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QUARTERLY PERSPECTIVE

DVI

DAVID VAUGHAN INVESTMENTS

NEVER REST ON YOUR LAURELS

Will Williams *President*

As we have progressed through the calendar year of 2016, the fundamental investing environment has in general benefitted those active managers, like DVI, that have a bias towards large market capitalization, high quality, low volatility, dividend paying common stocks. As you might know, this is in direct contrast to the headwinds these same types of stocks faced during most of 2015. During times like this, with a bit of wind in your sail, one might be tempted to rest on your laurels and relax a bit. I can assure you, for the investment team here at DVI, that option has never crossed our mind. As an active manager of individual security strategy portfolios, the research process, both quantitative and qualitative is never ending. Sector allocations need to be monitored, company fundamentals need to be assessed and the entire risk management process needs to be constantly validated to make sure we are going to be able to deliver the high quality low volatility return stream that our clients have come to expect. As history has demonstrated to us time and time again, as soon as you think you have it all figured out, the capital markets will turn around and in quick order turn you into a humble investor once again.

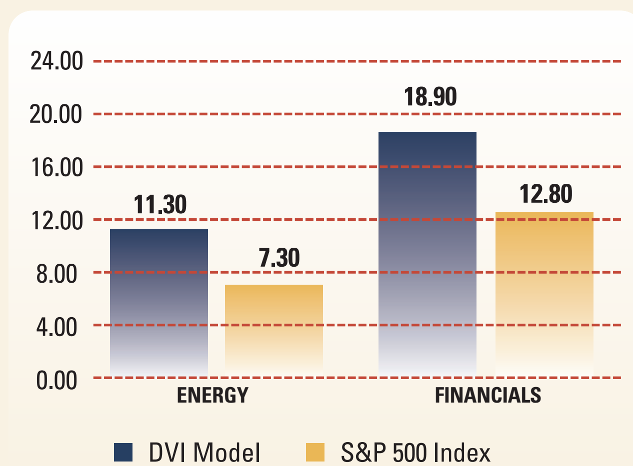
Risk Management is Our Core Competency

A part of this ongoing calibration of our strategy is the constant assessment of risk and where it lurks. We certainly are not perfect, but our portfolio management process has historically created an asymmetrical return stream, where our down market capture ratio (what percentage of a market downturn does the portfolio suffer) is significantly lower than the overall market and most active managers as well. We can attribute this to three primary factors: 1) DVI has a tendency to fish in a pond of companies that exhibit fundamentals such as low valuation, high cash flow generation and dividends. All fundamental characteristics that have historically reduced company specific price risk. 2) The market, whose underlying construction formula is momentum based, has a tendency to decline far more than active managers when growth related investment bubbles eventually pop. Wall Street has never known a market excess that it did not adore. 3) DVI has the ability to be somewhat contrarian and opportunistic and overweight economic sectors that might be beaten down or significantly out of favor. As the famous quote attributed to Wayne Gretzky's father goes, "try to skate where the puck is going rather than where it has been". Being contrarian allows you to participate in recovering economic sectors with less downside risk. In truth, down market performance has been the key to our long-term success and a significant part of DVI's value proposition.

The process that I have outlined above has been time tested and refined by DVI's Investment Committee over the past nearly four decades, but the market dynamics are such that there always seems to be a new twist on the current day facts and circumstances. Simply put, things change and we have to be able to accommodate those changes in our thinking. It would be financial suicide to be close-minded. Growth stocks have become value stocks and vice versa, companies that never paid a dividend can transform into a yield investment. It just happens! In the end, it takes loads and loads of patience and discipline.

When we assess where we stand today, there are a few notable decisions that we have made in 2016 that demonstrate our best efforts to manage overall portfolio risk. As the chart below illustrates, in the DVI equity model, the "ideal state" without client centric restrictions and limitations, we have elected to overweight both the energy and financial sectors. *Continued on page 4*

Portfolio Sector Weights



Source: Factset

THE MYTH OF UTILITIES AND RISING INTEREST RATES

Investing in the common stock of electric and natural gas utility companies has been a core part of the DVI equity investment strategy since the firm's inception in 1977 and a key ingredient in our "Dare to be Different" active investment process. Firm Founder David Vaughan explained his rationale for emphasizing the sector by saying, "I would much rather own a utility stock that has a long history of paying and increasing its dividend than own a bond which will pay me the same rate of interest until maturity, offering absolutely no growth to my portfolio." Beyond the appeal of a reliable and growing dividend income stream and more predictable financial results, utilities have a long history of providing stability during times of market volatility. Certainly all investments have weaknesses and utility stocks are no exception. Many market observers raise concerns about utility stock performance during periods of rising interest rates. Counter to this concern is the simple fact that utility companies enjoy monopoly status, giving them the opportunity to earn guaranteed returns within the confines of a highly regulated industry. What follows is an evaluation of the performance of utility company stocks considering a wide variety of economic and market environments. Perhaps we will dispel several of the market myths about this equity sector deemed most suitable for widows and orphans.

The predictability of growth in both customers and consumption creates the foundation for consistent financial results within the industry's companies. The FactSet universe of North American utility companies consists of 109 electric, natural gas and water utility companies. Over the past 10 years this universe has experienced steady net profit margins of about 8% each year, and average annual dividend increases exceeding 4%. Not surprisingly, the low volatility in earnings and high relative dividend yields results in a universe Beta of 0.4. This implies that the universe is experiencing only about 40% of the broad market risk where the Beta is 1.0. It should come as no surprise that DVI sees these utility industry statistics as core to our objective of providing superior risk management within client portfolios.

Pundits often site poor performance during periods of rising interest rates as a reason to avoid investing in the utility sector. Since 1990, there have been six distinct periods where interest rates increased significantly.

RISING INTEREST RATES - 10 YEAR U.S. TREASURY

Beginning Month	Yield	Ending Month	Yield
October 1993	5.33%	November 1994	7.96%
October 1998	4.53%	January 2000	6.66%
June 2003	3.33%	July 2007	5.00%
December 2008	2.42%	April 2010	3.85%
July 2012	1.53%	January 2014	2.86%
February 2015	1.64%	June 2015	2.35%

Source: Morningstar

The performance by the Dow Jones Utility Index reflects the interest rate sensitivity known to exist with utility stocks. Clearly, broad U.S. stocks as measured by the S&P 500 Index are not deterred by rising interest rates. Most importantly to the DVI investment process is the meaningful outperformance of utility stocks relative to U.S. bond investments.

The performance of various investments during those periods of rising interest rates are shown below.

	10/1/93 to 11/30/94	10/1/98 to 1/31/00	6/1/03 to 7/31/07	12/1/08 to 4/30/10	7/1/12 to 1/3/14	2/1/15 to 6/30/15	Average for all Six Periods
Dow Jones Utility Index	-19.68%	5.63%	21.46%	5.58%	7.34%	-12.12%	4.07%
US Intermediate-Term Govt Bonds	-5.21%	-1.88%	2.04%	1.30%	0.35%	-1.11%	-0.68%
US Long-Term Govt Bonds	-9.11%	-6.32%	2.98%	-1.96%	-5.03%	-10.58%	-3.89%
S&P 500 Index	1.85%	28.32%	12.41%	24.77%	21.10%	4.36%	17.69%

Source: Morningstar

CONTINUED FROM PAGE 2: THE MYTH OF UTILITIES AND HIGH RISING INTEREST RATES

While utility stocks experience negative pressure when interest rates rise, they should not be considered bond proxies. Annual growth in dividends and earnings are two factors that clearly differentiate utility stocks from bonds.

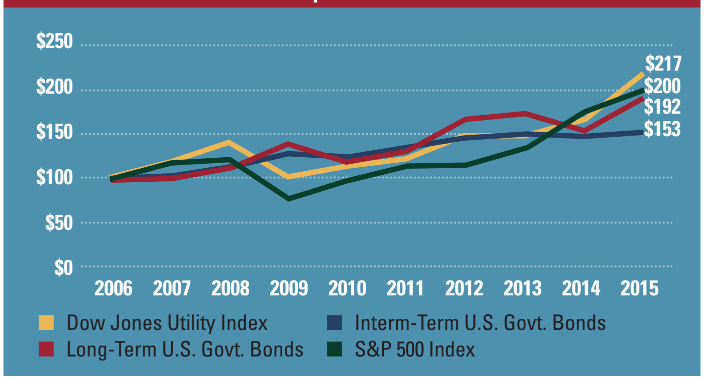
Further, rising interest rates have historically been met with higher allowed rates of return for utility companies. Regulatory agencies tasked with determining how much profit a utility company can earn base a large portion of the judgment on interest rates. While this link between interest rates and utility profitability tends to lag the market by eight to ten months, there is still an additional hedge against rising interest rates created.

If we consider utility sector returns across longer market cycles the story becomes even more compelling. Shown below are charts reflecting the growth of $100 placed in four different investments – the S&P 500 Index, the Dow Jones Utility Index, Long-Term U.S. Government Bonds and Intermediate-Term U.S. Government Bonds. We measured results over ten year and twenty year time periods to capture full market cycles.

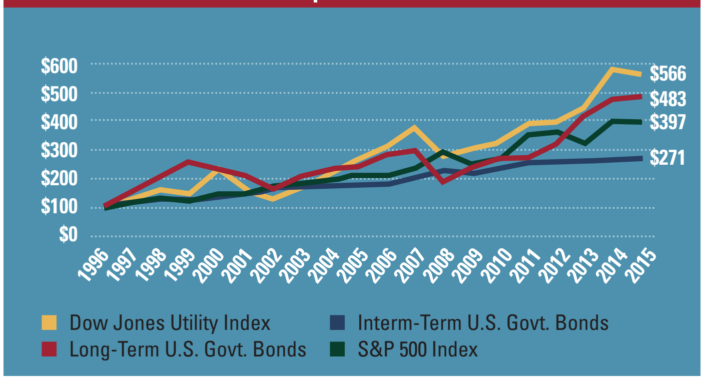
The twenty year window captures the Technology Bubble, the collapse of Enron, the 9-11 terrorist attacks, two Bear Markets and two Bull Markets, two Recessions and plenty of interest rate volatility. At the end, the Dow Jones Utility Index proves to be a very worthy investment.

These results may surprise the casual investor and clearly go against the conventional market pundit's view that utilities are poor investments in rising interest rate environments. The fact that these companies own real assets that comprise a significant portion of the operating infrastructure of the U.S. is critical to our investment decisions. Further, a strategy of being stock owners not stock traders, affords DVI the ability to see longer term trends and ignore the short-term noise so prevalent in our world today.

GROWTH OF $100 | 10 YEARS ENDING 2015



GROWTH OF $100 | 20 YEARS ENDING 2015



Source: Morningstar

DVI WELCOMES TENSHAR FARMER

We are extremely pleased that Tenshar Farmer joined DVI on a full-time basis in August of 2016. As the Front Office Associate, Tenshar contributes to the overall success of the firm by performing a wide variety of administrative duties, and acts as the initial point of contact for many clients and vendors; effectively handling inbound telephone calls, greeting visitors to the firm and setting up internal meetings. She manages the daily mail and shipping, handles the ordering and inventory of company supplies, maintains the firm's daily filing and scanning efforts, and assists the Client Services team in terms of operational workflow and database support.

Tenshar built most of her experience at Caterpillar as an analyst in various departments including Logistics and Global Purchasing. She has earned her Associates Degree and is working towards a Bachelor of Science degree in Business Administration/Accounting. Tenshar is also a faithful volunteer in the community, giving her time to such organization as Peoria Friendship House, Central Illinois on Aging, and CASA.

PRESIDENTIAL ELECTION MARKET RESULTS

A recurring question in many client meetings the past several weeks is how will the upcoming presidential election impact the stock market? We feel these charts provide a concise summary of what the historical impact has been to both market and sector performance.

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Market Performance by Year in Election Cycle

	ELECTION YEAR	ELECTION YEAR + 1	ELECTION YEAR + 2	ELECTION YEAR + 3
Number of Up Years	13	9	11	15
Number of Down Years	3	7	6	2
Average Return	6.6%	6.5%	7.0%	16.4%

Source: Schwab Center for Financial Research with S&P 500 data from 1/1/1950 through 12/31/2015

Sector Performance in Election Cycle

	ELECTION YEAR	ELECTION YEAR + 1	ELECTION YEAR + 2	ELECTION YEAR + 3
Financials	8.8%	15.7%	4.5%	8.1%
Utilities	6.2%	3.7%	0.3%	12.8%
Consumer Staples	6.1%	8.5%	8.3%	10.2%
Energy	4.6%	13.9%	2.4%	19.9%
Healthcare	4.5%	13.1%	10.4%	14.3%
Industrials	3.5%	14.9%	3.2%	18.5%
Consumer Discretionary	1.1%	19.9%	9.4%	13.7%
Materials	-3.5%	14.7%	4.7%	16.7%
Information Technology	-4.3%	18.3%	15.7%	36.1%
Telecom-munications	-6.0%	5.7%	7.9%	13.5%

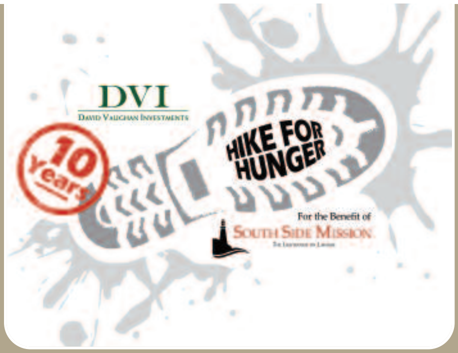
Source: Strategas Research Partners S&P 500 data from 1/1/1992 through 12/31/2014 Past performance is no guarantee of future results.

CONTINUED FROM PAGE 1: NEVER REST ON YOUR LAURELS

Of note, both of these sectors have been the absolute worst performing among the eleven economic sectors since the prior market peak dating back to October 9, 2007. Financials as an example have returned a negative 20%, as they were devastated in the 2008-2009 Great Recession market decline. However, in both of these instances, we expect their economic fortunes to improve, future earnings growth to well exceed that of the overall market and for future price appreciation and dividend growth to be significant.

Our incremental risk management process is engaged and we are leaning forward on behalf of our clients to provide world-class risk adjusted rates of return. As I commented in a recent meeting with an institutional client praising the DVI team for its near and long-term track record, "We are simply as good as yesterday, but thank you for placing your faith and confidence in DVI. It means the world to us."

2016 HIKE FOR HUNGER



Thank you to everyone who supported our annual Hike for Hunger event to benefit the South Side Mission. We had another successful year with nearly 200 hikers participating and raising approximately $53,000. The morning started a little rainy, but cleared quickly so we had a beautiful day for a Hike.

The 2016 event marked our 10 year anniversary of hosting the Hike for Hunger and total funds raised for Southside Mission over the life of the event is approximately $613,000! The Mission is a vital part of the Peoria community and cares for over 15,000 poor people each year through youth ministry, homeless shelter, food pantry, outreach and career training ministries.