DAVENPORT PARTNERS

Davenport Advisors Stock Fund

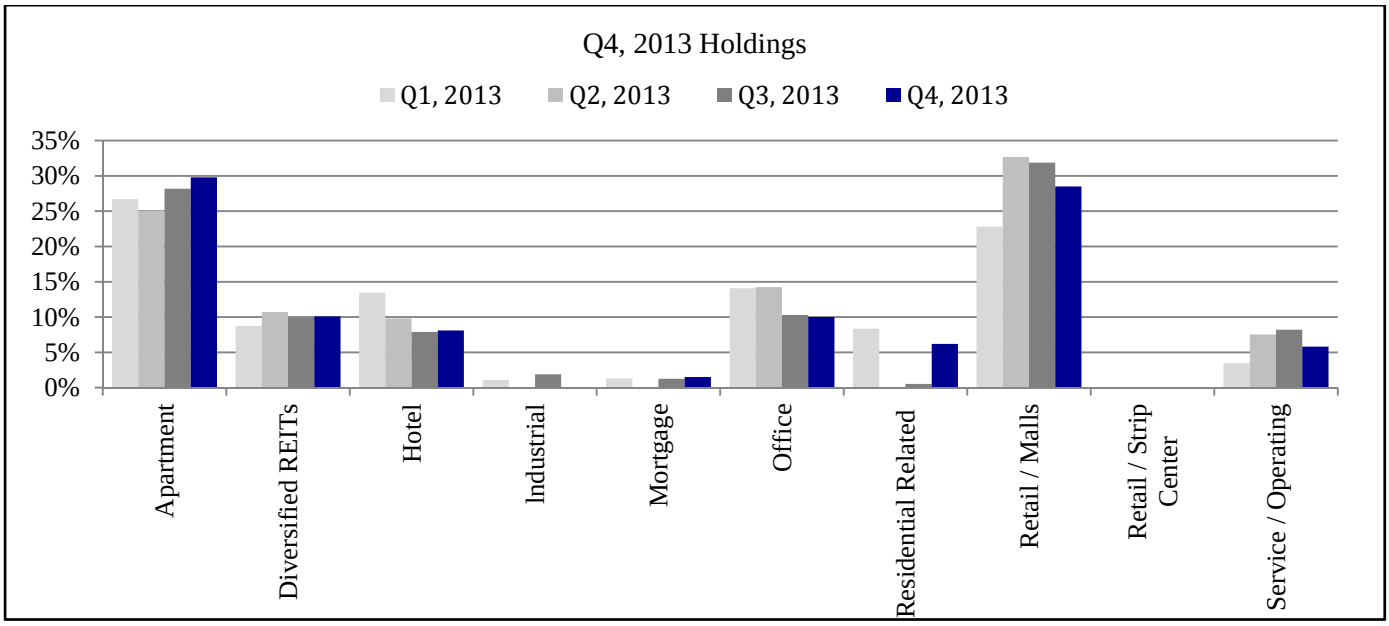
February 12, 2014

Update on the Fund:

As of December 31, 2013, the total value of the fund was approximately $3,360,000 (before fees and expenses). The fund was 94.7% invested in stocks, 5.3% in cash. We started the year at $3,007,000 (adjusted for contributions/distributions from or to LPs since January 1, 2013), so the value of the fund was up approximately 11.7% for the year.

Fund Holdings by Industry:

29.8%	Apartment	10.0%	Office
10.1%	Diversified REITs	6.2%	Residential Related
8.1%	Hotel	28.5%	Retail/Malls
0.0%	Industrial	0.0%	Retail/Strip Center
1.5%	Mortgage REITs	5.8%	Service/Operating Companies



Top 5 Holdings:

EQR - Equity Residential
GGP - General Growth Properties
SPG - Simon Property Group
AIV - Apartment Investment & Management
PEI - Pennsylvania Real Estate Investment Trust

EQR: Equity Residential is one of the largest owners of apartments in the US. EQR owns 398 properties consisting of 113,388 apartments.

EQR continues to sell properties in order to fund their acquisition of 60% of Archstone in February 2013, for a price of $9 billion. During the 3rd quarter, the company sold 10 apartment communities with 4,131 apartment units (Four thousand! I know someone who bought one apartment unit – well, a condo - last year, and it took a lot of time and effort!). They also sold two land parcels. Using the

cash generated from the sales and "cash on hand" they paid off a $964 million loan, a whole year before it was set to come due in November 2014.

GGP: General Growth Properties is the second largest mall company in the U.S. There is a lot of chatter about the demise of "bricks and mortar" retailing and that consumers are shifting their purchases online which, or course, would be bad for owners of real estate. Yet General Growth's mall portfolio is 96.6% leased, and their Same Tenant sales increased 3.8% on a year to year basis, and rental rates on newly signed leases commencing in 2013 compared to expiring leases increased by 12.2%. These are all really good numbers!

I was at a Harvard/USC Lusk School real estate conference recently in Deer Valley. John Bucksbaum, formerly CEO of General Growth Properties gave a very personal talk about his experience taking General Growth into Chapter 11 Bankruptcy in 2009. His father and uncle started the company in 1954 and by 2009 they had $25 billion in real estate. The company had a lot of debt coming due. They had plenty of cash flow to service the debt, yet because of the financial crisis the banks were unwilling to refinance or extend the loans. So they were forced into bankruptcy. John Bucksbaum talked about how it felt to be at the helm of a family company, with all the brothers, sisters, cousins and long-time employees depending on him to protect their livelihoods. He had a slide with a black vortex and the slide was titled "Are You Considering Suicide?" He went to a counsellor for the first time in his life in 2009 and the first question the counsellor asked was "Are you considering suicide?" One of his best moments was when the Bankruptcy Judge looked at the lead attorney for the Creditor Committee and said, "this is a great company with a long successful history and $2.5 billion in annual cash flow….there is no way I am going to let you take this company down…"

Our fund has owned General Growth on and off since 2009 when they were still in Chapter 11. Our first purchase of the stock was at $2.50/share. The stock now trades around $20/share.

SPG: Simon Property Group: Simon is new to our top five holdings list. Frankly, we have never been comfortable purchasing the stock before. SPG has one of the most respected management teams and a very high quality retail portfolio and the stock has historically traded at a big premium to its NAV/share.

Simon is the largest REIT in the US, with a total market capitalization of over $80 billion (about 23,000 times the size of our stock fund). Simon owns about 325 retail properties - malls, outlets and strip centers throughout the United States, Asia and Europe. Examples include Stanford Shopping Center, Copley Place in Boston, Forum at Caesars in Las Vegas, Houston Galleria, Desert Hills Premium Outlets in Cabazon and Ontario Mills, to name just a few.

In December, Simon announced their intent to spin off 44 of its smaller malls and 54 strip centers into a new REIT. The new company, for now being called "SpinCo", will have about 53 million square feet of properties worth approximately $5 billion.

The result will be that Simon Properties will focus on high end malls - the A's - while SpinCo will focus on the B's and C's.

AIV: Apartment and Investment Management Company is one of the largest owners of multifamily apartments in the US. On October 31st AIV Chairman and CEO Terry Constantine reported that "….Business is good with steady demand driving higher rents. Our portfolio got better…."

Oh please Terry! Enough with the good results! ***Tweet*** me when you have something more exciting to report.

Since October 31st AIV stock is down almost 5%. Despite the good results and increasing earnings AIV trades at more than a 20% discount to its NAV/share.

PEI: Pennsylvania Real Estate Investment Trust. PEI focuses on retail shopping malls on the East Coast. They own a $4 billion portfolio consisting of 6 higher end malls, 29 lower end malls, 5 community centers and 3 development projects. PEI has paid dividends for 147 consecutive quarters (36 ¾ years!). PEI recently increased its quarterly dividend by 11%. Yet PEI stock trades at a 35% discount to its NAV/share! Some think PEI might be a logical first acquisition for Simon Properties' new SpinCo REIT.

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Trading during the Quarter: We started the quarter with 84% stocks and 16% cash. We ended the quarter with 95% stocks and 5% cash. We were net buyers. We sold out of several stocks: BMR, FCH, REXR, ROSS and VNO. We bought back a few stocks: BRE, CWH and GRT. We added one new company: ESRT (Empire State Realty) !

Comments:

REITs were actually doing quite well until May 22nd when Federal Reserve Chairman Ben Bernanke announced the possibility of Tapering. From then on it was a tough year for REITs as fixed income and non-dedicated investors (those investors who owned bonds, utility stocks and REITs for interest payments and dividends) abandoned REITs, often in favor of high-flying new Silicon Valley tech and South San Francisco social media stocks.

For the entire year REIT indexes were generally flat to slightly up. The Vanguard REIT index ended the year down approximately 1.9%, while the MSCI REIT index was up 2.5% for the year.

Our little fund, ended the year up 11.7% (before fees and expenses). It actually performed very well - relative to the indexes.

Based on the fundamentals REITs should perform well in 2014. Many high quality REITs are trading below their private market values or Net Asset Value. Through the fund we get to buy quality property portfolios with quality management (who do all the work for us) at less than the cost to buy the properties in the private markets. REITs should have the wind at their backs this year - there has not been much new construction and as the economy improves, occupancies and rents should trend up.

"Risk On … Risk Off"

If you listen to CNBC, then you know the terms "Risk On" and "Risk Off". Those words sound really cool when said casually by the Talking Heads. "Are you Risk-On or Risk-Off, today?" Translated, are you buying stocks or selling stocks, today? Or it could mean, are you buying long bonds or buying intermediate bonds, today? The great thing is, no matter to whom they are talking or what that person is saying, it works: Are you Risk-On or Risk-Off, today?

Applied to REITs, it could mean: "Are you buying Junk REITs or Blue Chip REITs, today?" It appears that the public REIT investor world has been Risk-On for the last year or so. Many Junk REITs (companies with low quality properties and/or with too much debt, etc.) are trading at a premium to their asset value, while many Blue Chip REITs (companies with high quality properties and low leverage) are trading at a discount to their asset value.

This is not the case in the private real estate world, where regular or low quality properties (Class B or C properties in the suburbs or secondary markets) have been selling, if at all, for higher cap rates (low prices) while Blue Chip properties (Class A properties in core or primary markets) have been selling for very low cap rates (high prices).

For instance, institutional real estate investors are falling all over themselves to buy Class A office buildings in San Francisco (think Twitter), whereas it's almost impossible to get an institutional investor to look at a Class B office building in Orange County.

Question? Would you rather invest in an office building South of Market Street in San Francisco (in the center of the Social Media Boom) at a stabilized price of $750 per square foot with a pro forma return of 4% (for reference, this building might have sold for $300-$400 per square foot before the recession) <u>OR</u> would you rather invest in an office building in Orange County at a stabilized price of $150 per square foot with a pro forma return of 9% (this building might have sold for $200-$250 per square foot before the recession)? Just Asking!

They say that the public stock markets are always looking ahead and are good indicators of the future. If true, the public REIT investors may be signaling that regular or low quality properties should go up in price, closing the gap between the price of Class B or C quality properties and Class A quality properties in the private markets.

Dividends: The Stock Fund made a Distribution in December. The email to investors said:

"Dear Investor: Our stock fund realizes long and short term capital gains and losses and earns taxable dividend income each year. Since the fund is structured as a Limited Partnership these taxable items flow through to each investor via a K-1 based on their partnership share.

We have decided to pay a distribution roughly equal to 75% of the dividends we expect to receive this year. Your share of the distribution is based on your percentage ownership in the Fund as of January 1, 2013."

Several investors asked about the size of the dividend distribution. Here is the math: Most REITs pay about a 3-4% dividend. On average DASF held about 76% stocks and 24% cash during the year. About 75% of our stock holdings are companies that pay dividends. (Conversely about 25% of our holdings are operating companies, retailers, or in some cases REITs that do not pay dividends). Finally, as stated in the email, we distributed approximately 75% of the expected annual dividends. So the math goes like this: (Assume 3.5% dividend) X (76% stocks) X (75% of the stocks we held pay dividends) X (DASF distributed approximately 75% of expected dividends) = 1.5% dividend distributions paid.

Maybe we will go all out in 2014 and pay a distribution of 100% of the expected dividend.

Fund Details:

As of December 31st we owned 159,197 shares of stock in twenty-three companies, with an approximate cost basis of $2,835,000 and a market value of $3,129,000, (prior to pending purchases of $99,658 and pending sales of $47,404). During the fourth quarter of 2013 the fund received dividends of approximately $3,353 (prior to pending dividends of $9,842).

We continue to have conference calls among the partners of Davenport Partners during which we review stocks in the portfolio, consider new companies, review industry trends, etc. Generally we have focused on buying good companies whose stocks are trading at or below their NAV/share. Lately we have had the opportunity to buy not just good companies, but Blue Chip REITs at or below their NAV/share.

Please feel free to contact us if you have any questions, would like to find out more about the fund's holdings or have a company whose stock you think we should consider buying.

Fund Philosophy

Invest in real estate related stocks. Real Estate Investment Trusts (REITs), Real Estate Operating Companies, Land and Natural Resource Companies, Hotel Companies, Banks, Lenders, Mortgage Companies, Retailers, Diversified Companies with real estate holdings, Construction Companies, Private Equity companies oriented toward real estate. Investments could include special situations, or illiquid stocks, companies in bankruptcy, or real estate stocks not widely followed by analysts or institutions or real estate sectors which are currently out of favor.

Key Information

Inception: August 1, 2009
Manager: John Davenport
Fees: 1%; 20% performance fee with Hurdle and High Water Mark
Minimum Investment: $10,000 initially, no minimum for additional investments
Timing: Initial and additional investments submitted at any time become effective at beginning of the next quarter
Liquidity: Withdrawals at year-end
Broker: Charles Schwab & Co.

Disclaimer Past performance is not an Indicator of future performance. Please read the subscription materials before Investing.