Davenport Asset Management
Quarterly Update | Q1 2017

March 31, 2017

After a strong finish in 2016, stocks continued to march higher in the first quarter of 2017. The S&P 500 Index finished up 6.1% in the first three months of the year, surpassing other domestic indices (the Russell 2000 Index gained 2.5% during the quarter). Impressively, since the most recent market trough on February 11th, 2016, the S&P is up 32% and the Russell 2000 is up 48%.

Since the fall election, the market has been salivating over the prospects of meaningful tax cuts and a rollback of regulations. Events during the last month threw a bit of cold water on these hopes, as President Trump was unable to push his healthcare bill through Congress. As a result, "Trump trade" beneficiaries softened and secular growth stories regained favor. The technology and healthcare sectors performed particularly well with this backdrop and were up 12.6% and 8.6%, respectively, during the quarter. Policy delays remain a potential threat to the market's rally, as illustrated by the more domestically-oriented Russell 2000's underperformance during Q1.

Despite only modest improvement in the tepid economic expansion we are currently experiencing, stocks have been able to accelerate to the upside as investor sentiment has turned more optimistic. Indicators such as mutual fund net inflows show that investor confidence is on the rise. While the market's recent spike and increased investor confidence has us more cautious, we don't yet sense euphoria. We continue to see plenty of reasons to remain invested, least of which is the inherent difficulty of attempting to time the market.

Alongside fiscal uncertainty, the market is also facing tightening monetary policy, with the Federal Reserve having recently raised short-term interest rates by 0.25% in March. The Fed is expected to raise rates twice more during the balance of 2017. With employment at full levels and economic indicators pointing up, we think the economy is strong enough to handle a move away from ultra-accommodative monetary policy.

Perhaps most encouraging, earnings growth could carry the torch for the next leg of the rally. After nearly two years of earnings declines, earnings returned to modest growth in late 2016 and are expected to snap back a vigorous 22% in 2017, as foreign exchange headwinds abate, the energy sector recovers, the US exits its industrial recession and international markets improve.

While stocks look relatively expensive today at 18.2x times 2017 earnings, if one assumes a modest 10% EPS growth rate over the next couple years the multiple quickly scales down to 16.5x on 2018 earnings and 15x on 2019 earnings. In sum, while the market's impressive spike may have borrowed some from the rest of 2017's returns, we see reason to remain optimistic based on fundamental improvement. Any forthcoming corporate tax cuts would be icing on the cake (and upside to those earnings estimates).

Market Returns	Q1 2017	2016
U.S. Large Caps	6.1	12.0
U.S. Mid Caps	5.1	13.8
U.S. Small Caps	2.5	21.3
International Developed Markets	7.2	-1.9
Emerging Markets	11.4	11.2
Interm. Term Bonds	0.8	2.1

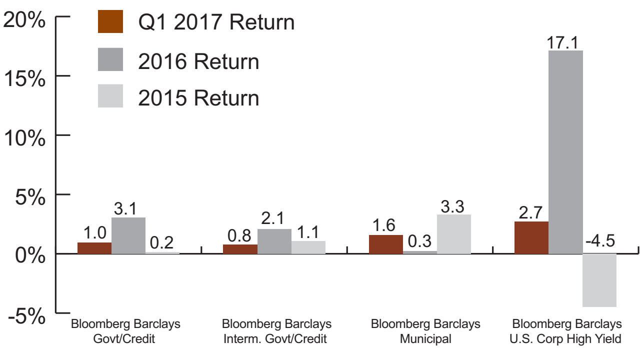
Source: Morningstar Direct. Please see Important Disclosures on following page for index definitions.

Bond Market Update

Coming off the heels of the bond market sell off subsequent to the Trump election and a December rate hike by the Fed, the bond market began 2017 stabilizing into a tight trading range waiting for actions, not promises, by the new administration in Washington. The treasury market traded sideways through late February until selling off due to a series of hawkish Fed speakers repositioning the market to expect a March rate hike. Even with the optimism of a new administration and the Fed raising rates for the second time in three months, the treasury curve ended Q1 2017 little changed from where we ended 2016. Shorter treasuries, 1 year and in, rose over 20 basis points (bps) during to quarter, and 2 year treasuries rose 7 bps. The intermediate and long maturities actually finished Q1 2017 lower than where they started the year. The yield on the 10 year treasury began the year at 2.45% and finished the quarter at 2.39%, after briefly trading above 2.60%.

Fixed income indexes performed relatively well during Q1 in the face of a "risk on" mentality inspired by the Trump administration's promised pro-growth reforms and policies. High yield led domestic credit returns up 2.7% during the quarter. The Bloomberg Barclays Intermediate U.S. Government/Credit Index returned 0.78%, Bloomberg Barclays U.S. Corporate Investment Grade index positive 1.22%, and Bloomberg U.S. Treasury index finished Q1 gaining 0.67%. These returns provide evidence that even in the face of rising or flat treasury yields the corporate bond market can provide attractive risk/return characteristics in spread products.

2017 Bond Index Returns



Source: Bloomberg Barclays. Please see below for index definitions.

Going forward, we are keeping our eyes on the next headlines coming out of Washington. The inability to repeal and replace the Affordable Care Act in March took some wind out of the sail of risk assets while bonds caught a bid. The question now is whether the new administration will face similar hurdles in their attempts to address tax reform and infrastructure spend. If tax reform faces the same roadblocks as the healthcare bill, this could provide a further bid for safe haven assets. Our attention also focuses on the Fed, as they have prepped the market for two more hikes this year. This would bring the Fed Funds rate to 1.25%-1.50% by the end of 2017, in line with the Fed's year-end median forecast on 1.4%. Unless the Fed turns to a more hawkish tone, we think that the market is well positioned to absorb two more hikes. Similar to the end of 2016, we prefer to maintain a defensive portfolio structure, short duration and high quality, until we have more certainty to the success of Trump's pro-growth agenda.

Changes in Treasury Rates for Q1 2017

	12/31/2015	12/31/2016	12 Mo Change	3/31/2017	3 Mo Change
3 Mo Treasury	0.17	0.50	33 bps	0.75	25 bps
1 Yr Treasury	0.60	0.81	21 bps	1.02	21 bps
2 Yr Treasury	1.05	1.19	14 bps	1.26	7 bps
5 Yr Treasury	1.76	1.93	17 bps	1.92	-1 bps
10 Yr Treasury	2.27	2.45	18 bps	2.39	-6 bps
30 Yr Treasury	3.02	3.07	5 bps	3.01	-6 bps

Important Disclosures

Any opinions expressed here are statements of judgment on this date and are subject to future change without notice. This information may contain forward looking predictions that are subject to certain risks and uncertainties which could cause actual results to differ materially from those currently anticipated or projected. The information contained herein has been compiled from sources believed to be reliable; however, there is no guarantee of its accuracy or completeness. There is no guarantee that a company will continue to pay a dividend. The investment return and principal value of an investment will fluctuate. Small and mid cap company stocks may be more volatile than stocks of larger, more established companies. The portfolios may invest in foreign securities which are subject to additional risks such as currency fluctuations, political instability, differing financial standards and the potential for illiquid markets.

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**. 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, which represents approximately 8% of the total market. 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 and Russell Midcap® Index are trademark/service marks of the Frank Russell Co. Russell® is a trademark of the Frank Russell Co. The **Lipper Equity Income Funds Index** is an unmanaged index of the 30 largest funds in the Lipper Equity Income Fund category. The **Lipper Large Cap Growth Funds Index** is an unmanaged index of the 30 largest funds in the Lipper Large Cap Growth Fund category. The **Lipper Large Cap Value Funds Index** is an unmanaged index of the 30 largest funds in the Lipper Large Cap Value Fund category. 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.

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