Davenport
Asset Management

Portfolio Perspectives:

Q&A: George Smith discusses recent market volatility and its impact on the portfolios

George L. Smith, III, CFA
Senior Vice President
Member, Investment
Policy Committee

Q: In your view, what have been the greatest contributors to the recent market volatility?

A: It's important to remember we haven't seen a market correction in recent years and a pullback seemed overdue. And while the correction has been swift, declines of this magnitude are certainly not unprecedented. Historically, these types of declines have occurred every 2-3 years on average. That said, signs of global economic strain and uncertainty surrounding Federal Reserve policy seem to be the primary drivers of market volatility. Economies around the world seem to be slowing and investors are anxiously anticipating the Fed's next move. Many believe it's time to raise interest rates (for the first time in nearly a decade), but "global cooling" may tie the Fed's hands.

Q: You mentioned the Fed. Do you share the market's concern over a potential rate hike?

A: Well, It's been a very long time since the Federal Reserve has raised rates, so it's logical to expect them to want to do so in order to get interest rates back within historical norms. On one hand, rate hikes have historically been disruptive over the short term for markets and this could prove to be the case again. On the other hand though, we would hope this would happen alongside a strengthening US economy, which we would view as a positive.

Q: Given the factors mentioned above, how do you manage risk within the portfolios?

A: We are always mindful of risk, perhaps even more so now after the sizeable market gains of recent years. But, we strive to avoid emotional responses to market weakness and media hype and don't dramatically alter our portfolios in response to short-term swings. We try to consistently be very price sensitive and look to make investments that appear to have manageable downside risk. Many refer to this as a "margin of safety". Moreover, we tend to avoid companies that possess substantial business risk or balance sheet risk.

Q: On the flip side of the coin, has recent volatility also presented opportunities within the portfolios?

A: Yes it has. While no doubt unnerving, fear and indiscriminate selling can work in our favor. Recently, we've been able to add to some positions at what appear to be attractive prices. With the broader market as measured by the S&P 500 recently moving into correction territory (down just over 10% from its highs), numerous stocks have been down much more (30-40% in some cases). Investors seem to be favoring a sub set of growth stories, especially in the tech sector, and leaving behind companies that face near-term headwinds. The gap between the "haves" and "have nots" is now very wide; hence, it seems like an okay time to look at some of the "have nots".

Q: How does the often highlighted weakness in international economies impact the portfolios?
A: Most of our holdings are domiciled in the U.S. However, many of them do business around the world and are impacted by weaker demand abroad. In addition, the strong dollar can create a currency headwind - in that sales in foreign currencies translate back into fewer U.S. dollars. Understandably, we've seen stocks with meaningful foreign exposure be disproportionately impacted as of late. It appears such stocks have significantly discounted slowing growth abroad and currency headwinds will ultimately abate. As a result, we have been looking at shares of good businesses that seem to have been overly punished.

Q: Currently, there is a noticeable overweight in the portfolios toward consumer stocks. Can you explain?
A: This heavy weighting is more a byproduct of our bottoms-up research process, which focuses on individual company selection. Still, we do think the outlook for the domestic consumer is improving. Unemployment is at multi-year lows, lower energy prices provide a spending tailwind and many consumers have greatly reduced debt following the 2008 financial crisis. Also, a strong U.S. dollar lowers the price of imported goods. While other areas of the world appear to be stalling, we think solid consumer spending in the U.S. bodes well for our economy.

Q: What is your outlook for the U.S. equity markets and portfolios as we move forward from here?
A: We do not typically try to make market predictions and cannot say that in the near term, things won't get worse before they get better. Given the lengthy bull market we have experienced alongside an underlying, slow economic recovery, it does seem logical that we have borrowed some returns from the future. Though we would expect more subdued returns going forward, we note that returns more consistent with historical norms still make an attractive case for equities. Ultimately, we continue to find opportunities in high quality companies with attractive business models that can weather a variety of economic outcomes.

To learn more about Davenport Asset Management
call (888) 285-1863
email us at DAMinfo@investdavenport.com
visit www.davenportassetmanagement.com

As of August 2015

The statements and opinions expressed in this article are those of the authors as of the date of the article, are subject to rapid change as economic and market conditions dictate, and do not necessarily represent the views of Davenport & Company LLC. This article does not constitute investment advice, is not predictive of future performance, and should not be construed as an offer to sell or a solicitation to buy any security or make an offer where otherwise unlawful. Investing in securities carries risk including the possible loss of principal. Individual circumstances vary.