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 Large Cap portfolio gained 14.8% (14.3% net) for the year vs. an 11.5% increase in the Russell 1000 Value Index. Sector allocation aided relative performance, partially offset by the impact of stock selection.

The Large Cap portfolio outperformed the Russell 1000 Value Index and exceeded our 85-90% upside participation expectations for the year. Having some exposure to the Magnificent 7 and sector-level leadership reversal also played a role in our relative outperformance. Our lack of exposure to Energy and Utilities transformed from a drag in 2022 to a tailwind in 2023, as well as being underweight the Health Care sector.

As the past few years have demonstrated, market trends and leadership can turn on a dime. We don't chase the ups and downs of the risk trade; instead, we commit long-term capital to Quality companies that have greater control over their own destiny. Historically, a reliance on high Quality investments has proven to be a strategy that can lose battles along the way but tends to win the war over time.

Top 3 Contributors to Relative Performance

Apple (AAPL) – AAPL was strong all year reflecting growth in iPhone sales as well as gains from the mix toward services. AAPL returned significant cash to shareholders via share repurchase and dividends, and the balance sheet remains strong. Valuation based on near term profits is relatively high.

Alphabet (GOOG) – GOOG's outperformance this year reflected stabilization in the Search business, momentum in the Cloud segment, and better cost control execution. GOOG continues to find ways to monetize the business and improve efficiency. GOOG continues to invest in the business and return capital to shareholders via its buyback program. GOOG has a solid balance sheet, significant market share, and generates strong returns.

NewMarket (NEU) – NEU outperformed after reporting solid earnings in recent quarters reflecting a recovery in pricing and margins after a long period of higher base oil and chemical prices. NEU also used stronger cash flow to repay debt and repurchase company shares. Late in the year, NEU announced the planned acquisition of American Pacific Corp., a manufacturer of solid rocket propellants and fire suppressants. This acquisition will help diversify the business away from petroleum additives, which is likely in long-term decline.

Top 3 Detractors from Relative Performance

Charles Schwab (SCHW) – SCHW was weak early in the year reflecting broader banking concerns and cash sorting. The Silicon Valley Bank implosion gave rise to a misinformed bear narrative that SCHW would face insolvency from bank runs and client cash sorting. We strongly disagreed and believed that SCHW had ample short-term financing to shield them from having to realize any losses on their securities book. Meanwhile, multiple members of senior management and the board all stepped up to buy stock. While we concede that there may be short-term headwinds to earnings from elevated cash sorting, the long-term growth and earnings power of the company remains intact.

Albemarle (ALB) – We purchased shares of ALB during 2Q. Following our purchase, ALB underperformed as weak lithium prices drove downward revisions to earnings expectations, and sentiment became more negative regarding demand for electric vehicles. Commodity prices are inherently uncertain, but we continue to view ALB as a winner in this growing industry and favorably positioned on the cost curve. Our long-term view of ALB is not affected by short-term supply-demand dynamics for the commodity.

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.

Sector Influence

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

- What Helped: Underweight both Utilities & Health Care (two weaker performing sectors)
- What Hurt: Overweight Materials (a weaker performing sector) & underweight Communication Services (a better performing sector)

Portfolio Characteristics & Positioning

We believe the Large Cap 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 free cash flow generation, low leverage ratios, and an attractive shareholder yield (dividends + net buybacks). The portfolio trades at a premium to the Value index, but we believe this is justified as companies in the Value indices have lower returns on capital and higher leverage. 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 Large Cap portfolio offers an attractive option for equity investors.

Portfolio Characteristics	Large Cap	Russell 1000 Value
Pre-tax ROC (3 Yr. Avg.%)	26.0	11.5
Net Debt/EBITDA	1.4x	2.4x
Enterprise Value/EBITDA	15.3x	12.0x

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
Large Cap (Gross)	7.6%	14.8%	7.8%	11.7%	9.7%	11.2%
Large Cap (Net)	7.5%	14.3%	7.4%	11.2%	9.2%	10.6%
Russell 1000 Value	9.5%	11.5%	8.9%	10.9%	8.4%	9.5%

Inception date: 6/30/1994. 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 Advisor, 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: 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. As of July 1, 2022 The London Company redefined the composites to exclude all dual contract relationship and any potentially bundled fee scenarios. This policy is not retroactive, but will continue to apply going forward.

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. The Large Cap product is typically compared to the Russell 1000 Index. Any comparison to the Russell 1000 Value 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.

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