Davenport Asset Management AUGUST 2024

Dog Days Bring Volatility

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Much has changed since we penned our mid-year market update. In fact, it almost feels as though that letter is already obsolete. Perhaps a one-month shelf life is the new normal with today's fast-moving and wildly unpredictable news cycle.

In July, we witnessed an assassination attempt on a presidential candidate, President Biden drop out of the 2024 race, and a giant market rotation away from large cap tech leaders into other areas of the market. Small caps and economically sensitive stocks rallied as benign inflation data supported hopes for the beginning of accommodative Fed policy (i.e. interest rate cuts).

We suggested that market leaders could cool off and that we might see the sun shine elsewhere. That proved right for a bit, but now almost everything has been going down in what looks like a semi panic. News that Warren Buffett's Berkshire Hathaway surprisingly unloaded half its position in Apple certainly didn't help either. Consider the following:

- NASDAQ is down over 13% in one month and is firmly in correction territory.
- The semiconductor index (SOX) has been hammered 24% and is in a bear market
- The S&P 500 just posted its worst day since 2022
- The Russell 2000 just declined over 3% three days in a row and erased July gains
- Defensive areas such as consumer staples and utilities have recent outperformed substantially
- The volatility index (VIX) hits its highest level since the pandemic market plunge in 2020
- Japan's Nikkei index declined 12% in one day - the worst loss since "Black Monday" in 1987
- The yield on a 10-year Treasury went from 4.4% on July 2nd to 3.8% on August 2nd

What's more, earnings season has been replete with jarring blowups. It's been unusually common for stocks to slide 10-20% after missing earnings expectations, even if by slight margins. Take Amazon.com Inc. (AMZN) for example. The stock has declined 14% and the company has lost nearly $300 billion of market capitalization since the company missed Q2 revenue expectations by 0.5% and guided to Q3 sales 1.3% short of forecast. While this is a good lesson in the risks associated with high expectations, the long-term growth profile of AMZN has barely budged.

The CNN Fear & Greed Index, a popular measure of investor sentiment, is now firmly in "fear" territory. Why are anxiety levels running so high? Weaker employment data, softer manufacturing readings, and consumer malaise are to blame. Simply put, the economy is slowing and many areas are dealing with hangovers after robust pandemic recoveries. We've also seen investors start to cast some doubt on the huge sums being spent on artificial intelligence (AI) by the technology leaders. Some are also citing the unwind of the Japanese "carry trade", where investors have been borrowing cheaply in Yen to fund the purchase of U.S. assets.

Our view – Keep Calm and Carry On. We aren't sure there's as much to panic about as recent action would suggest. We are indeed seeing a slowdown, but it's more likely to be a moderation than a painful recession, which rarely occurs outside of unexpected events. Economic growth is still decent (albeit slowing), the unemployment rate is still low by historical norms, inflation is moderating, and we believe are on the cusp of a Fed rate cut cycle that has the potential to support asset values and areas such as housing. Indeed, the Fed has plenty of room to loosen policy.

Shares of a number of great businesses are now offering much more attractive entry points. This includes many of the high-growth tech leaders that have fallen precipitously (see Amazon example). Excess cash in our strategies has been coming in handy and we have been adding to a few positions that have sold off sharply. We don't know when this bout of volatility will subside, but we do know we are getting better deals than we were just a few weeks ago.

On performance: Our Davenport Funds are generally flattish to up nicely on a year-to-date basis following recent tumult. Relative performance has been mixed, with Core Leaders and Value & Income holding in relatively well YTD, while Equity Opportunities, Small Cap Focus, and Insider Buying have lagged. Most of the Funds have proven more resilient than benchmarks during the swoon. Here are quick thoughts on each:

Davenport Core Leaders Fund (DAVPX): Core Leaders is up nicely on the year. After a solid relative showing in 2023, we are almost even with the S&P this year. We are very pleased with this performance given the top-heavy performance of the S&P and our underweight positions in names like NVIDIA Corp (NVDA) that have supported the benchmark. Indeed, it has been a very tough benchmark to keep pace with this year.

Davenport Value & Income Fund (DVIPX): We are having a good absolute and relative year. The Fund has performed well in recent months and is slightly ahead of the Russell 1000 Value® Index. Big positions in defensives such as NextEra Energy Inc. (NEE), Johnson & Johnson (JNJ) and Philip Morris International Inc. (PM) have been helpful as have recent additions to steady names such as American Tower Corp (AMT), Hershey Co (HSY) and PepsiCo Inc. (PEP). We have taken strides to both lower overall Fund beta and lift yield.

Davenport Equity Opportunities Fund (DEOPX): After a solid multi-year run, DEOPX is having a tougher relative year. We are up marginally but trailing the Russell Midcap® Index by about 400 bps. A few names posted unusual drawdowns following earnings reports. We've been adding to high conviction names to coil the spring for potential future outperformance. Recent buys include Kinsale Capital Group Inc. (KNSL), Clean Harbors Inc. (CLH), Casey's General Stores Inc. (CASY) and Align Technology, Inc. (ALGN).

Davenport Small Cap Focus Fund (DSCPX): Here again we are lagging in 2024 following a solid multi-year run. However, the Fund has gained meaningful ground on the Russell 2000® Index during recent weakness. Small caps have been very volatile, but we still like the setup here with the asset class having underperformed for many years. We have used volatility to add to numerous positions in the Fund and think we are well positioned for a recovery.

Davenport Insider Buying Fund (DBUYX): The first half of the year was tough for our new Fund from a relative standpoint as technology bellwethers led markets higher (insider buying in these names has been rare so the Fund can't own them by mandate). However, relative performance has recently turned sharply during both the July market rotation and the recent selloff. It has been very satisfying to see the Fund act more stable than the S&P 500 during this volatile patch.

Thanks for your time and please call with any questions.

Sincerely,

George L. Smith III

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You should consider each fund's investment objectives, risks, charges and expenses carefully before investing. Each fund's prospectus contains this and other important information, should be read carefully before investing or sending money, and can be obtained by contacting your Financial Advisor, or by calling 800-846-6666. Investing in securities carries risk including the possible loss of principal.

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Fund Holdings: As of 7/31/24. DAVPX - AMZN 4.62%, NVIDIA 2.93%; DVIPX - NEE 3.76%, JNJ 3.50%, PM 3.14%, AMT 2.23%, PEP 1.89%, HSY 1.54%; DEOPX - KNSL 4.91%, CLH 4.04%, ALGN 3.08%, CASY 2.00%.

Mutual funds are distributed by Ultimus Fund Distributors, LLC.

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