Portfolio Commentary

Q4 Market Update

U.S. stocks traded higher during Q4, reflecting softening inflation data and a slowdown in the pace of interest rate increases from the Federal Reserve. For the quarter, the broader market, as measured by the Russell 3000 Index, rose 7.2%. Q4 started strong following reports that broader inflationary pressures were beginning to moderate. Shares reversed course in December as more hawkish commentary from the Fed led to falling prices. Fear of a pending recession remains high and the yield curve remained inverted at the end of the quarter. Stocks traded higher across the market cap spectrum led by strength in Mid Cap companies. Stylistically, Value had one of its strongest quarters of relative performance versus Growth since the popping of the Tech Bubble. Cyclical sectors generally had the edge over Defensive. In terms of market factors that drove performance, Value (lower valuation) and Yield (higher) had a positive impact on relative returns. Volatility factors presented headwinds, while Growth, Quality, and Momentum factors had a mixed impact.

Key Performance Takeaways

The London Company Large Cap portfolio returned 10.4% gross (10.3% net) during the quarter vs. a 12.4% increase in the Russell 1000 Value. Both sector exposure and stock selection were headwinds to performance.

The Large Cap portfolio trailed the Russell 1000 Value in Q4, but performance was in line with our longer-term expectations for 85-90% upside capture. The quarter, just like the year, was a historically strong period for large cap value—with Q4 being one of the best quarters for the Russell 1000 Value Index vs Growth since the popping of the Tech Bubble. As was the case all year, having zero exposure to Energy, an overweight position in Information Technology, and a lack of deep value holdings were headwinds to relative performance. Looking ahead, we believe the strong cash flow generation and capital flexibility of our businesses should provide meaningful protection if market fundamentals continue to deteriorate.

Top 3 Contributors to Relative Performance

Blackrock (BLK) – BLK outperformed in Q4 after under-performing for the first three quarters of 2022. In the short term, BLK tends to trade with market sentiment due to the bulk of revenue tied to assets under management. Longer term, we see BLK as a high quality compounder that will likely outperform the asset management industry over full cycles. We remain attracted to BLK's strong competitive positioning, low leverage, high margins, and healthy capital return.

Air Products & Chemicals (APD) – APD reported favorable results in November that highlighted the stability in the business model through take-or-pay contracts and benefits of pricing power in a rational, oligopolistic industry. APD is pushing through 20%+ pricing increases that are helping them to recapture margin lost from energy inflation. Additionally, APD's megaprojects in the U.S. have recently become more attractive, and new projects are reaching the return threshold to move forward, due to provisions for blue and green hydrogen included in the Inflation Reduction Act.

O'Reilly Auto Parts (ORLY) – ORLY outperformed during Q4 reflecting share gains with Pro customers and solid do-it-yourself results. ORLY has been successful in passing on higher costs and customers have not traded down to lower-priced products. ORLY remains the gold standard for service, part availability, and logistics in this industry. The average age of cars on the road continues to rise and is now in the sweet spot for auto repairs and failures. ORLY has a strong balance sheet and continues to return capital to shareholders through its buyback program.

Top 3 Detractors from Relative Performance

Apple (AAPL) – AAPL shares consistently underperformed the broader market as the Fed raised rates, which caused a broad rotation out of technology stocks. Additionally, there has been concern about iPhone supply and demand as the global economy weakens and China grapples with a new round of Covid incidents. We continue to believe that AAPL has a wide moat thanks to its nearly impenetrable ecosystem of hardware and services.

Alphabet (GOOG) – GOOG underperformed in Q4 reflecting the slowdown in digital ad spending and concerns around expense controls in a softening environment. The Search business decelerated sequentially and there is uncertainty in the ad business. YouTube continues to take ad dollar share from linear TV and the Cloud business continues to ramp up. Management started to right size the cost structure of the business by realigning resources, reducing the pace of hiring, and reallocating capex spending. GOOG has a solid balance sheet, significant market share, and has become more shareholder friendly with its capital allocation decisions.

Meta Platforms (META) – META underperformed the broader market during the brief period that we owned the shares in Q4. We sold the stock in October reflecting headwinds to topline growth along with concerns about future spending.

Sector Influence

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

- What Helped: Overweight Materials (a better performing sectors) & underweight Utilities (a weaker performing sector)
- What Hurt: Underweight Energy (the best performing sector) & overweight Info. Technology (a weaker performing sector)

Trades During the Quarter

- **Exited:** Meta Platforms (META) – Exit reflects near term headwinds to topline growth and management's plans for elevated spending. The stock underperformed the broader market over our holding period, reflecting numerous issues (Apple's IDFA change, competition from TikTok, and a macroeconomic slowdown leading to weaker ad spending). While META faced headwinds to revenue growth, management remained intent on spending on numerous initiatives. While the spending could lead to strong growth in the future, the willingness to spend in the face of a more uncertain revenue outlook was a concern. There were no insider purchases from company executives on this weakness, which further reduced our conviction and led us to sell the shares.
- **Increased:** Starbucks (SBUX) – We used excess cash to add to our existing SBUX position. We first purchased a roughly 2% position in SBUX in September. This addition brings the position size to roughly 3.5%.

Looking Ahead

As we enter 2023, conditions remain fragile, and the lagged effect of 2022's rate hikes and Quantitative Tightening (QT) may lead to further economic weakness. Inflation remains higher than desired, but inflation readings have improved from peak levels. Meanwhile, the labor market remains tight and the service side of our economy remains strong. As the Fed continues to balance its goals of stable pricing and full employment, additional rate hikes are likely early in the year. It is hard to predict what could happen longer term, but the message from the Fed is that rates will stay higher for longer. Much will depend on the level of inflation and the performance of the broader economy. In terms of the equity market, we recognize the difficulty in determining what is already factored into stock prices at this point in the economic cycle. With higher interest rates likely, equity valuations may experience multiple compression, while a slowing economy may lead to weaker earnings from many companies. The next phase of this slowdown will likely hinge on the path of earnings, credit spreads, and employment. In this more challenging environment, we continue to expect greater volatility in share prices and lower expected returns relative to the strong returns generated from 2009-2021. Longer term, we continue to believe that quality attributes and solid company fundamentals will lead to strong risk-adjusted returns.

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Annualized Returns
As of 12/31/2022

	QTD	1Y	3Y	5Y	10Y	ITD
Large Cap (Gross)	10.4%	-14.2%	6.8%	7.4%	11.0%	11.1%
Large Cap (Net)	10.3%	-14.6%	6.3%	6.9%	10.5%	10.5%
Russell 1000 Value	12.4%	-7.5%	6.0%	6.7%	10.3%	9.5%

Inception date: 6/30/1994. Past performance should not be taken as a guarantee of future results.

Disclosure Notes

The London Company's performances are size weighted and annualized based on calculations for the period ending 12/31/2022. 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. 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. 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. In making an investment decision, individuals should utilize other information sources and the advice of their investment advisor.

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