Davenport Asset Management
Quarterly Update | Q3 2017

The market posted another quarter of solid gains in Q3, with the S&P 500 Index up 4.5% and the Russell 2000® Index advancing 5.7%. Year-to-date returns are an impressive 14.2% and 10.9%, respectively. The Dow Jones Industrial Average finished the quarter with eight consecutive quarters of gains, its longest positive streak in twenty years. The market continues to shrug off fears, which have recently included rising tensions with North Korea, two powerful hurricanes, and continued gridlock in Washington, DC.

The key driver behind the market's advance has been impressive earnings growth, which has emerged from negative territory as recently as mid-2016 to around 10% year-over-year currently. Broadly, this is due to several factors, including modest top-line growth, efficiency gains on the expense side, and shareholder-friendly capital allocation in the form of stock buybacks. Adding to this backdrop is a weaker U.S. dollar, benefiting multi-nationals, and the energy and financial sectors coming off easy comparisons from a year ago.

Market Returns	Q3 2017	YTD
U.S. Large Caps	4.5	14.2
U.S. Mid Caps	3.5	11.7
U.S. Small Caps	5.7	10.9
International Developed Markets	5.4	20.0
Emerging Markets	7.9	27.8
Intermediate Term Bonds	0.6	2.3

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

The "goldilocks" environment—where economic expansion is neither too strong or too weak—remains in place for equities. The economy continues to grow slowly, keeping inflation contained. Gross domestic product (GDP) is just strong enough to allow the Federal Reserve to tighten monetary policy in a measured way, without disrupting expectations of continued economic improvement. However, in recent months, we have seen the "reflation" trade re-emerge with improvement in economic data.

In a reflation scenario, economic growth heats up, stoking inflation and wage gains and disproportionately benefiting "old economy" sectors. While we are seeing the green shoots of reflation, it has yet to take hold more broadly. Building materials is an area that could benefit from this scenario, especially with the increase in renovations and housing formations that were delayed in the wake of the Great Recession. We have continued to invest in this sector.

Growth stocks have thrived under the current goldilocks environment, as investors have been willing to pay increasing premiums for the handful of companies that can post strong top-line growth in spite of the tepid broader economy. If reflation were to take hold, it would likely provide a shot in the arm to value stocks, which investors have shunned due to their uninspiring relative growth rates. While we have a balanced mix of growth and value across our portfolios, we remain quite valuation-sensitive and thus may stand to benefit from a reflation scenario.

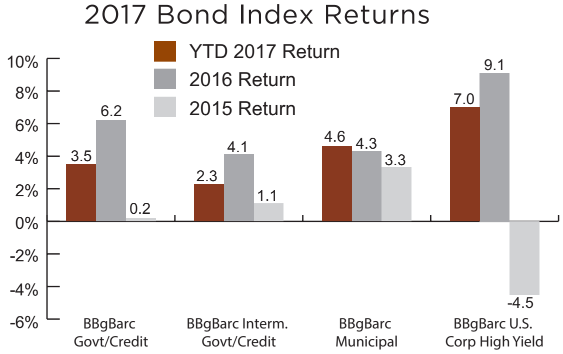
The market is increasingly paying attention to the machinations in Washington regarding a tax package. The current administration's efficacy has been weak, evidenced by the failure on healthcare reform, but the pressure to succeed has ratcheted up as we are now just a year out from mid-term elections. While stocks appear to have priced in a small amount of success on tax cuts towards the end of the quarter, Washington remains a wild card for the market.

Volatility remains extremely low. The market appears a bit complacent, and we do not want to be lulled into a false sense of security. While the market has posted strong returns so far this year, we remain cautiously optimistic going into year end, which is a historically favorable period for equity returns. While valuations remain slightly above their long-term averages, they do not strike us as unreasonable in the current low interest rate world.

Bond Market Update

The most significant event of the quarter was the statement by Janet Yellen that the Federal Reserve would start to reduce its $4.5 trillion portfolio of securities. The commencement would be in the fall of this year. She added that the economy is in good shape and the expectation is the Fed would raise rates at its December meeting.

2017 Bond Index Returns



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

The rate changes for the recent quarter were uneventful with Treasury rates slightly higher at the end of the third quarter relative to the second quarter. The 3 Month Treasury bill yield was 1.1% vs. 1.0%, 2 Year notes were 1.5% vs 1.4%, 10 Year unchanged, and 30 Year bonds were 2.9% vs 2.8%. Rates for the year tell a different story with short term Treasury rates up by 0.6%, 2 Years up 0.3%, 1 Year lower by 0.1%, and 30 Years lower by 0.2%.

Portfolios are in a defensive posture, given the fact that we continue to be in a low rate environment and expect rates to edge higher. Emphasis continues to be on floating rate notes and high grade corporate bonds.

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.