Investment Management of Virginia

Select Equity Income Portfolio
4th Quarter, 2018

The Select Equity Income Portfolio Composite was down 12.34%, net of fees, for the quarter. This result was ahead of the S&P 500 Index's decline of 13.52% and behind the Russell 3000 Value Index's decline of 12.24%.[1] For 2018, the Select Equity Income Portfolio Composite was down 6.93%, net of fees, versus down 4.38% for the S&P 500 Index and down 8.58% for the Russell 3000 Value Index.

While the Select Equity Income Portfolio outperformed the market during the fourth quarter downturn, our stocks were swept up in the sharp sell-off. Fears of an economic slowdown mounted toward the end of 2018, but the steep correction from September and the widespread worry of recession probably mean that a decent portion of that risk is already priced into the market. While this is a trying time for equity investors, selling equities when the market is panicking is usually not profitable for the long-term investor. We have tried to use the weakness to buy high quality companies that appear to have higher-than-average dividend yields, attractive valuations, and lower volatility than the overall market.

The Portfolio[2]

During the quarter, our purchases included new positions in Kinder Morgan (KMI), Oaktree Specialty Lending (OCSL) and Travelers (TRV).

Kinder Morgan is the largest energy infrastructure company in North America. The company owns an interest in ~84,000 miles of pipelines and 180 terminals across North America. These pipelines transport natural gas, gasoline, crude oil, carbon dioxide, and other products; the terminals store petroleum products and chemicals and handle bulk materials such as coal and petroleum coke. The stock trades at a discount to similar pipeline companies and has an attractive dividend, which we expect to increase over time. Rich Kinder, founder of the company, recently made a $9 million purchase of the stock; his confidence gives us confidence.

Oaktree Specialty Lending Corporation is a specialty finance company which provides loans to small companies that do not have access to public market financing. OCSL was acquired by Oaktree Capital in late 2017; we view OCSL as an inexpensive way to get access to Howard Marks, one of the best private market investors in the world. Over the past year, Oaktree has positioned the OCSL portfolio in a more defensive posture so that it will have capital available to invest if and when there is a downturn. OCSL stock is not widely followed by the Street and is trading at just 0.8x Net Asset Value (NAV, or theoretical liquidation value).[3] As of 12/31/18, OCSL had a dividend yield of 8.9%.

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[1] Past performance is no guarantee of future results, and no representation is made that results similar to those shown can be achieved. To receive a complete list and description of Investment Management of Virginia, LLC's composites and/or a presentation that adheres to the Global Investment Performance Standards (GIPS), contact Investment Management of Virginia at (804) 643-1100.

[2] The transactions/securities discussed in this section are generally portfolio-wide transactions for the accounts in this Portfolio and have not been selected by any performance criteria. It should not be assumed that all accounts in the Portfolio had the same transactions or that transactions in the future will be as profitable or will equal the performance of the securities mentioned.

[3] OCSL is structured as a Business Development Company (BDC), so it is required to pay out the vast majority of its pretax income in the form of dividends. The dividends are typically unqualified and thus considered taxable as ordinary income.

Finally, we purchased Travelers during the quarter. TRV is the second largest underwriter of commercial insurance lines in the United States and also the second-largest underwriter of personal insurance through independent agents. Travelers is differentiated by its product breadth, clean investment portfolio, and conservative underwriting standards. The stock has a 2.6% dividend yield.

We sold a partial position in Merck (MRK), the best performing Dow Jones Industrial stock this year, and moved the proceeds into Bristol-Myers Squibb (BMY). Merck recently won several FDA approvals for its cancer drug, Keytruda, which helped the stock advance to our initial price target. We reinvested the proceeds into BMY because the company has a vast pipeline of new cancer therapies and trades at an attractive valuation. While Bristol-Myers has not enjoyed the momentum of Merck, we believe the market has become too pessimistic about BMY's prospects.

We also added to our position in Iberiabank (IBKC) which had sold off with the rest of the banking sector because of interest rate worries. We believe the company still presents an interesting merger target for larger banks trying to enter the Texas and Louisiana markets.

During the quarter, we reduced our positions in Intel (INTC), WEC Energy (WEC), United Parcel Service (UPS), Fastenal (FAST), Wells Fargo (WFC), and Abbot Labs (ABT).

The Market

The equity market turned treacherous in the fourth quarter. Almost all asset classes around the world were weak, and the U.S. stock market had the worst December since the Great Depression. We hear a litany of concerns on all forms of media, day and night, but the fundamental issue for U.S. markets is the prospect of a recession and what that downturn might do to corporate earnings. The depth of a possible economic slowdown could be affected dramatically by Federal Reserve policy/decisions and collateral damage from a trade war with China. All of these issues must be evaluated with the understanding that political considerations may degrade objective thinking in each case. There are myriad political issues/risks to consider, but dysfunction in Washington, D.C. and a no-deal Brexit, including an implied threat to the basic underpinning of the European Union, are near the top of the list. Computerized trading, the spread of populism/protectionism, and global warming/volatile weather are a few more things to keep you awake at night. Climbing the wall of worry seems more Sisyphean than profitable, these days!

Over any reasonable investment horizon, the expected level of corporate earnings and the multiple that investors will pay for those earnings are what determine stock prices. A wide range of extremely well informed opinions on both of those numbers for 2019 are easy to find, so there is no "right answer". But, it appears the recent repricing (losses) have been prompted by fears of lower earnings in 2019, and perhaps a lower multiple on those earnings. Computerized trading programs and limited liquidity in the market are probably exacerbating the moves in the market, up and down. The equity market, and the Treasury yield curve, is most likely correct in forecasting some sort of economic slowdown, but no one knows if this slowdown will devolve into a recession. Only time will tell. But, we have seen valuations contract to levels that seem very reasonable. In late December, Abby Joseph Cohen, the highly respected strategist at Goldman Sachs, observed that the S&P 500's valuation had reached levels that reflect the fundamentals (primarily, expected earnings growth and interest rates)[4]. The market can, of course, overshoot to the downside, or future earnings may be worse than she expects, but valuation is probably not the issue, at this point.

What if we do go into a recession, what happens then? We all remember the carnage from the 2007/2008 Great Recession, but most recessions are less malevolent for stock prices, and some have even produced positive stock returns.[5] The general rule is that stocks will underperform the year before a recession, especially in the prior six months. Stock performance during recessions since WWII has been mixed, and, as you would expect, performance is usually strong coming out of a recession.[6] If history is any guide, we will be most of the way through a recession by the time the National Bureau of Economic Research (NBER) makes that determination, as happened with the recessions identified in 2008, 2001, and 1990. To complicate matters, the years leading up to a recession can be very profitable for investors. In sum, recessions, and the six months preceding them, are generally bad for stocks, but that pitfall is extremely hard to predict, and missing the run-ups, both before and after, can hurt long-term returns.

Looking on the bright side, current investor sentiment is very low; the Federal Reserve Board and Chairman do not want to cause a recession; neither the U.S. nor China wants an ugly trade war; and equity valuations, relative to modest earnings expectations and low interest rates, appear reasonable. Perhaps some of the doom and gloom is “fake news”.

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[4] Interview on Bloomberg Surveillance, December 21, 2018
[5] “Stock Performance Before, During & After Recessions”, Ben Carlson, March 15, 2015
[6] “What History Says About Recessions and Market Returns”, Connected Wealth, April 17, 2018

INVESTMENT MANAGEMENT OF VIRGINIA, LLC
SELECT EQUITY INCOME PORTFOLIO COMPOSITE
ACCOMPANYING NOTES

Year[A]	Total Return Gross (Percent)	Total Return Net[B] (Percent)	Benchmark S&P 500 (Percent)	Benchmark Russell 3000 Value (Percent)	Composite 3 Yr. St. Dev.[C] (Percent)	Benchmark S&P 500 3 Yr. St. Dev.[C] (Percent)	Benchmark Russell 3000 Value 3 Yr. St. Dev.[C] (Percent)	Number of Accounts	Composite Dispersion[C] (Percent)	Composite Assets End of Period (Millions)	Non-Fee Paying Composite Assets End of Period (MM)	Percentage of Non-Fee Paying Composite Assets	Total Firm Assets End of Period (Millions)
2008	-32.95	-33.39	-37.00	-36.25	N/A	N/A	N/A	16	1.34	10.22	0.00	0.00%	285.31
2009	27.76	26.94	26.46	19.76	N/A	N/A	N/A	15	2.63	11.90	2.61	21.93%	335.79
2010	16.77	16.10	15.06	16.23	N/A	N/A	N/A	13	1.47	12.87	3.02	23.43%	427.21
2011	3.54	2.95	2.11	-0.10	18.12	18.70	21.04	14	0.47	13.83	2.84	20.53%	409.51
2012	9.80	9.18	16.00	17.55	14.49	15.09	15.81	15	0.48	22.87	3.05	13.35%	526.95
2013	32.98	32.18	32.39	32.69	11.44	11.94	12.90	16	0.53	29.04	3.96	13.64%	697.44
2014	10.28	9.55	13.69	12.70	9.60	8.98	9.36	16	0.36	30.57	4.30	14.06%	549.17
2015	-4.18	-4.75	1.38	-4.13	10.60	10.48	10.74	25	0.33	38.79	3.85	9.92%	437.32
2016	25.78	24.98	11.96	18.40	10.93	10.59	10.97	27	0.79	45.35	3.07	6.78%	484.18
2017	7.78	7.11	21.83	13.19	10.55	9.92	10.33	27	1.05	46.07	3.30	7.16%	491.22
*2018	-6.37	-6.93	-4.38	-8.58	12.11	10.80	11.06	28	0.55	39.90	2.81	7.04%	448.68

* 2018 performance returns are for the period ending 12/31/18.
A. Inception of the composite was 7/1/01. Creation of the composite was 7/1/01.
B. Fee schedule: 1.00% per annum on the first $1 million of assets; 0.75% per annum on assets greater than $1 million. Fees are negotiable.
C. N/A for the current year signifies that the information is not available until year end. N/A for previous years signifies that the information was not required.

Investment Management of Virginia, LLC claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. Investment Management of Virginia, LLC has been independently verified for the periods January 1, 1993 through September 30, 2018. Verification assesses whether (1) the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and (2) the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. The Select Equity Income Portfolio composite has been examined for the periods July 1, 2001 through September 30, 2018. The verification and performance examination reports are available upon request.

1. Basis of Presentation
Investment Management of Virginia, LLC ("IMVA") is a registered investment adviser under the Investment Advisors Act of 1940. IMVA was originally established as Scott & Stringfellow Capital Management, Inc., a division of Scott & Stringfellow, in 1982. In March 1999, Scott & Stringfellow became a wholly owned subsidiary of Branch Banking & Trust Company (BB&T). IMVA became an independent investment adviser in July of 2000 when the principals of Scott & Stringfellow Capital Management, Inc. purchased the Company from BB&T. Total firm assets exclude model programs. Additionally, as supplemental information, as of December 31, 2018, the firm provides models to programs managing a total of approximately $12.56 million in assets based on those models (this figure includes all model portfolio assets at IMVA).

2. Composite Criteria
The Composite consists of institutional, endowment, retirement, and individual accounts. Tax-exempt and taxable accounts are included. The Composite seeks a strong total return through capital appreciation in small, medium, and large capitalization companies, including limited use of ETFs. The primary investment criteria are strong upside potential at a reasonable price. Results are based on fully discretionary accounts under management, including those accounts no longer with the firm. Performance results of the Composite are based on U.S. dollar returns.

3. Calculation Methodology
The Composite results are time-weighted rates of return net of commissions, custodial fees, and any other expenses incurred in the management of accounts. Accounts may be shown gross or net of withholding taxes on foreign dividends based on the custodian. These returns have been presented both gross and net of investment advisory fees. Quarterly composite rates of return, which are net of investment advisory fees, are calculated at the account level. For each account, the fee percentage is subtracted from the account's gross monthly return, during the month the fee is incurred, to obtain a monthly account return net of investment advisory fees. The three-year annualized standard deviation measures the variability of the composite and the benchmark returns over the preceding 36-month period. The annual composite dispersion presented is an asset-weighted standard deviation calculated for the accounts in the composite the entire year. Additional information regarding policies for valuing portfolios, calculating performance and preparing compliant presentations is available upon request.

4. Comparison with Market Index
Results of the Composite are shown compared to the Standard & Poor's 500 Index and to the Russell 3000 Value Index. The Standard & Poor's 500 Index is a capitalization-weighted index, and is calculated based on a total return basis with dividends reinvested. The Standard and Poor's 500 Index is a capitalization-weighted index of 500 blue-chip U.S. companies representing the industrial, transportation, utility, and financial sectors with heavy emphasis on the industrial sector. The Russell 3000 Value Index is based on the Russell 3000 Index, which measures the performance of the 3,000 largest publicly held companies incorporated in America, as defined by total market capitalization. The Russell 3000 Value Index is a market capitalization weighted equity index and is calculated based on a total return basis with dividends reinvested. It measures how U.S. stocks in the equity value segment perform and includes stocks from the Russell 3000 Index with lower price-to-book ratios and lower expected growth rates. The Russell 3000 Value Index was added as a benchmark in September 2018. Performance has been linked in the same manner as the Select Equity Income Portfolio Composite. The returns for these unmanaged indexes do not include any transaction costs, management fees, or other costs. Investment Management of Virginia, LLC takes no responsibility for the validity of the index and/or other performance numbers provided by reputable outside sources.

5. SEC Advertising Disclosure Footnotes
All performance composite returns are reported **net** and **gross** of investment advisory fees charged by Investment Management of Virginia, and reflect the reinvestment of dividends and other earnings. The investment returns will be reduced by commissions, custodial fees, and any other expenses incurred in the management of accounts. Accounts may be shown gross or net of withholding taxes on foreign dividends based on the custodian. Net performance reflects the deduction of actual quarterly fees for each account in the composite. Gross of fees performance returns are presented before investment management fees.

6. Additional Information
A complete presentation of any composite and/or a list of all composite descriptions is available upon request. Such inquiries should be addressed to George McVey, Investment Management of Virginia, LLC, 919 E. Main Street, Suite 1600, Richmond, Virginia 23219, or contact him through email at gmcvey@imva.net.

Past performance is no guarantee of future results, and no representation is made that results similar to those shown can be achieved. All portfolios have the potential of profit and/or loss on the investment securities.