Portfolio Commentary

Full Year Market Update

U.S. equities traded lower during 2022 reflecting higher than desired inflation, a shift toward tighter monetary policy from the Federal Reserve, and geopolitical concerns. Persistently high inflation combined with a strong labor market led to the Fed increasing its funds rate seven times during the year for a total of 425bps. Separately, the Fed began reducing the size of its balance sheet via Quantitative Tightening (QT). Taken together, this resulted in a higher cost of capital, lower valuation multiples, and weak returns from most asset classes. The broader market, as measured by the Russell 3000 Index, was down 19.2% for the year. All of the major core indices posted double-digit declines with relatively small differences across the market cap ranges. Stylistically, this was the best year for Value versus Growth since the popping of the Tech Bubble. There was a huge spread in sector leadership as well. Despite oil and gasoline prices making a dramatic roundtrip, Energy was up ~66% for the year—its largest outperformance versus the market in the history of GICS sectors. Turning to factors driving performance during the year, Value (lower valuations) and Yield factors had the most positive influence on relative returns. Growth (with the exception of dividend growth) and Volatility factors had a negative impact. Momentum and Quality factors had a mixed impact.

Key Performance Takeaways

The London Company Small-Mid Cap portfolio declined -13.8% gross (-14.4% net) during the year vs. a -13.1% decrease in the Russell 2500 Value. Negative sector exposure was a headwind to performance, partially offset by positive stock selection.

For the full year, the SMID portfolio trailed the Russell 2500 Value index, and it came up short of our longer-term expectations for 75% downside participation in falling markets. Amidst 2022's valuation-driven selloff, investors sought safety in stocks with cheaper valuations, often overlooking fundamentals such as balance sheet flexibility & consistency of cash flow. Sector dispersion was extreme in 2022, and sector leadership was atypical. Having zero exposure to Energy & Utilities (the two best performing sectors), an overweight position in Information Technology, and a lack of deep value holdings were headwinds to relative performance vs. the Value index all year. The portfolio outperformed the core Russell 2500 Index over the same period.

We believe the SMID portfolio remains built for long-term durability. If economic conditions deteriorate further and credit risks rise, we believe the benefits of high returns on capital and balance sheet strength could stand out in a meaningful way.

Top 3 Contributors to Relative Performance

Lamb Weston (LW) – LW's outperformance reflected the recovery in overall fry demand, better than expected pricing, and the execution of its cost-saving initiatives. Fry attachment rates are higher than ever despite total restaurant traffic remaining below pre-pandemic levels. LW has proactively invested in additional capacity to meet demand over the long term. Pricing actions have offset higher costs and demand has been stable. This is a consolidated industry and the long-term outlook remains very favorable. We remain attracted to LW's market share, pricing power, and industry tailwinds.

Lancaster Colony (LANC) – LANC outperformed the benchmark in both Q4 and 2022. LANC's earnings results continue to outpace expectations. The quality of LANC's brands has enabled them to push pricing at retail and alleviate some of the heavy gross margin pressure from input cost increases. The outlook for margins looks favorable heading into 2023. We're attracted to LANC's cash balance sheet and willingness/ability to invest in high-return, organic projects.

White Mountains (WTM) – Consistent with other insurance stocks, WTM performed well in 2022. This was further compounded by their sale of their NSM division (and subsequent share repurchases), capitalizing on a hot M&A market for insurance brokers. We believe management will continue to create value for shareholders with their opportunistic asset purchases and sales, as they have before.

Top 3 Detractors from Relative Performance

Entegris (ENTG) – Despite outperforming end markets, ENTG underperformed due to demand uncertainties and elevated debt levels after the CMC Materials acquisition. Industry-wide challenges around excess capacity, elevated inventory, and higher costs have pressured semiconductor names this year. Despite short-term uncertainty, we believe demand will be a tailwind in the future driven by leading edge nodes and digitalization. ENTG is one of the most diversified players in the semi-materials industry with its size and scale. We remain attracted to the industry's high barriers to entry, limited competitors, and high switching costs.

Hayward Holdings (HAYW) – HAYW underperformed in 2022 due to concerns about pool demand, excess inventory in the channel, and margin pressure. HAYW continues to see healthy demand and high adoption rates for content-rich products. The environment has started to normalize back to pre-pandemic levels but with a higher installed pool base. Management has enacted significant pricing actions to mitigate cost pressure and maintain margins. We remain attracted to the consolidated industry, the repair and maintenance dynamic of the installed base, and the competitive moat of the business.

CarMax (KMX) – After outperforming in 2021, KMX lagged the broader market in 2022. Investors are concerned about affordability, increasing rates, and higher fixed costs given recent investments. KMX continues to disrupt the used car ecosystem by adding new capabilities and widening its moat with its omni-channel investments. We maintain our conviction in the stock.

Sector Influence

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

- What Helped: Overweight Cons. Staples (a better performing sector) & underweight Healthcare (a weaker performing sector)
- What Hurt: Underweight Energy (the best performing sector) & overweight Info. Technology (a weaker performing sector)

Portfolio Characteristics & Positioning

We believe the SMID portfolio is well positioned for an uncertain future and possesses the fundamental ingredients that stand the test of time: wide moats, durable profitability, strong free cash flow, healthy balance sheets, 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 we face an economic slowdown and a higher cost of capital environment, we believe companies with strong balance sheets and the ability to self-fund their operations should have a structural advantage in 2023 and beyond.

Portfolio Characteristics	Small-Mid Cap	R2500V
Pre-tax ROC (3 Yr. Avg.%)	13.6%	7.4%
Net Debt/EBITDA	2.8x	3.4x
Enterprise Value/EBITDA	15.2x	10.0x

Source: FactSet

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
SMID Cap (Gross)	6.9%	-13.8%	5.2%	8.2%	10.2%	14.5%
SMID Cap (Net)	6.7%	-14.4%	4.4%	7.4%	9.4%	13.7%
Russell 2500 Value	9.2%	-13.1%	5.2%	4.8%	8.9%	12.7%

Inception date: 3/31/2009. 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: March 31, 2009

Composite Definition: The Small-Mid Cap strategy is an extension of our Small Cap strategy with weighted market capitalization higher than our Small Cap portfolio, and is within the market capitalization ranges of the major domestic small to mid-cap indices. Accounts in this product composite are fully discretionary taxable and tax-exempt portfolios with a minimum of $100,000 in assets. The product is measured against the Russell 2500 Index and has a creation and inception date of March 31, 2009. 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 dual contract relationships and any potentially bundled fee scenarios. This policy is not retroactive, but will continue to apply going forward.

Benchmark Description: Primary: Russell 2500 Index measures the performance of the small to mid-cap segment of the U.S. equity universe, commonly referred to as "smid" cap. Russell 2500 is a subset of the Russell 3000 Index. It includes approximately 2500 of the smallest securities based on a combination of their market cap and current index membership. Secondary: Russell 2500 Value Index measures the performance of the small to mid-cap segment of the U.S equity universe. It includes those Russell 2500 Index companies with lower price-to-book ratios and lower forecasted growth values. Benchmark returns are not covered by the report of independent verifiers. The SMID Cap product is typically compared to the Russell 2500 Index. Any comparison to the Russell 2500 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.

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