Portfolio Commentary

Market Update

U.S. stocks posted solid gains in 1Q as stable economic growth, decelerating inflation, and some weakening in the labor market suggest a greater chance of a soft landing. Still, sticky inflation data and a tight labor market pushed out the timeline for the Fed's first rate cut, leading to a rise in yields. Nevertheless, the S&P 500 notched its strongest start since 2019. For the quarter, the broader market, as measured by the Russell 3000 Index, rose 10%. Stocks were higher across the market cap spectrum, but larger companies exposed to growth factors posted the strongest gains. The Artificial Intelligence (AI) hype that powered 2023's market rally extended its momentum into 2024. Although there were signs of some rotation away from the dominance of mega-caps, leadership dynamics largely remained unchanged. Market performance continued to be driven by Momentum, Growth, and Volatility market factors, while Yield, Value, and Quality factors lagged behind.

Key Performance Takeaways

The London Company Small Cap portfolio gained 8.3% (8.2% net) during the quarter vs. a 5.2% increase in the Russell 2000 Index. Outperformance was driven by stock selection, partially offset by sector exposure.

The Small Cap portfolio produced solid absolute and relative performance in 1Q, exceeding our upside capture expectations of 85-90%. Our Quality orientation continued to stand out down the market cap spectrum where earnings weakness was more pervasive. Company fundamentals continued to drive price, and the strong balance sheets of our companies—many with net cash—remained a significant advantage in this high rate environment.

Top 3 Contributors to Relative Performance

Masonite (DOOR) – DOOR was up 55% in 1Q after receiving a buyout offer from Owens Corning for $133 per share. Earlier in the quarter, DOOR had tried to acquire PGT Innovations, a deal that that we thought would have put too much leverage on the company, so we were quite happy to have Owens Corning acquire DOOR.

Vontier (VNT) – VNT outperformed to start the year as the company continues to show progress on its portfolio transformation efforts and drive efficiencies across the core business. Underlying demand has been stronger than expected, driven by industry consolidation, site buildouts, and technology modernization. Management has made encouraging progress optimizing the cost structure, and opportunity remains to improve profitability over the medium-term. We believe VNT's portfolio of resilient franchises remains well positioned to serve its large customer base with a variety of value-added solutions to capitalize on emerging trends within the mobility market.

Armstrong World Industries (AWI) – AWI was up 27% in 1Q after reporting strong quarterly results while providing solid guidance. AWI is executing effectively on key growth initiatives, leveraging pricing power, and demonstrating earnings resiliency. We remain attracted to the business because of its strong pricing power, annuity-like nature of the remodel portion of the business (roughly 70% of revenue), and management's excellent capital allocation.

Top 3 Detractors from Relative Performance

Cable One (CABO) – The market environment remains challenging for CABO with greater competition and lower move activity. While the competitive threats from fixed wireless and fiber-to-the-home are not affecting CABO's existing customer base, the market's perception is that it will limit the growth opportunities for the broadband provider going forward. CABO's recent subscriber growth was driven by new pricing schemes and promotions, which negatively affected ARPU (average revenue per user) during the quarter. While investors fear this trend will continue, management remains disciplined with its pricing strategy to ensure durable free cash flow growth over the long-term. CABO remains well positioned as an advantaged provider of high-speed internet in rural markets. We believe its relatively low penetration, superior service, and M&A prowess are supportive of long-term earnings growth.

Qualys (QLYS) – The underperformance by QLYS this quarter was largely the result of timing – it was trading near an all-time high at year-end 2023. However, due to a challenging macro environment for cybersecurity spend, the stock traded down in 1Q. Our conviction on QLYS is based on their strong product strategy, competitive moat, and potential to improve their go-to-market execution, all of which are intact despite the macro issues.

Malibu Boats (MBUU) – Shares of MBUU dropped significantly in late January after the surprise resignation of the CEO.

Sector Influence

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

- What Helped: Underweight Utilities (a weaker performing sector) & overweight Industrials (a better performing sector)

- What Hurt: Underweight Energy (a better performing sector) & overweight Real Estate (a weaker performing sector)

Trades During the Quarter

- Reduced: **Tempur Sealy (TPX) –** Reduction reflects market cap constraints (now over $8.5B). We trimmed the position on strength (up 48% in 2023), and believe TPX remains well positioned for future growth.
- Reduced: **Qualys (QLYS) –** Reduction reflects market cap constraints (now over $7B). We trimmed the position on strength (up 75% in 2023), and believe QLYS remains well positioned for future growth.
- Reduced: **Matson (MATX) -** We trimmed the position on strength (up 75% in 2023). We maintain a position based on its moat due to the Jones Act for many shipping lanes as well as its expedited service to China.
- Initiated: **Certara (CERT) -** CERT is the global leader in biosimulation technology, providing software and science-based services to big pharma, biotechs, and regulatory bodies. CERT runs an attractive software and services model that generates high-margin recurring revenues. Over 50% of revenues come from blue-chip customers, including 39 of the top 40 biopharma companies in the world. CERT's flagship platform, Simcyp, is the gold standard in the industry, and disruption risk is low. CERT is poised to benefit from the mid-teens% growth projected for the biosimulation market. CERT boasts a strong balance sheet and impressive cash flow generation.

Looking Ahead

With slowing inflation, signs of better balance in the labor market, and normalized GDP growth expectations, the Fed will probably start to lower rates later this year. We believe the Fed will proceed with caution, attempting to balance the risk of easing policy too early against the risk of maintaining rates in a restrictive position for too long. While the odds of a recession in the near term have declined, risks remain. Longer term, we remain positive regarding the U.S. economy and expect real annualized GDP growth in the 2% range driven by growth in the labor force and improving productivity.

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. After such a strong five-month rally, it's fair to question the sustainability of the market's strength. Narrow, top-heavy markets are fragile, and the recent surge in insider selling activity, especially in tech companies, likely reflects the extreme valuations and unsustainability of this AI momentum trade. The odds of a recession have come down, but our cautious posture persists due to high valuations, market concentration, looming debt challenges, and the lengthiest inversion of the yield curve in history. Continued multiple expansion in a higher rate environment is unlikely. We suspect the S&P 500 will eventually track earnings, so we would expect more volatility, especially in stocks where a lot of growth is already priced in. We see a greater opportunity for quality operators with durable cash flow generation, strong balance sheets, and attractive shareholder yields in the years ahead.

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Annualized Returns
As of 3/31/2024

	QTD	1Y	3Y	5Y	10Y	ITD
Small Cap (Gross)	8.3%	22.7%	9.4%	12.5%	7.9%	12.7%
Small Cap (Net)	8.2%	21.9%	8.7%	11.7%	7.2%	12.2%
Russell 2000	5.2%	19.7%	-0.1%	8.1%	7.6%	8.2%

Inception date: 9/30/1999. 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 March 31, 2024. 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: September 30, 1999

Composite Definition: The Small Cap strategy invests mainly in conservative, low-beta, small-cap equities with a focus on above-average downside protection. Primarily we seek profitable, financially stable small-cap companies that consistently generate free cash flow, high returns on unleveraged operating capital, trade at significant discounts to their intrinsic values, and are run by shareholder-oriented management. Positions are usually within the market capitalization range of the major, domestic small-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 2000 Index and has a creation and inception date of September 30, 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 relationship and any potentially bundled fee scenarios. This policy is not retroactive, but will continue to apply going forward.

Benchmark Description: Primary: Russell 2000 Index measures the performance of the small-cap segment of the U.S. equity universe. Russell 2000 is a subset of the Russell 3000 Index representing approximately 10% of the total market capitalization of that index. It includes approximately 2000 of the smallest securities based on a combination of their market cap and current index membership. Secondary: Russell 2000 Value Index measures the performance of the small-cap segment of the U.S. equity universe. It includes those Russell 2000 Index companies with lower price-to-book ratios and lower forecasted growth values. Benchmark returns are not covered by the report of independent verifiers.

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 London Company 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. Prior to April 1, 2024 returns are calculated gross of withholding taxes on foreign dividends and interest. Starting April 1, 2024, performance is calculated net or gross of foreign withholding taxes on dividends and interest income dependent on custodian data. Dividends are reinvested. The accounts represented in the composite reflect actual London Company fees paid on the particular account which may be different from the fee normally offered to other clients. Policies for valuing investments, calculating performance, and preparing GIPS Reports are available upon request.

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