Investment Management of Virginia

Small Capitalization Portfolio
4th Quarter, 2019

The Small Capitalization Portfolio Composite was up 10.71%, net of fees, for the quarter. This was slightly ahead of the 9.94% gain for the Russell 2000 Index.[1] The Small Capitalization Portfolio Composite was up 14.74%, net of fees, for the year. Up nearly 15% for the year is a nice return but was considerably behind the 25.53% return of the Russell 2000 Index. The Small Capitalization Portfolio Composite remains ahead of that index since inception.[2]

We had several great stock picks during 2019, but our efforts to outsmart the market in turnaround/underperforming stocks, especially those with leverage, hurt our performance. As mentioned in our last letter, this experience has burned a fear of high debt/leverage into our collective investing approach, and we believe our current holdings are very high quality, reflecting our determination to avoid out-of-favor companies with substantial leverage. Those companies are proving dangerous in a low growth economy. Looking ahead, we have a couple of positions that are being acquired (KEM, IBKC), and we will likely put those proceeds into exchange traded funds. We intend to increase our use of ETFs in general and would like to eventually have a substantial portion of the portfolio (50%) in ETFs. This change will allow us to access some portions of the small capitalization market that are difficult to invest in through individual securities (deep value stocks, bio-technology, and alternative energy companies to name a few). Using both ETFs and individual stock positions should also simplify our holdings and, hopefully, increase our ability to exceed the performance of the Russell 2000 Index by concentrating our focus, and capital, on our very best ideas.

The Portfolio[3]

After substantially repositioning the portfolio in the third quarter, we were less active this quarter.

In October, we added to our existing position in Hain Celestial (HAIN). We initially purchased a small position in HAIN this summer. We believe HAIN will continue to execute its strategy to cull low margin, low selling products and focus on higher margin, higher velocity offerings. This quarter illustrated that process as revenues declined (as expected), but margins, profitability and cash flows all improved. HAIN also sold two of its non-core brands during the quarter, further strengthening its balance sheet. We like the transformation at HAIN and expect continuing improvements in 2020.

In December, we initiated a new position in the Hackett Group, Inc. (HCKT). Hackett is an IT consulting company that we've been tracking for over two years. Prior to that time, the company was showing consistent, profitable growth with a high return-on-capital. However, growth began to slow as many of Hackett's traditional customers reduced spending as they evaluated cloud computing.

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[1]Past performance is no guarantee of future results, and no representation is made that results similar to those shown or discussed 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] Inception of the portfolio is 1/1/94.
[3] 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.

After two years of weak fundamentals, we think HCKT has finally reached an inflection point where customers are once again upgrading their IT platforms and migrating to the cloud. As such, we expect revenue and earnings growth to resume this year. Hackett has high inside ownership, no debt, consistent free cash flow, and an attractive dividend that has been increased yearly for the past six years; the current dividend yield is 2.3%. Like many of our positions, we think HCKT is a likely takeout candidate over the next 2-3 years.

We trimmed Quidel (QDEL) late in December. Quidel sells, among other things, quick turn-around flu diagnostic kits. This year's flu season looks serious, and Quidel's stock price reflects that trend. We thought the news and high expectations were priced into the stock in the near-term and decided to reduce our position a bit. We are maintaining a core position since the company plans to introduce a new molecular diagnostics platform this year, is increasing its lead in the point-of-care testing market, and should continue to generate strong earnings growth.

The Equity Market

The U.S. equity market enjoyed a strong 4th quarter. The widespread fear of recession that gripped the market in August gave way (capitulated?) to a more bullish outlook as a variety of perceived risks faded from view. These positive developments included the partial resolution of Brexit, the increasing likelihood of a Phase 1 trade deal with China, the completion of a trade agreement with Mexico and Canada (USMCA), no real surprises in the impeachment process, and confirmation, basically, that the Federal Reserve is unlikely to raise interest rates before the election.

Market projections are inherently problematic because investors price-in new news and/or predictions very quickly. So, we will leave 2020 market predictions to others, shown below. In general, we suspect optimism is currently high in the equity market, and that can set the stage for fear-inducing volatility. We don't see conditions for a recession in 2020, but, as we have said before, the equity and fixed income markets ensure that recessions are very hard to predict. We continue to suspect that small capitalization stocks are relatively attractive versus large capitalization stocks, and we believe the performance gap between growth and value stocks is likely to narrow.

Vanguard's chief economist is fairly cautious on 2020:

> U.S. stocks face a greater-than-usual risk of a sell-off next year (2020), with investors overconfident in an economic resurgence, according to Vanguard Group Inc.'s investment-strategy chief. "Financial markets run the risk of getting ahead of themselves," Joseph Davis, who also serves as Vanguard's chief economist. . . . He sees 50% odds on a correction in 2020, against what he terms a more typical figure of about 30% (A correction is often defined as a 10% drop). While this year (2019) investors were too pessimistic about recession odds, next year they'll be too optimistic on reflation, Davis said. He also sees a pick-up in U.S. equity volatility from "unsustainably low" levels. "Across the board, expected returns for most strategies are below trailing three-year returns," said Davis. The investment chief for the $5.6 trillion asset manager estimates that risk assets are pricing in close to 3% U.S. economic growth, an outcome he sees as unlikely. Davis said U.S. equities have broken out onto the expensive side of fair value on their price-to-earnings ratio, a measure Vanguard prefers rather than identifying target levels on indexes.[4]

Blackrock, the world's largest provider of exchange traded funds, is slightly more optimistic.

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[4] "Stocks Face 50% Odd of Correction in 2020, Vanguard's Davis Says", Advisorhub.com, 12/30/19

> Growth (U.S. economic) should edge higher in 2020, limiting recession risks. This is a favorable backdrop for risk assets. But the dovish central bank pivot that drove markets in 2019 is largely behind us. Inflation risks look underappreciated, and the lull in U.S.-China trade tensions could unwind. This leaves us with a modestly pro-risk stance for 2020.[5]

We are slightly cautious, given recent trends in market strategists' sentiment (increasingly positive). One comforting fact is that individual investors have been very suspicious of this bull market and are not participating fully. The Wall Street Journal reports that investors have pulled $135.5 billion from U.S. stock funds and ETFs this year; this is the biggest withdrawal on record and could be a bullish sign (since individual investors, especially market timers, are usually wrong). The Journal concludes: "This suggests the major indexes, such as the S&P 500, still have plenty of room to run after a decade-long rally".[6]

Basically, we agree with those who expect sub-par, long-term equity returns (5 to 10 years) from today's level and valuation, but we also believe that small capitalization stocks are relatively attractive and should help investors outpace inflation and preserve purchasing power over the long-term.

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[5] "Testing Limits", Blackrock 2020 Global Outlook,

[6] 'Individual Investors Bail on Stocks", The Wall Street Journal, 12/9/19. Data from Refinitiv Lipper.

INVESTMENT MANAGEMENT OF VIRGINIA, LLC
SMALL CAPITALIZATION PORTFOLIO COMPOSITE
ACCOMPANYING NOTES

Year[A]	Total Return Gross (Percent)	Total Return Net[B] (Percent)	Benchmark Russell 2000 (Percent)	Composite 3 Yr. St. Dev.[C] (Percent)	Benchmark Russell 2000 3 Yr. St. Dev.[C] (Percent)	Number of Accounts	Composite Dispersion[C] (Percent)	Composite Assets End of Period (Millions)	Strategy Assets End of Period[D] (Millions)	Model Assets End of Period[D] (Millions)	Non-Fee Paying Composite Assets End of Period (MM)	Percentage of Non-Fee Paying Composite Assets	Total Firm Assets End of Period (Millions)
2009	39.21	38.57	27.17	N/A	N/A	17	4.12	14.06	29.22	N/A	4.55	32.37%	335.79
2010	32.00	31.51	26.85	N/A	N/A	15	0.74	13.39	38.39	N/A	2.64	19.74%	427.21
2011	1.89	1.41	-4.18	24.19	24.99	16	0.74	13.41	38.85	45.11	2.47	18.43%	409.51
2012	24.37	23.70	16.35	19.84	20.20	22	0.55	15.46	58.06	73.37	2.77	17.94%	526.95
2013	36.11	35.24	38.82	15.86	16.45	53	0.80	29.85	139.01	184.94	2.26	7.56%	697.44
2014	-6.44	-7.10	4.89	11.98	13.12	50	0.68	27.70	106.25	162.01	2.40	8.65%	549.17
2015	-12.27	-12.88	-4.41	13.59	13.96	41	0.66	22.58	64.53	93.92	2.19	9.71%	437.32
2016	25.83	24.99	21.31	15.12	15.76	33	0.80	25.71	67.55	41.43	1.95	7.57%	484.18
2017	4.90	4.25	14.65	14.74	13.91	26	0.70	30.23	62.09	12.09	2.04	6.74%	491.22
2018	-8.56	-9.05	-11.01	17.31	15.79	25	0.46	24.91	54.44	7.73	1.68	6.75%	448.68
*2019	15.33	14.74	25.53	19.16	15.71	19	0.76	24.57	58.41	9.01	1.54	6.25%	509.85

* 2019 performance returns are for the period ending 12/31/19.
A. Inception of the composite was 1/1/94. Creation of the composite was 1/1/94.
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.
D. Supplemental information. In addition to composite assets, strategy assets include separately managed accounts that do not meet the criteria for inclusion in the composite and wrap accounts. Small Capitalization Portfolio model assets are managed by other firms based on model portfolios submitted by IMVA.

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, 2019. 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 Small Capitalization Portfolio composite has been examined for the periods January 1, 1994 through September 30, 2019. 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 IMVA from BB&T. Total firm assets exclude model programs. Additionally, as supplemental information, as of December 31, 2019, the firm provides models to programs managing a total of approximately $14.40 million in assets based on those models (this figure includes the Small Capitalization Portfolio model assets and all other 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 capitalization companies, including 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. Net performance returns have been calculated by reducing gross performance returns by the actual investment management fees charged. 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 Russell 2000 Index. The Russell 2000 Index is comprised of the 2,000 smallest companies in 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 2000 represents approximately 1% of the Russell 3000 Index total market capitalization. For comparison purposes, the Russell 2000 is a fully invested index, which includes reinvestment of income, and the performance has been linked in the same manner as the Small Capitalization Portfolio Composite. The returns for this unmanaged index do not include any transaction costs, management fees, or other costs. The information contained in this material is based on data we have obtained from third party sources. While this information has been obtained from sources we believe to be reliable, we do not guarantee, nor are we responsible for, the accuracy, completeness, or timeliness of the information provided in this presentation. The S&P 400 Index was used prior to 12/31/00 as a comparison index. It was replaced with the S&P 600 Index on 12/31/00 because this index was a more accurate representation of the market capitalization of the securities in the client accounts. The S&P 600 Index was dropped as an index as of 3/31/12 due to low usage of that index by institutional investors.
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 with the exception of one non-fee paying account in the composite for the periods prior to 9/30/2006. An implied 100 bps fee was applied to calculate net performance for the account. 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.