

Portfolio Commentary

Market Update

U.S. stocks posted mixed results during 2Q24. The broader market, measured by the Russell 3000 Index, rose 3.2% with gains concentrated in large companies with ties to spending on artificial intelligence. The S&P 500 reached new all-time highs during the quarter, but market breadth (a measure of how many stocks are participating in the rally) sharply declined once again. The Russell 2000 Small Cap Index was down 3.3%. Economic data released during the quarter reflected decelerating growth, some weakening in the labor market, and lower inflation, which collectively support the notion of rate cuts beginning in the next few months. Corporate earnings were solid, but there were signs of greater caution from consumers. Investors continued to favor Large Cap, Growth and Momentum factors, consistent with trends in recent quarters. Value and Yield factors continued to face headwinds, while Quality & Volatility had a mixed impact.

Key Performance Takeaways

The London Company Large Cap portfolio declined 1.9% (2.0% net) during the quarter vs. a 2.2% decrease in the Russell 1000 Value Index. Stock selection was additive to relative performance, partly offset by sector allocation.

The Large Cap portfolio outperformed the Russell 1000 Value in 2Q, in line with our 75-80% downside capture expectations. Exposure to Quality factors was additive to results, and having some exposure to the Magnificent 7 also played a role in our relative outperformance.

Top 3 Contributors to Relative Performance

Alphabet (GOOG) – GOOG was a top performer this quarter as it reported strong Search revenue, tighter cost controls, and momentum in Cloud. Both direct and brand Search ads were better than expected and the strength in YouTube monetization continues. Expense controls have translated to 700bps of margin improvement. Management is removing layers to improve efficiency, which should drive margins higher. GOOG also provided details on paths to monetize AI for advertisers. GOOG initiated a dividend during the quarter to return additional cash to shareholders. It has a solid balance sheet, significant market share, and generates strong returns.

Apple (AAPL) – Shares rallied during the second quarter after posting strong results with improvement in China. The company also announced a \$110B share repurchase authorization and a 4% increase in the dividend. iPhone revenue was down a bit although there were some moving pieces that made y/y comparisons challenging. Positive comments about potential with AI helped drive the shares.

Texas Instruments (TXN) – TXN rallied in the second quarter despite declining revenue in its latest update. The company is beginning to see some encouraging signs of destocking nearing an end and some sub-segments of the market are experiencing improving demand. The company continued to spend on capex and should begin to see positive benefits to cash flow next year from the CHIPS Act.

Top 3 Detractors from Relative Performance

NewMarket (NEU) – NEU underperformed after reporting declining revenue in its latest quarter reflecting lower selling prices. The company also added debt after acquiring AMPAC.

Norfolk Southern (NSC) – NSC pre-announced weaker results in early April. Revenue declined in its latest quarter driven by lower fuel surcharges, an unfavorable product mix, and lower intermodal ancillary fees. Costs continued to rise. Activist involvement may lead to lower costs in the future.

Old Dominion Freight Line (ODFL) – ODFL reported solid results in its latest quarter, but is still feeling the negative impact of the freight recession. The company continues to invest in the business by adding capacity, while focusing on superior service. We trimmed the position in the Large Cap portfolio in early 2Q24 due to valuation concerns.

Sector Influence

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

- What Helped: Underweight Health Care (a weaker performing sector) & overweight Info. Technology (a better performing sector)
- What Hurt: Overweight Cons. Discretionary (a weaker performing sector) & underweight Utilities (the best performing sector)

Trades During the Quarter

- Reduced: **Martin Marietta (MLM) & Old Dominion Freight (ODFL)** – Trimmed both positions following recent strength in shares. There is no change to our long-term thesis for either company.
- Increased: **Air Products (APD) & Norfolk Southern (NSC)** – Added to both positions following recent weakness in the shares. We believe the competitive advantages are intact and valuation is attractive.
- Increased: **Norfolk Southern (NSC) & Nestle (NSRGY)** – We reduced the portfolio’s cash position and added to each holding. We remain confident in the outlook for both companies and note that each trades at an attractive valuation. Recent insider purchases at both companies gave us greater conviction in the timing of the additions.
- Exited: **Albemarle (ALB)** – Sold our remaining position in ALB after the stock triggered our soft stop loss review. We are concerned that weaker demand in the US for electric vehicles coupled with greater than expected supply of lithium reaching the market may lead to declining lithium prices. This will likely lead to lower cash flow generation in the years ahead, which weakens the downside protection case for the stock.
- Initiated: **TE Connectivity (TEL)** – TEL designs and manufactures connectors and sensors, supplying solutions to the transportation, industrial, and communications industries. The critical components that TEL sells have long life cycles and they make up a small percent of the overall cost of materials for a complex electronic systems (i.e. low cost but high-cost failure products), creating high switching costs and barriers to entry. TEL has leading share in the global connector market (including 30-35%

share in automotive) with leverage to secular growth from the ‘electrification’ of multiple end markets. TEL’s management team has enacted successful cost-realignment strategies, driving significant margin improvement and leading to mid-teens returns on invested capital. TEL fits our process well. It has a low level of net debt, generates healthy cash flows, returns a significant amount of capital back to shareholders through its dividend and buyback program, and it currently trades at a discount to our estimate of intrinsic value and a discount to its peers. Given its strong competitive position, capital allocation philosophy, and favorable industry tailwinds, we believe TEL presents an opportunity to own a high quality compounder.

Looking Ahead

Conditions are trending in a positive direction for the Fed to begin reducing rates. Inflation is still higher than the Fed’s target, but it has continued to drift lower. The labor market remains strong, but there have been some signs of weakening. Together with signs of weakness in some recent economic data, we could see the Fed shift to a less restrictive policy and reduce rates before year-end. 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 1.5-2% range driven by growth in the labor force and improving productivity.

In terms of equities, we note that narrow, top-heavy markets are fragile markets. 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 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. In our view, this uncertain economic backdrop warrants an investment approach that prioritizes consistency and stability—not excessive wagers. Owning great businesses at reasonable prices and allowing them to compound is still a winning, long-term strategy.

Annualized Returns

As of 6/30/2024

	QTD	YTD	1Y	3Y	5Y	10Y	ITD
Large Cap (Gross)	-1.9%	6.2%	9.9%	5.0%	10.1%	9.5%	11.2%
Large Cap (Net)	-2.0%	6.0%	9.5%	4.6%	9.6%	9.0%	10.7%
Russell 1000 Value	-2.2%	6.6%	13.1%	5.5%	9.0%	8.2%	9.6%

Disclosure Notes

The London Company's performances are size weighted and annualized based on calculations for the period ending June 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 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. The Large Cap product is typically compared to the Russell 1000 Index. Any comparison to the Russell 1000 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 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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