Davenport Asset Management Quarterly Update | Q1 2019

March 31, 2019

Equities surged higher to start 2019. The S&P 500 Index gained 13.7% while the Russell 2000 Index was up 14.6%. Of note, this was the best quarter for the S&P 500 Index since 2009 and the best first quarter since 1998. Clearly, this advance represented a dramatic turn of events from Q4 2018, when stocks declined and the S&P 500 Index experienced its worst December since 1931.

What sparked this turn? For one, by late 2018 it appeared investors had generally accepted signs of moderating economic growth. Shares of many companies, especially those most sensitive to economic pressures, seemed to be discounting a full blown recession. With market expectations reset, it only took decent fourth quarter earnings reports from corporate America for stocks to rally. Also, fears of a trade war with China diminished as the Trump Administration seemed to make progress with Chinese leadership.

Market Returns	Q1 2019	2018
U.S. Large Caps	13.7	-4.4
U.S. Mid Caps	16.5	-9.1
U.S. Small Caps	14.6	-11.0
International Developed Markets	10.0	-13.8
Emerging Markets	9.9	-14.6
Intermediate Term Bonds	2.3	0.9

Source: Morningstar Direct.
Please see last page for index definitions.

Perhaps most notable, the Federal Reserve backed off its tightening agenda. The Fed had been raising interest rates and appeared intent on continuing to do so in response to low unemployment, economic growth (prompted in part by fiscal stimulus/tax cuts) and the threat of inflation. As signs of slowing growth became apparent, many feared the Fed's agenda was misguided and Fed Chairman Jerome Powell gained some vocal critics. Ultimately, Powell acknowledged the case for raising rates had weakened and noted rate hikes were less likely. Investors promptly cheered a continuation of the "cheap money" environment that has buoyed stock valuations for much of the last decade. Many investors are going so far as to predict the Fed's next move may potentially be an interest rate cut.

As described in our year-end letter, we continue to expect more moderate equity returns when compared to the heady returns of 2013-2017. However, as shown by the wild swings of Q4 2018 and Q1 of this year, this clearly won't happen in a smooth fashion. Our outlook is based on a fairly balanced risk/reward profile for the market. Although we think the odds of a recession are low, we remain mindful of slowing earnings growth (partly a function of lapping corporate tax reductions) and "peakish" conditions for gauges such as unemployment and consumer credit. On the other hand, it appears the Fed still "has the market's back" and valuations aren't unreasonable. The S&P's current P/E of 17x on 2019 earnings is only slightly above the average of the last 25 years.

In terms of our Portfolios, we were pleased with both absolute and relative performance in the first quarter. We continue to find new ideas, although the market's impressive bounce has made it a little more difficult to find value. We are currently carrying some cash and look to take advantage of any market pullbacks.

Bond Market Update

The Federal Reserve's March meeting was the biggest event of the recent quarter. Expectations were the Fed would announce a more dovish view than what was communicated at the end of 2018. The actual announcement was even more so. Their statement was confirmation they had paused their tightening moves broadcast at the end of 2018.

The market reacted with lower rates across all maturities as we ended the first quarter. Two-year Treasuries were lower by 23 basis points, fives by 28 basis points, tens by 28 basis points, and the thirty-years were lower by 20 basis points. Additionally, the Treasury yield curve, the difference between short rates and longer rates, inverted during the last days of March with the three-month Treasury bill yield at 2.39% and the ten-year Treasury note at 2.37%.

Domestic economic releases for the quarter were delayed due to the government shutdown, which effected data gathering services, causing the validity of released indicators to be questioned. Payrolls increased by 304,000 for January and dropped to just an increase of 20,000 for February versus expectations of an increase of 180,000. It is estimated that payrolls increased by 179,000 for March. Retail sales, an important component of U.S. GDP, rose 0.2% in January yet fell 0.2% in February – indications the U.S. economy has slowed from the 2.9% rate of GDP for 2018. Additionally, the CPI for January and February were at 1.6% and 1.5% - relatively tame levels.

Economic growth outside the U.S. tells a very different story. Italy is in a recession, Greece continues to have issues, the Eurozone is verging on a stall, and Britain has yet to resolve Brexit. Many of the world's economies are much weaker as 2019 progresses versus a year earlier when we had a worldwide expansion.

Our outlook is for rates to remain near these low levels for the immediate future. One caveat that must be considered is the flight to quality should our stock markets experience increased volatility on the downside.

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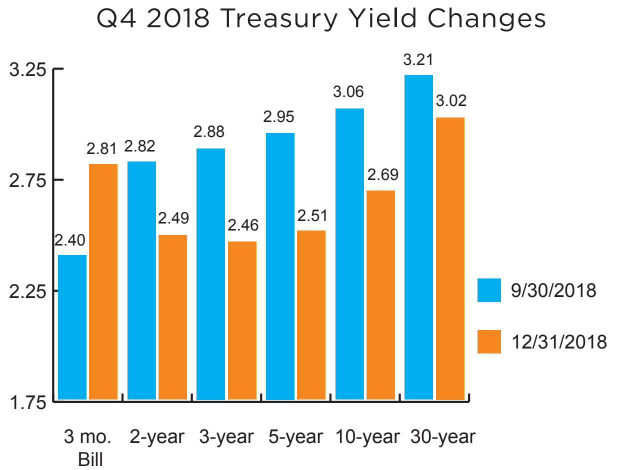
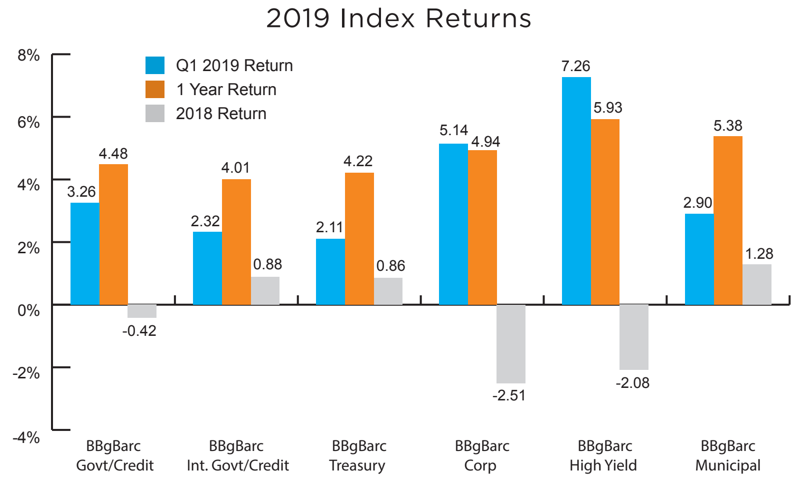


Source: Bloomberg Barclays. Please see last page for index definitions.



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Important Disclosures

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Performance shown is historical and is no guarantee of future results. Investing in securities carries risk including the possible loss of principal.

Index Definitions: U.S. Large Caps represented by the **S&P 500 Index**. U.S. Mid Caps represented by the **Russell Midcap Index**. U.S. Small Caps represented by the **Russell 2000 Index**. International Developed Markets represented by the **MSCI EAFE Index**. Emerging Markets represented by the **MSCI EM Index**. Intermediate Term Bonds represented by the **Bloomberg Barclays Intermediate Government/Credit Index**.

The **S&P 500 Index** is comprised of 500 U.S. stocks and is an indicator of the performance of the overall U.S. stock market. The **Russell 2000® Index** measures the performance of the 2000 smallest companies in the Russell 3000 Index, representing approximately 8% of the total market capitalization of the Russell 3000. The **Russell 1000® Value Index** measures the performance of the Russell 1000 companies with lower price-to-book ratios and lower forecasted growth values. The **Russell Midcap® Index** measures the performance of the 800 smallest companies in the Russell 1000, which represent approximately 25% of the total market capitalization of the Russell 1000. The Russell 2000® Index, Russell 1000® Index and Russell Midcap® Index are trademark/service marks of the Frank Russell Co. Russell® is a trademark of the Frank Russell Co.The **Morgan Stanley Capital International Europe, Australia and Far East (MSCI EAFE) Index** is an unmanaged index composed of the stocks of approximately 1,000 companies traded on 20 stock exchanges from around the world, excluding the U.S., Canada, and Latin America. The **Morgan Stanley Capital International Emerging Markets (MSCI EM) Index** is a capitalization-weighted index of stocks from 26 emerging markets that only includes issues that may be traded by foreign investors. The reported returns reflect equities priced in US dollars and do not include the effects of reinvested dividends. The **Bloomberg Barclays U.S. Corporate High Yield Index** measures the U.S. dollar-denominated, high yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB+/BB+ or below. The **Bloomberg Barclays Intermediate Government/Credit Index** is an unmanaged index composed of debt securities with maturities from one to ten years issued or guaranteed by the U.S. Treasury, U.S. Government agencies, quasi-federal corporations and fixed rate dollar denominated SEC-registered corporate debt that are rated investment grade or higher by Moody's Investors Service and Standard and Poor's Corporation or Fitch Investor's Service, in that order. The **Bloomberg Barclays Municipal Index** covers the U.S. dollar-denominated long-term tax exempt bond market. The **Bloomberg Barclays U.S. Government/Credit Bond Index** measures the non-securitized component of the U.S. Aggregate Index. It includes investment grade, U.S. dollar-denominated, fixed-rate Treasuries, government-related and corporate securities. The **Bloomberg Barclays U.S. 1-3 Year Government/Credit Index** includes all medium and larger issues of U.S. government, investment-grade corporate, and investment-grade international dollar-denominated bonds that have maturities of between 1 and 3 years and are publicly issued. The **Bloomberg Barclays U.S. 1-5 Year Government/Credit Index** measures the performance of U.S. dollar-denominated U.S. Treasury bonds, government related bonds (i.e., U.S. and non-U.S. agencies, sovereign, quasi-sovereign, supranational and local authority debt) and investment grade U.S. corporate bonds that have a remaining maturity of greater than or equal to one year and less than five years. **The Bloomberg Barclays Intermediate Corporate Index** The Index measures the investment grade, fixed-rate, taxable corporate bond market. It includes USD denominated securities publicly issued by US and non-US industrial, utility and financial issuers.

An investor cannot invest in these indices and their returns are not indicative of the performance of any specific investment.