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 Large Cap portfolio gained 8.3% (8.2% net) during the quarter vs. a 10.3% increase in the Russell 1000 Index. Sector exposure had minimal impact, while stock selection detracted from relative performance.

The Large Cap portfolio produced solid absolute returns, but relative results came up short of our 85-90% upside capture expectations. Our focus on Quality factors faced headwinds in a market favoring Momentum, Growth, and Volatility. A handful of mega-cap stocks continued to skew index results, and the opportunity cost of not owning several holdings, like NVIDIA or Meta Platforms, was significant.

While predicting market cycles is challenging, we anticipate some reversion to the mean for our Large Cap portfolio. A byproduct of the Momentum surge is that low beta & low volatility stocks now trade at historically wide discounts to the S&P 500. We believe the Large Cap portfolio's quality portfolio characteristics and attractive relative valuation can help offset the risks associated with growth stocks and lofty valuation multiples.

Top 3 Contributors to Relative Performance

Progressive (PGR) – PGR was up 31% during 1Q as it continues to report better margins and faster growth compared to the industry. PGR's policy in force (PIF) delivered positive growth, and it achieved necessary pricing actions with existing customers. Profitability remains better than peers as PGR has been successful at lowering ad spending while growing its mix of preferred customers. PGR's underwriting risk segmentation continues to be a competitive advantage as it has delivered industry-leading accident frequency results.

Martin Marietta (MLM) – MLM reached all-time highs during the quarter as the company executes on its value-over-volume strategy, exhibiting strong pricing power and margin expansion. The company continues to increase its leading position in aggregates by adding strategic assets that will be beneficial to overall profitability. Strategic M&A, strong financials, and resilient end market outlooks gives us confidence that the company will benefit from growth in infrastructure and construction spending for many years.

Berkshire Hathaway (BRK.B) – Insurance was once again a bright spot in Berkshire Hathaway's (BRK.B) 4Q earnings; GEICO showed meaningful margin improvement. The company once again sold some securities in the quarter, resulting in near all-time highs in the balance of cash & short-term investments. Overall, we continue to appreciate BRK.B for their financial strength, investment acumen, and disciplined management.

Top 3 Detractors from Relative Performance

Nestle (NSRGY) – Sentiment across the packaged food space is low as it emerges from two years of unprecedented food price inflation (not seen since the 1970s). High prices pressured volumes and margins industry-wide, and caused consumers to trade-down to value and private label. We view NSRGY as attractively positioned in categories that have stable, long-term volume tailwinds such as coffee, pet food, and nutritional health. We believe the stock can re-rate as volume-led growth returns, and the company continues to execute against profitability and operational goals.

Air Products (APD) – Stock weakness continued in 1Q as slower industrial production in the China and semis markets is weighing on the base business. APD's multiple compressed significantly in past months to 19.5x PE (vs. close peer Linde {LND} at 30.5x) which points to investor skepticism in both management's ability to execute competitively in the core business and in the capital allocation strategy focused on clean energy megaprojects. In Q1, we spoke with the CEO and he is prioritizing the restoration of investor trust while also protecting APD's long-term strategy. We believe the stock is positioned to both re-rate as APD delivers consistent execution in the base business, and compound over time as offtake agreements offer tangible return for megaprojects.

Starbucks (SBUX) – A handful of revenue headwinds weighed on SBUX's results in the quarter. Boycotts due to conflict in the Middle East should be a shorter-term headwind to traffic. The dynamics in the China market may take a bit longer to shake out. That said, as the China consumer gains strength there should be plenty of whitespace for a more rational, tiered market to prosper. The U.S. loyalty base remains strong as ever, cost cutting measures are being pulled forward to counter deleverage from lower revenue, and cash flow is healthy and growing (>4% FCF yield).

Sector Influence

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

- What Helped: Underweight Real Estate (a weaker performing sector) & overweight Financials (a better performing sector)

- What Hurt: Underweight Information Technology (a better performing sector) & overweight Materials (a weaker performing sector)

Trades During the Quarter

- Reduced: **Apple (AAPL) –** Reduction reflects strong performance in 2023 and resulting elevated valuation. We believe the outlook for AAPL remains strong with slow growth in iPhone (now #1 global market share) and faster growth in the higher margin services business. R&D will continue to drive new products and AAPL now has over 2 billion installed devices around the world. While near term earnings expectations appear reasonable, we felt it was prudent to reduce the position size based on risks to valuation.
- Increased: **Air Products (APD) -** Addition follows recent weakness reflecting headwinds from higher inflationary costs and the associated impact potential on expected returns from some of APD's largest projects. Fundamentally, APD is in a strong position to capitalize on the clean energy revolution due to their scale, experience, technology, and customer relationships. Management has shown they will allocate capital efficiently and effectively by walking away from deals that do not meet return thresholds, while taking advantage of government policies, tax credits, and favorable green bond prices. We remain confident in the long-term outlook, and a recent large share purchase by the CEO is a strong sign of conviction.

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.

> A byproduct of the Momentum surge is that low beta & low volatility stocks now trade at historically wide discounts to the S&P 500.

Annualized Returns
As of 3/31/2024

	QTD	1Y	3Y	5Y	10Y	ITD
Large Cap (Gross)	8.3%	21.0%	7.5%	11.0%	10.3%	11.4%
Large Cap (Net)	8.2%	20.5%	7.0%	10.5%	9.8%	10.8%
Russell 1000	10.3%	29.9%	10.5%	14.8%	12.7%	10.8%

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 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: 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.

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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