Davenport Asset Management
Quarterly Update | Q4 2017

December 31, 2017

What a year! To call 2017 a pleasant surprise for equity investors would be an understatement. The current bull market completed its ninth year with astonishing gains. The S&P 500 Index gained 21.8% while the Russell 2000 Index advanced 14.7%. The Nasdaq was even more impressive, setting a record 72 new closing highs during the year and finishing with a 29.6% gain. In addition, the rally was largely uninterrupted and characterized by very subdued volatility. On a total return basis, the S&P 500 Index didn't have a single down month during the calendar year for the first time since 1927.

Market Returns	Q4 2017	YTD
U.S. Large Caps	6.6	21.8
U.S. Mid Caps	6.1	18.5
U.S. Small Caps	3.3	14.7
International Developed Markets	4.2	25.0
Emerging Markets	7.4	37.3
Intermediate Term Bonds	-0.2	2.1

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

What drove these gains? A number of ingredients created the perfect cocktail for equity markets. Perhaps most important, we started to witness synchronized global growth for the first time in a decade. Here in the U.S., we averaged roughly 2% GDP growth from the end of the recession through the first quarter. We saw an acceleration to 3% growth in both the second and third quarters and many economists think this persisted in Q4. This led to improved earnings growth for corporate America. This year the S&P 500 Index is expected to generate roughly 10% earnings growth as compared to flat results in both 2015 and 2016. All the while, tame inflation has allowed for interest rates to remain low, thereby making stocks look relatively attractive versus fixed income assets.

More recently, the market got a jolt from sweeping tax reform here in the U.S. In a victory for the Trump administration, Congress passed new law that dramatically lowers corporate tax rates. Not surprisingly, this provided a disproportionate lift to companies with a domestic bias. For some companies, especially full taxpayers, this could yield a 15-20% lift to earnings. Much of the lift has clearly been discounted already as evidenced by the S&P 500 Index's 6.6% gain in the fourth quarter. Still, rising earnings estimates could provide further support to stocks. We are also hopeful it will incent companies to not only return more capital to shareholders, but also more aggressively invest in their businesses for growth.

One of the more interesting market dynamics in 2017 was the dramatic outperformance of "growth" versus "value." To put it in perspective, the Lipper Large Cap Growth Index was up 31.9% for the year as compared to 16.1% for the Lipper Large Cap Value Index. Much of this can be attributed to the strong performance of the technology sector, which gained 38.8% for the year. Of note, technology and internet retail (e.g. Amazon) accounted for more than 40% of the S&P 500 Index's return. Such robust performance has been a function of both outsized earnings growth for tech leaders like the oft-discussed FAANGs (Facebook, Amazon, Apple, Netflix and Google) and a relative scarcity of growth in other sectors. We suspect the spread between growth and value may have gone too far and would not be surprised to see the relative performance of momentum-oriented stocks cool somewhat. Improved economic growth should lead to better performance for more cyclical and/or value-oriented investments.

We also suspect equity returns in general will be more subdued in the near-to-intermediate term. The S&P 500 Index has generated annualized returns of 15.8% over the last five years and seems like it may have borrowed gains from the future. Along the same lines, we would not be surprised to see volatility increase after a period of unprecedented calm. All that said, it typically proves futile to try to time markets and it's worth remembering there are many positives to consider. Perhaps most notable, growth is improving and traditional indicators of a recession (labor markets, manufacturing activity, housing, credit markets, etc.) are not flashing any warning signals. Concurrently, valuations are above historical norms, but aren't outlandish (18.2x 2018 earnings estimates for the S&P 500 Index) in the context of accelerating growth and low interest rates. These move lower if you factor in a further lift to earnings from corporate tax reform. Finally, we don't sense we've reached a state of investor euphoria that typically characterizes market peaks. Bottom line: we think it's reasonable to expect more modest returns, but wouldn't try to time a market pullback. We hope you enjoyed the holidays and wish you all the best in 2018!

Bond Market Update

The rate environment of the fourth quarter changed significantly as short rates rose and rates on longer dated securities actually dropped a bit. This quarterly change is represented by the yield of the two year Treasury rising 33 basis points, directly related to actions by the Federal Reserve, while the yield on the thirty year Treasury fell 12 basis points. In a year where equities were the asset of choice, fixed income assets performed relatively well given the rising rates. In the 4th quarter of 2017, the Bloomberg Barclays Intermediate Government/Credit Index returned -0.20%, ending the year up 2.14%.

On December 13th, the Federal Reserve raised rates for the third time this year, bringing the Federal Funds rate to a range of 1.25%-1.50%. Even with this rate hike, the 10 year Treasury ended the year at 2.41%, lower than where it began 2017 at 2.44%. The most dramatic move within the treasury complex during the year came with the 2 year treasury ending the year at 1.89%, having started the year at 1.19%.

2017 Yield Curve Change

Security	12/30/16	12/29/2017	Change
3 Mo. LIBOR	1.00	1.69	0.69
2 Year Treasury	1.19	1.89	0.70
5 Year Treasury	1.93	2.21	0.28
7 Year Treasury	2.25	2.33	0.08
10 Year Treasury	2.45	2.41	-0.04
30 Year Treasury	3.07	2.74	-0.33

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

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DAVENPORT ASSET MANAGEMENT

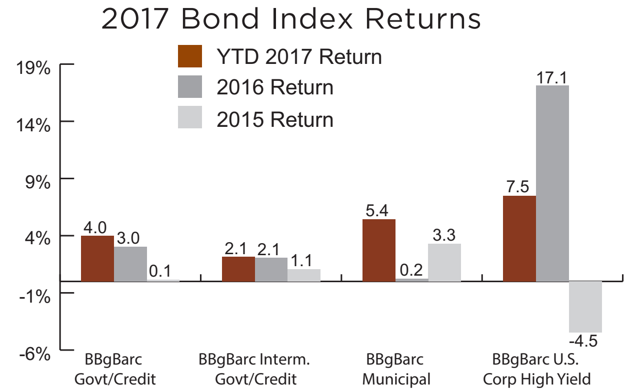
Bond Market Update Continued

The flattening of the yield curve, the difference between short rates and long rates, became a focal point of the financial press during the last months of the year, as the 2s/10s yield spread ended the year at just 0.52% having started the year at 1.26%.

Low inflation and moderating GDP growth expectations kept long rates relatively flat. Global demand for yield, where central bank's easing programs have kept global bond yields low, with the German 10 year Bund around 0.40%, created relative value for long end US Treasuries, another force anchoring the longer end of the yield curve.

Looking to 2018, the Fed is expected to continue to raise the Fed Funds rate 2-4 times and we continue to believe a defensive structure is warranted. Structurally, we like a barbell portfolio utilizing floating rate notes in the front end and 7-10 year fixed rate securities to increase portfolio income. Portfolio durations reflect this defensive view by being shorter than the respective benchmark indices.

In the coming year we will need to pay attention to the composition of the Federal Reserve Board under their new leader Jerome Powell and the steps towards reducing the Federal reserve balance sheet. Other things to consider will be global political tensions, implications of the new tax bill and global economic growth with central banks reducing their easy monetary policies...just to name a few.



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

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**. 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.