

Portfolio Commentary

Market Update

U.S. equities rallied during 4Q with the major indices posting double-digit returns. Moderating inflation, some weakening in the labor market, and slowing economic growth raised the odds of a soft landing. The easing of financial conditions combined with indications by the Federal Reserve that it would pivot to rate cuts later in 2024 set forth a positive feedback loop for risk assets in 4Q. For the quarter, the Russell 3000 Index rose 12.1%.

There was a notable broadening of market strength in 4Q, as Small and Mid-Cap stocks posted the strongest gains. The recent broadening out of the market was a welcome reprieve, yet the cap-weighted Large Cap indices remain historically top-heavy and the mega-cap Magnificent 7 (Apple, Microsoft, Amazon, NVIDIA, Alphabet, Tesla, & Meta Platforms) were dominant in 2023. Some of the biggest beneficiaries of the 4Q drop in yields were the biggest victims of the rise in yields: regional banks, property stocks, cyclical sectors, and low quality, highly levered companies. Looking at market factors, Volatility and Growth were positive in 4Q while Value and Yield factors were mixed. Quality and Momentum factors were the biggest detractors during the final quarter.

Key Performance Takeaways

The London Company Income Equity portfolio gained 8.2% (8.1% net) during the quarter vs. a 12.0% 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 Index in 4Q and came up short of our 85-90% upside capture expectations. As was the case all year, the lack of exposure to high Volatility and Growth factors, along with an overexposure to Quality factors were headwinds. The concentration of the Russell 1000 Index had little impact on relative performance during the 4Q, but the strength in the Magnificent 7 was a significant headwind to relative performance for the year.

Following prior episodes of peak index concentration, there have historically been prolonged digestion periods in the market, which have typically favored lower market capitalizations and active management. We believe we're approaching a similar inflection point with the dominance of the mega-cap stocks. Weakness typically works its way up from the bottom, and we believe a Quality tilt in large cap equities will likely help in the years ahead as it has in the small cap area over the last few years.

Top 3 Contributors to Relative Performance

BlackRock (BLK) – BLK rallied in 4Q after underperforming earlier in the year. BLK performance from quarter to quarter is often a function of market performance, which drives the company's assets under management. Our conviction in BLK remains high based on the company's durable competitive position, under-levered balance sheet, persistently strong profitability, and capital return.

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.

Norfolk Southern (NSC) – NSC rebounded in 4Q after hitting a three-year low in late October. NSC reported a strong earnings report, provided more visibility into the Ohio derailment and suggested pricing power remains solid, and will be evident going forward to offset inflationary pressures.

Top 3 Detractors from Relative Performance

Chevron (CVX) – CVX underperformed during 4Q as oil prices fell, 3Q results missed expectations, and CVX negatively adjusted 2024-2025 cash flow guidance for its key asset in Kazakhstan. It is also notable that CVX announced a deal to acquire Hess Corp in a stock-for-stock transaction. While we generally do not maintain a high degree of exposure to pure commodity businesses, we continue to view CVX favorably for its conservative balance sheet, focus on returns, and commitment to the dividend.

Air Products (APD) – APD came under pressure in 4Q due to weakening industrial production in the Asia/Pacific region as well as 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.

Cisco Systems (CSCO) – CSCO declined following management's guidance reduction reflecting weaker demand trends. The revised outlook raised concerns that lower IT spending could be a headwind in the near term. We remain encouraged by CSCO's ongoing business transformation, and the shift to higher recurring software revenue should provide greater resiliency going forward.

Sector Influence

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

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

Trades During the Quarter

- There were no trades during the quarter.

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%

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.

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