Investment Management of Virginia

Opportunity Portfolio
2nd Quarter, 2022

The Opportunity Portfolio Composite was down 14.61%, net of fees, for the quarter; this result was ahead of the S&P 500 Index's loss of 16.10% and the S&P 1500 Index's loss of 16.02%.[1] The Portfolio Composite was ahead of both of these indices for the year-to-date and one year periods.

As in the first quarter, the Portfolio's best relative performers were defensive, dividend paying stocks along with the Energy sector holdings. Detractors included our Information Technology, Materials and Consumer Discretionary companies. Year-to-date, the portfolio has benefited from an overweight Energy exposure and an underweight Technology exposure. We are maintaining our Energy Exposure but have gradually begun to increase our Technology holding as interest rates appear to be leveling out. Lower volatility in interest rates, if the current trend continues, could help the Technology sector regain its footing.

The Portfolio[2]
Purchases during the quarter included Amazon (AMZN), MDC Holdings (MDC), Blackstone (BX), Qualcomm (QCOM), and the Vanguard Information Technology ETF (VGT).

In April, we initiated a new position in Amazon. Over the past year, Amazon's valuation has declined to an attractive level, in our opinion. AMZN is entrenched in our lives in a variety of ways, and we want to have exposure to this juggernaut. Specifically, we like Amazon Web Services' (AWS) dominant business position in the IT Cloud and the future price increase/margin improvement potential at Amazon Prime. Furthermore, the company continues to invest for future growth (albeit too quickly for many on Wall Street); these investments positions AMZN well for future earnings and cash flow growth.

We initiated a new position in MDC during the quarter. MDC is a high quality small capitalization homebuilder that we have owned before. Housing stocks have underperformed the broader market this year due to rising mortgage rates and fears that home prices have peaked. Nonetheless, we continue to like MDC; management has shown their ability to serve a lower price buyer while maintaining margins. The balance sheet is in great shape, the dividend appears sacrosanct (and the dividend yield near an all-time high), and the stock is trading below tangible book value. Despite the near-term industry dynamics, the U.S. housing industry is not producing enough homes to meet demand, and existing home inventory remains low. We think demand for new home construction is solid for the foreseeable future.

In May, we initiated a new position in Blackstone. BX is a replacement for our T. Rowe Price (TROW) sale. We prefer BX at this point given its attractive dividend yield, exposure to alternative investments like real estate, and higher projected earnings growth rate.

[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 GIPS report 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.

In June, we initiated a new position in Qualcomm (QCOM). Our Technology exposure has been well below the sector in the S&P 500 Index for some time. This underweight has helped us this year on both a relative (versus the index) and absolute basis. We are also relatively light in semiconductor exposure. The weakness in large capitalization technology stocks gave us an opportunity to buy this high quality semiconductor player at out-of-favor prices. We do not see semiconductor demand declining going forward (think electric cars, the Internet of Things) even with an expected 20% increase in capacity by 2024. QCOM management appears to share our confidence; they are buying back stock steadily and have raised the QCOM dividend every year since 2003.

We also boosted our Technology exposure by adding to the Vanguard Information Technology ETF (VGT). Microsoft and Apple make up approximately 40% of this ETF, and we think these technology stalwarts will regain some of their leadership after six months of underperformance.

Sales during the quarter included PayPal (PYPL), Magnite (MGNI), T. Rowe Price (TROW), Argan (AGX), and Dow (DOW).

In April, we liquidated our position in PayPal (PYPL). We purchased PYPL in the first quarter on the assumption that the bad news was priced into the stock; turned out we were wrong. The stock continued to decline on valuation compression, so we decided to take the loss and put the funds into the aforementioned AMZN purchase. PYPL remains a very interesting company with impressive long-term growth prospects, but it is too volatile for us right now.

In May, we liquidated our position in Magnite (MGNI). The stock had declined on lower online advertising spend. The slowdown continued into the second quarter and was exacerbated by a change in Apple's privacy policy.

In June, we liquidated our position in Argan (AGX). The stock had outperformed well, year-to-date, but the company's backlog is very hard to predict, which made us nervous. We used the proceeds to fund our purchase of QCOM, which we believe has better long-term potential.

Late in the quarter we liquidated our position in Dow Inc. (DOW). DOW has been a steady performer for most of the year but sold off recently on both expense and demand (revenue) concerns. We overstayed our welcome in DOW and now suspect the stock will be out of favor for a while. We used the proceeds to add to our position in VGT.

The Equity Market

The first six months of 2022 are in the history books, and, from the perspective of equity investors, it has been a rough ride. But, we need to remember that 20% market declines come around, on average, every three years.[3] Looking ahead, in years where the first half of the year experienced large losses, the second half, historically, is often pretty good.[4] Nonetheless, the experience of

[3] Podcast: Chris Davis Picks Stocks, Praises Buffett, Rips Politicians. Barron's Advisor, 6/14/22.

[4] Research from LPL Financial shows that, since 1932, when the S&P 500 Index (or its predecessor, the S&P 90 Index) was down more than 17% in the first half of the year, the second half returns were positive 100% of the time; the average return was 23.7% and the median was 15.3%. Source: LPL Research, FactSet Data as of 6/21/22.

reasonably diversified investors in the second quarter was definitely unpleasant, and those who loaded up on the hottest technology stocks and other "long duration" assets (like cryptocurrency) experienced a very ugly reversal.

The current list of investor concerns is longer than usual:

- The Federal Reserve seems determined to control inflation, even at the risk of a recession. In other words, the Fed is focused on price stability over full employment. Federal Reserve Chair Jerome Powell hopes to cool the economy enough to bring inflation back to 2% without putting our economy into a recession (two consecutive quarters of negative GDP growth). This outcome is the elusive "soft landing" (possible, but probably unlikely). Chair Powell seems to want us to remember "don't fight the Fed" more than he wants a soft landing.
- The war in Ukraine continues with no end in sight (but we need to be careful about predictions). The human tragedy in Ukraine is stunning, and the war's effect on commodity prices may multiply the tragedy to include famine in some countries and the possibility of severe economic hardship in Europe this coming winter, if energy prices stay where they are.
- The culture war in the U.S. is getting hotter (is that possible?) as we head into mid-term elections. It is hard to translate these issues into potential economic outcomes and investment strategies, but the partisan divide in the U.S. is growing, and the possibility of wise and objective governance, through cooperation and compromise, seems like a pipe-dream at this point. This kind of dysfunction is not good for productivity improvement, the key ingredient for long-term GDP growth.
- Global warming, our massive government debt (with rising interest expense), a threatened election system, and ominous threats of nuclear war fill out the list.

We are long-term investors and try to prepare for this kind of volatility with a thoughtfully positioned portfolio (depending on each client's risk tolerance) and the understanding that we should not try to predict the market's direction in the short or even medium-term. But, the equity market may be less risky for long-term investors than it was six months ago. Investor (and consumer) sentiment is very negative[5], valuations are lower and more interesting (especially for small capitalization stocks), commodity prices seem to have peaked (this will help cool inflation), speculators in risky assets have taken a historic beating, and the "wall of worry" seems too high to see over. We cannot say if the equity market rally off of the bottom in June will hold (few market commentators think it will)[6], but we believe that the prospects for reasonable long-term returns for equity investors have improved from the end of last year. This is not a hugely bold prediction given the losses in the market so far this year, and the U.S. market is unlikely to replicate the equity returns of the past decade, but we suspect the forward outlook, long-term, is considerably better than it was on 12/31/21.

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[5] American Association of Individual Investors (AAII) bullish sentiment fell to 18.2% in week-ended 22-Jun from 19.4% in prior week. Bearish sentiment ticked up to 59.3% from 58.3%. AAII tweeted that the 18.2% marked the 25th lowest bullish sentiment reading in the survey's history, while the 59.3% marked the 6th highest bearish sentiment reading

[6] "Morgan Stanley's Big Bear (Mike Wilson) Sees Temporary Respite From Selloff", Bloomberg News, 6/27/22