.com