

Portfolio Commentary

Market Update

U.S. equities traded higher during Q3 with most of the major indices posting mid-single digit gains. The quarter was marked by significant market shifts, including inflation cooling, employment weakening, volatility spiking, and a larger-than-expected Federal Reserve rate cut, yet the stock market ended on a high note. The broader market, measured by the Russell 3000 Index, rose 6.2%. There was a notable rotation to small cap and value styles away from large cap growth. This fostered broader market participation, with a wider range of sectors participating, especially the rate sensitive areas. Looking at market factors, Yield and most Value factors posted the strongest returns while most of the Growth, Volatility, and Momentum factors presented headwinds. Quality factors had a mixed impact.

Key Performance Takeaways

The London Company Income Equity portfolio gained 10.5% (10.4% net) during the quarter vs. a 6.1% increase in the Russell 1000 Index. Sector exposure and stock selection were both tailwinds to relative performance.

After several quarters of weak relative returns, the Income Equity portfolio solidly outperformed the Russell 1000 and our expectations 85-90% upside capture expectations in a robust return environment. Factors like increased volatility and surging market breadth favored our portfolios. Greater exposure to Yield and Value factors, as well as less exposure to Volatility and Momentum factors aided relative performance. We were encouraged to see the Income Equity portfolio protected on the downside amidst the volatility and market drawdown while staying ahead of its benchmark during the market's sharp recovery.

Top 3 Contributors to Relative Performance

Progressive (PGR) – PGR was a top performer year to date due to its success in growing the business and improving margins. PGR has gained market share from competitors and improved its margins by effectively segmenting underwriting risks and implementing strategic pricing. PGR has achieved its profitability target by lowering advertising costs and focusing on acquiring preferred customers. We remain confident in PGR's ability to execute in all environments, competitive advantages, and capital allocation strategy.

Lowe's (LOW) – LOW was a top performer due to the execution of its ongoing productivity initiatives, share gains, and margin improvement. The Pro business continues to post better than expected results due to LOW's multiyear investments. LOW is in a good position to continue to gain share despite some moderation following the pandemic boom. LOW has a very strong balance sheet and returns cash to shareholders through dividends and share buybacks.

Blackrock (BLK) – Shares of BLK rallied during 3Q as organic growth improved sequentially. Our long-term view of BLK has not changed. In the near-term, strong equity market performance is supportive of AUM and fee growth, and visibility on declining interest rates is a potential tailwind to the fixed income ETF business. We continue to view BLK as a long-term share gainer with a broad spectrum of solutions, and we appreciate the strong balance sheet and steady capital return.

Top 3 Detractors from Relative Performance

Charles Schwab (SCHW) – SCHW were weak during 3Q, which led to underperformance vs. the broad market YTD. In its latest quarter, SCHW reported weaker results, though with little implications on company fundamentals. Cash sorting from consumers continued in the latest quarter and has persisted longer than we anticipated. We believe that an end to SCHW's headwinds are near, especially as the Federal Reserve shifts to lower rates, and consequently, we expect a strong rebound in earnings power within the next 18 months. Longer term, we believe the company is well positioned to continue capturing market share and driving sustainable earnings growth.

Merck (MRK) – MRK continues to experience solid growth in key therapeutic areas, driven by its blockbuster immunotherapy treatment, Keytruda. However, MRK recently lowered its outlook for its HPV vaccine due to challenges in China, which has weighed on investor sentiment. Management attributes the demand decline to the delayed effects of China's anti-corruption campaign and elevated inventory at its distribution partner. Despite these headwinds, they are confident in the vaccine's long-term potential especially outside China. We remain attracted to MRK's strong bullpen of drugs and vaccines and believe MRK's leadership team can accelerate its drug pipeline and supplement growth with business development opportunities.

Chevron (CVX) – CVX shares underperformed during 3Q reflecting falling oil prices. CVX's latest quarterly earnings were below expectations, and the uncertainty of the pending acquisition of Hess remains an overhang. Bigger picture, there is no change to our view on the defensive capital structure, competent management team, and attractive cash generation of the asset base.

Sector Influence

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

- What Helped: Underweight Info. Technology (a weaker performing sector) & overweight Financials (a better performing sector)
- What Hurt: Underweight Utilities & Real Estate (both better performing sectors)

Trades During the Quarter

- Increased: **TE Connectivity (TEL)** – Late in Q3, we added 1% to the existing position in TEL. We initiated our position during Q2, and this recent addition brought the position size close to the 3% weighting that we often target for new positions. We reduced cash in the portfolio to make the addition.

Looking Ahead

Stocks enter 4Q in good form, but challenges remain. The market appears priced for near perfection, with expectations of a soft landing and healthy earnings growth driving the S&P 500 to a lofty valuation that leaves little room for error. The Fed's recent rate cut may sow the seeds for a cyclical recovery, but whether the economic impact arrives in time to avoid a downturn is uncertain. Lower rates tend to support market sentiment and multiples in the short term, but it can take up to two years for policy changes to impact economic and earnings data. Meanwhile, rates remain in restrictive territory. Therefore, the impact of restrictive policy may continue to affect the economy in the months ahead. While we believe that the odds of a near term recession are low, we note the difficulty in navigating a soft landing.

In terms of the equity market, valuations based on near term earnings are elevated in the context of moderate GDP growth. We believe that equity returns in the near term may be modest, with shareholder yield (dividends, share repurchase, debt reduction) comprising a significant percentage of the total return from equities. Moreover, as a large corporate debt maturity wall approaches, balance sheet strength will likely become a differentiator and an advantage for investors focused on fundamentals. We believe our focus on quality, diversification, and valuation will continue to reinforce our margin of safety, positioning our portfolios for success in this uncertain climate.

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Annualized Returns

As of 9/30/2024

	QTD	YTD	1Y	3Y	5Y	10Y	ITD
Income Equity (Gross)	10.5%	14.9%	24.3%	6.9%	10.0%	9.8%	9.3%
Income Equity (Net)	10.4%	14.6%	23.8%	6.5%	9.5%	9.3%	8.7%
Russell 1000	6.1%	21.2%	35.7%	10.8%	15.6%	13.1%	7.8%

Inception date: 12/31/1999. 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 September 30, 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 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 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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