

Investment Management of Virginia, LLC
Small Capitalization Portfolio
4th Quarter, 2011

The Small Capitalization Portfolio Composite had a strong quarter. The Portfolio Composite was up 14.0%, net of fees.¹ The Russell 2000 Total Return Index was up 15.5%, and the S&P 600 Index was up 17.2%. This past quarter was fairly volatile but ended very well and helped put the Portfolio slightly into the green for the year. The Small Capitalization Portfolio remains well ahead of its indices for the 3, 5-year, and since inception periods.²

The Portfolio³

During the quarter, we liquidated School Specialty (SCHS) and added a new position in MDC Holdings (MDC). School Specialty is a leader in its business and generates excellent cash flow, but the stock has been disappointing. Our thesis that spending in school districts would improve after a three year decline did not materialize. In SCHS' place, we added a position in another out-of-favor sector, homebuilding. MDC Holdings (MDC) is a high quality homebuilder that has suffered through the industry-wide slowdown. However, the company has a solid balance sheet, attractive assets, and an experienced management team that we believe can lead the company out of the housing slump. In addition to MDC, we added to our existing positions in KVH Industries (KVHI) and Titanium Metals (TIE). Finally, we reduced our positions in Quidel (QDEL) and Ocwen (OCN) because both reached our initial price targets. We continue to like the underlying fundamentals in each company and have retained a smaller position.

The Market

The equity market took small steps up the "wall of worry" during the 4th Quarter. The issues we mentioned in our 3rd Quarter letter, namely, the downgrade of U.S. Treasury debt, chaos in Europe, gridlock in Washington, and fears of another recession, were all ameliorated somewhat (except gridlock in Washington!). The fixed income markets lowered the Federal Government's borrowing rates in spite of the ratings downgrade; Europeans appear to be making progress, begrudgingly, toward preventing a meltdown of the Eurozone; and, U.S. economic prospects appear to be improving. We will suffer through another recession at some point, but the equity market does not see that happening in the next six months. We are watching corporate earnings closely, as usual, but the other building blocks of a positive market trend appear to be in place: attractive valuations (indicated, in part, by the historically high level of the equity risk premium), low interest rates, cautious investor sentiment, positively trending economic data, and a lack of attractive alternatives to the equity market, in our opinion. These conditions could create a solid foundation for positive equity returns in 2012. Some market prognosticators have even suggested that we may see some reversion to the mean in equity market volatility and a return to more normal interest rates. Neither of these developments is clear right now, but the market often moves in unexpected ways, so we may be pleasantly surprised.

¹ Past performance is no guarantee of future results, and no representation is made that results similar to those shown 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 John H. Bocoock at (804) 643-1100, or write to Investment Management of Virginia, LLC, PO Box 1156, Richmond, VA 23218-1156, or jbocoock@imva.net.

² Portfolio inception is 1/1/94. Inception for the S&P 600 Small Capitalization Index is 11/13/95.

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.