The Trust Company of Virginia

It seems that 2015 market volatility has followed us into the first quarter of 2016. On February 11th, the S&P 500 was down 10%, only to end the quarter up 1.3%. Few foreign equity markets made it into the black. China and Japan both ended the quarter in negative territory, down 17.2% and 12% respectively. US Economic growth for the quarter looks poor; however, first quarter economic statistics are notoriously misleading. 2011, 2014 and 2015 started out with either a contraction or weak first quarter economic growth, and then ended the year at a growth rate around 2%. First quarter weakness is an ongoing problem with seasonally-adjusting the economic data. These adjustments to the numbers tend to make the first quarter look artificially slow, while making the remaining quarters look artificially fast. On a positive note, the labor market continues to make huge strides. Payrolls grew 209,000 per month in Q1 and initial jobless claims averaged the lowest for any quarter since the 1970s. Oil also seems to have found a bottom, which has calmed some of the volatility. As stated above, international markets remain volatile. China continues to be a drag and negative interest rates in both Japan and Europe seem to be producing unintended consequences – the Yen and the Euro both strengthened during the quarter causing some to believe negative interest rates may actually be turning into a de facto tightening.

The Fed actually helped to reassure the markets and calm volatility by backing away from their target of four rate increases this year and creating a more subdued pace to tightening. It's likely the Fed will only raise rates one or two times this year, something Janet Yellen spoke about at length in her meeting with the Economic Club of NY. She addressed why market volatility and slower growth in China and other international markets pose risks to US growth and downward pressure on inflation, too. She warned not to place too much weight on these risks, but insisted caution is justified. She then went on to say that Fed forecasts should be seen as a "forecast" for the trajectory of policy rates, not a "plan set in stone that will be carried out regardless of economic developments." That's a very important distinction and one the market seems to have responded to favorably. A few more important points from Yellen: she believes the US economy's neutral rate (the federal funds rate that would be neither expansionary nor contractionary) is now close to zero. However, she believes that the "current real federal funds rate is even lower, at roughly minus 1-1/4 percentage point." Therefore, she sees current monetary policy as still very accommodative.

One more helpful quote from Yellen:

"Looking beyond the near term, I anticipate that growth will also be supported by a lessening of some of the headwinds that continue to restrain the U.S. economy, which include weak foreign activity, dollar appreciation, a pace of household formation that has not kept up with population and income growth and so has depressed homebuilding, and productivity growth that has been running at a slow pace by historical standards since the end of the recession…That said, this assessment is only a forecast. The future path of the federal funds rate is necessarily uncertain because economic activity and inflation will likely evolve in unexpected ways. For example, no one can be certain about the pace at which economic headwinds will fade. More generally, the economy will inevitably be buffeted by shocks that cannot be foreseen."

This has given the market and investors a much needed look into how Janet Yellen has and will continue to run the Fed going forward. Bernanke was dedicated to forward guidance: if he said something was going to happen, it happened. Yellen has said repeatedly that she wants the Fed to be more data driven, but it has taken some time for the market and investors to learn how to react to a new style.

Taxable Fixed Income Performance Composite

While we enjoy following reactions and over-reactions to everything noted above, our investment policy has been little changed in the past few years. High quality bonds will always mitigate volatility, and we are finding yield even in highly rated names. We continue to see value in high quality taxable municipal bonds and still recommend a shorter average duration and maturity. When rates move up, it is important to be able to respond to that movement: investing in a 5-10 year bond allows us to do that while holding the bond to maturity; a 15-30 year bond would not. Our composite continues to hold higher credit quality and shorter duration than the benchmark, while also outperforming its benchmark.

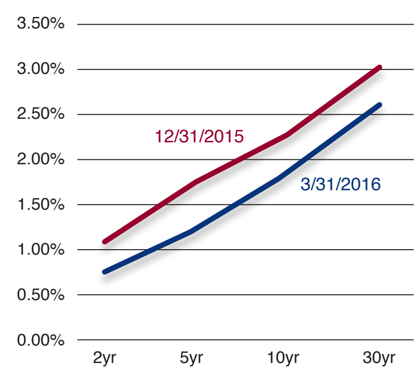
Portfolio Characteristics:

Average Maturity	3.7 yrs
Average Duration	3.3 yrs
Average Yield to Maturity	2.30%
Average Coupon	4.29%
Average Quality	AA

Credit Quality:

AAA	14%
AA	53%
A	25%
BBB	8%

Treasury Yield Curve



Fixed Income Sector Breakdown