Villere & Co.

Webinar – Volatility – Friend or Foe?

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Fund Managers George Young, Sandy Villere III, Lamar Villere

Moderator: Thank you for attending today's webinar, Volatility – Friend or Foe? Presented by Villere & Company, which has been providing investment counsel since 1911. In a few moments, co-founders George Young, Sandy Villere III, and Lamar Villere will go through their presentation. We encourage you to ask questions. There will be a brief question and answer session following the presentation where your questions will be answered in the order they are received. If time does not allow for us to get to your questions right away, either George, Sandy, or Lamar will be in contact with you to address your questions by e-mail or phone. To ask a question please type it in the question box in the GoToWebinar software panel. If you are interested in asking a question directly please raise your hand by clicking the Raise Your Hand icon in the panel and we will unmute your line during the Q&A session. With that I turn it over to George.

George Young: I want to thank everybody for participating in the webcast and we want to give you a general overview of what Villere & Company is all about, our investment style, some of our stock picks, and make sure that we answer any and all of your questions.

So, by way of introduction – let me go to the first slide – you can see there I'm on the upper left-hand corner. My cousin Lamar is next, our mutual uncles Sandy Villere, George Villere, and then Sandy Villere III who is also going to participate today. Note that our firm is over 100 years old, and I think that's very important especially given our theme of volatility. I think in this market a lot of people want continuity. They want to understand that the people that are handling their money, which is very personal, have experience. It is also important to understand that we here today represent the fourth generation of our family. The firm was started in 1911 by our collective great-grandfather.

We currently have $2.5 billion in assets under management. There are three different ways that you can invest with our firm. Our two mutual funds have about $500 million altogether, and then the investment advisory side, the custom accounts if you will, have about $2 billion.

I don't want to dwell too long on custom accounts, but I think it is important to mention because that is how we began our business-with the custom side. As you can see, that's tailored to the client's needs. We have a minimum investment of $1 million. We charge one percent on the first $5 million in a given account.

Then we turn to the Villere Balanced Fund, VILLX, and you may want to note – I think everybody on the call is aware – this is a no load fund, and it is available on multiple platforms including Schwab, Fidelity, TD Ameritrade, Merrill Lynch, and many others. It's a versatile fund available throughout different platforms.

This mutual fund, VILLX, was started in 1999. We invest in stocks, bonds, and cash, and the minimum investment is $2,000.00. We like to think that the volatility target is moderate, and the reason we say that is that we have to have between 25 and 40 percent in fixed income, and we have to have between 60 and 70 percent in equities. The equities that we have tend to be more small and midcap. We do have a few large cap. Some might say that our style is somewhat eclectic, but we like to think that we own stocks that we feel comfortable with and, that we know well. Our style is that we tend to be a little bit more concentrated than a lot of our peers. We'll have 20 to 25 stocks in our portfolios, and that's typical for VILLX. That is balanced with the 25 to 40 percent in fixed income. About ten percent of that can be in high-yield bonds, but overall we give that a classification of moderate. Expense ratio – as I said before it's a no load fund, so the fee is 89 basis points.

And let's turn to VLEQX, which is a bit newer. That fund was started almost three years ago. As the name implies and as the SEC requires we have to have at least 80 percent in stocks to be called an equity fund. We have about 90 percent invested right now, 10 percent cash, and again the same minimum investment of $2,000.00 per year. As you might expect without having the fixed income component, the volatility is a little bit higher and that's why we created this fund. A number of people – clients - had asked if it was possible to invest directly in the equities that we had in the Villere Balanced Fund. They didn't want the bonds. Then they regret that decision that they didn't have bonds, because bonds have been strong performers, but the volatility is a little bit higher. The expense ratio is a little bit higher at 1.11percent because it's a smaller fund. As assets have grown that expense ratio has come down a bit.

So with that I'll turn it over to my cousin Sandy.

Sandy Villere III: Thanks, George. When we look at the different portfolios that we're building there are several characteristics that are pretty common. We shy away from debt. We love companies with low debt. We love companies with strong free cash flow characteristics and we always look at a company's growth rate. In fact, we're always looking for companies who can grow north of12 to 15 percent, and we try to buy that with a price to earnings ratio less than that growth rate if we can. We love companies that absolutely dominate in a particular niche with very high barriers to entry. We do buy companies that vary in size but our focus is definitely on smaller and mid cap companies. Probably 85 percent of our equities are going to be in small to midcap companies.

We often have to buy companies at times that are larger, that are contrarian or out of favor because that is when they're cheap. A few quick examples in in the recent past, were when we bought Apple when Steve Jobs died – all of a sudden it was cheap. We bought Carnival Cruise Lines when the Concordia sank and was floating around for some time. Unlike the BP oil spill that we couldn't figure out the liability, we knew the insurance premium they were going to have to pay to get that ship removed and it was only 1 boat out of 100- 1 percent. The stock got pretty decimated and we saw it as an opportunity. We bought VISA, a larger cap name, when the Daubert amendment came around in January of 2011, and it also got cheap as people thought there would be a government overhang forever, and that just wasn't the case. So these are some of the characteristics that we look for when we buy a company.

We got added recently – just in the first quarter of this year to Schwab's Select List. This is on their Mutual Fund One Source Select List as well as their Income Mutual Fund Select List and their Select List for the Advisor edition. What I thought was interesting is that they have a team in San Francisco that goes through all this and finds good long-term performances that maybe have a rough year or two. We'll get into what small caps have done in the past two years, but it's been a tougher period. I'll turn it over to Lamar Villere.

Lamar Villere: Thank you, Sandy. We refer to this as the Chiclet chart. It's very colorful kind of a noisy chart-but actually it's pretty useful to look at. Each square or rectangle you see here represents an asset class. The dark blue is small stocks, the lighter blue is large stocks, and so on. You can see what they represent across the bottom. The ones at the top were the highest returners that year, while the ones at the bottom were the lowest returners that year. What you notice is that the trends don't last long. Generally you see something that might be very popular, very in vogue in one year, and it might slip down and be very out of favor the following year. For our style that is predominantly small cap. In 2014 the large stocks are shown here as the Morningstar benchmarks. For that same time, the S&P for large caps returned about13 percent, whereas the small cap Russell 2000 returned about 3 percent, so 10 percentage points of underperformance by small caps. In 2015, which is not shown on this chart, small caps again significantly underperformed, where the S&P was at about 1.4 percent, the Russell 2000 was at a negative 6 percent, so a tough 2-year run for small caps.

I think what you can see if you look historically – this is since '95 – if you tried to chase returns, you ran into a lot of trouble. For example, look at 2013 where long-term government bonds were the worst-performing asset class at minus 11 percent, and then in 2014 they were up – astonishing for long-term bonds – an astonishing 24 percent, government bonds. It's very difficult to try to time which type of investment you want to be in over time. For us the takeaway here is stick with your knitting and stick with what you've done historically.

The last slide showed why not to jump around from different asset classes. These two charts really show you the potential cost of trying to get cute and time the market in terms of just getting out entirely. What this shows is from 1995 through 2014, if you were invested in the market for that entire period you'd have returned nearly ten percent. That's great. If you were to have missed out on, for example, the best 40 days during that period – so over the course of 5,040 days- if you missed just the 40 best days, you'd have actually had negative returns over that period. So there's a huge price to pay by missing out on the best days.

The chart below that shows the daily returns. You can see the same periods that have the very steep negative returns also have the very steep positive returns. So we think it's very dangerous either for us to try to go to cash in the fund or for investors to try to time when they're in and out of the market.

George Young: I think one of the things that's important in this discussion of volatility and whether it can be your friend or your foe is to take a look at the potential for long-term asset class returns. As we mentioned earlier, we have a preponderance of small cap stocks in our portfolios, and many of you may have seen this slide before and I think it's very important to review. Although people on this phone call might not necessarily have an 80-plus year investment horizon, it is important to think about the power of long-term compounding returns in a given portfolio.

Let's take a look at small stocks for just a second. This chart shows the growth of $1.00 from 1926 through the end of 2014. We're obviously about a year out of date, but that shows $1.00 has grown to $27,000.00-plus. That's a 12.2 percent annual return. Large stocks have also done well at 10.1 percent annualized, but $1.00 only grows to $5,317.00. It's interesting because you look at government bonds and they say that's been a 5.7 percent return, but I think everybody on this call knows that government bonds yield about half of that right now. Let's not forget that if you're a taxable account you need to pay taxes on that, too, the highest rate. Treasury bills are a lot less, 3.5 percent, and then inflation – each one of these color returns have to be nicked by about 2.9 percent, and inflation has been running that for these 80 years. I think right now inflation is somewhere between one and a half and two percent. So again we know inflation is a real concern.

If you take a look at holdings in bonds, there's a very good chance that you will be getting negative returns in the near future. We have been saying that for some time. We've been wrong about that because interest rates have in fact dropped and we're seeing negative yields in Europe and other places. But that's something that gives us a bit of concern, to have too much in bonds. It’s also very important that people understand that taxes do play a big role in performance over a long period of time, and that's something that does make us somewhat nervous.

Sandy Villere III: Why don't we discuss a couple of the stocks. The first one is Taser. This has been in the news a lot. They make nonlethal weapons for the police and the military. We saw those shootings in Ferguson, Missouri, et cetera, and Rahm Emmanuel in

Chicago just ordered all the police cars to have body cameras and that is an increase from about half. That was an important win in Chicago, because Motorola was the local vendor in that area and they beat out a few other vendors in that market. So that was a big win for them.

Nonlethal weapons is a great cash flow business. It's a strong business for them, but the real advantage is in the body camera market where they've only penetrated by about seven percent. The body camera itself is a commodity, but the subscription revenue model, with the storage of all the data on their Evidence.com website, is where they make the money. That is it gets into being a SaaS company, a software as a service, and we love that. We love that model and believe it's going to award this company a higher valuation.

The stock's been getting very beat up. Management said they're going to have higher near-term expenses as they really take market share, because once you win Chicago, for example, it's going to be paying out over the course of five years and it's going to be a very good contract for them over time. Before we invested in this company, we spoke to not only the local police but we also had a conference call with four different decision makers all over the country at different police departments to fully understand and appreciate why the trend towards body cameras may be a trend versus just a blip on the radar. We came away feeling extremely confident that body cameras bring incidents down sharply on both sides of the badge and we think it's going to continue.. In the past two weeks alone we've seen amazing news flow as it relates to new business wins. I mentioned Chicago, also the New York and, San Francisco Police Departments, will be getting cameras. Minneapolis just approved $4 million for body cameras to be rolled out by year end. So the news flow is good. We think this is going to turn into a really good stock over the long run, and again our time horizon is three to five years. As they go out and take over this land grab we think it's going to continue to work well for us. George?

George Young: Thanks Sandy. Let me talk about LKQ, another stock that you may not have heard of but you've probably used, oddly enough. LKQ is an acronym that stands for Like, Kind, and Quality, and that is something that is mentioned in insurance contracts for your automobile. When you get in a car accident what you really want is to get your car back in good, working order and as soon as possible. What you probably don't realize is that when you get replacement parts, you get refurbished parts. They're not brand new. You can get brand new ones if you want, but you're going to have to pay for that. That's not within the purview of your insurance contract.

LKQ is in the business of buying wrecked cars, pulling out the parts that they can refurbish and use again, and getting rid of the rest in an environmentally safe manner. This is a company that we think has great visibility long term, meaning with lower fuel prices there's going to be more travel, and if there's more travel there's likely to be more accidents. I'm sure everybody on this call has experienced a car accident one way or the other, either personally or their family. It’s it's interesting because this company is in the business of taking hulks of cars and making sure they dispose of them properly. Around here, most of the scrap yards are full. They're not building more of them. It's a very dicey business in terms of expanding and trying to buy more square footage to use but in this case they've been very efficient. They've got a very visible earnings flow. It's something that we think has great long-term potential, but it's something that you would've heard of only if you'd experienced it and read through your contract with your auto insurance.

Lamar Villere: 2U is a recent addition to the portfolio. It is an online education company, and I think when people hear that, when they think of online education, traditionally they think of something that's a little bit cheaper than its bricks and mortar counterpart and possibly not the same level of quality.

2U has a very different model. You can see some of their programs on this page and they've got a number of other programs as well. They actually have 26 different programs right now. The tuition for these online versions of these programs is identical to the tuition for the bricks and mortar version. For example, if you're getting your PA degree from Yale you're going to pay the exact same amount online as you are in the bricks and mortar. I think a lot of people hear that and say, "Well, that's crazy. Why would you pay the full price?" Essentially it's because you're getting the full experience.

2U sources the students, thus handling the marketing for Yale. They handle all the interaction with the exception of the professors themselves. So Yale decides who gets in to the program, they decide who graduates, and they provide the professors. 2U handles the rest of it, and for that 2U keeps 60 to 65 percent of the tuition and the school keeps the remaining 35 to 40 percent.

Again you might think, "Well, that's crazy. These schools are used to getting 100 percent of the tuition. How could they allow that much of the money to go to 2U?" The answer is relatively simple. These schools are used to losing money on every single student. Under this 2U model they're actually profiting or having positive returns on each student. We've actually spoken to a number of the programs and they’re very excited. Their professors like it because they can earn extra income. The schools are finding that this is making a big difference in their ability to provide education both to bricks and mortar and to these online students.

As I mentioned, there are 26 programs. They're expecting an additional six new programs this year, for example, the UNC online business degree. One of the ways that they are able to then capitalize is they tend to add additional programs at the university and they add additional verticals. They also have the online business school for Syracuse, for example, and that's also a cross-sell. If someone applies to one of the schools and doesn't get in, they can follow up and say, "Hey, you'd actually be a great fit at this other school." So it's a very different way of looking at it.

Speaking of UNC, when we spoke to Susan Cates, who is the dean of the UNC online business school, she raved about the program and gave us a lot of insight.

About three months later she was named COO of the program. When you talk to these people, like the deans of the online programs, you learn they are very fervent believers in the company. This is one we think is going to be a great long-term story.

Sandy Villere III: With that why don't we open it up for questions? We're right at the 20-minute mark, and if you could open up the line that'd be great.

Moderator: **All right, thank you, Sandy, George, and Lamar, for your insight. Yes, we will now open it up for the Q&A session. As a reminder to ask a question please type in your question in the question box which is on your GoToWebinar panel, or if you would like to ask a direct question please raise your hand by clicking Raise Your Hand button and I will unmute your line.**

Okay, the first question comes from Bob. "How are you handling the slowdown in China and what is your exposure?"

Sandy Villere III: I can answer that. That's really the $64,000.00 question right now, and it's interesting because this market has really become very Fed-dependent. This year Janet Yellen said she was going to raise rates maybe four times in 2016. Now you look at the Fed Fund futures and they're predicting the rates aren't going to go up until 2018. We think right now there might be around a 15 percent probability of a recession. I think if rates go up that probability maybe doubles. Now that rates are going to stay lower, I think there's a good chance we get through this. But obviously if rates go up the dollar gets stronger. That's going to impact the Chinese yuan and other currencies in emerging markets and oil will go lower. I think at this point we feel pretty comfortable with this –with lower rates for longer, and it's going to be tougher to get out of this.

We do have some exposure to China. We want to have sort of smart beta as we call it. One of our positions is a company called Sotheby's, which is trading almost down to the value of the real estate alone that they own in New York and London, which would be about $15.00 a share. The stock isn't much higher than $20.00 at this point. We think it's a great way to play the ultimate turn around. If you go back to March of '09, Sotheby's went from under $7.00 to about $30.00 in one year. The turnaround can be quite dramatic for a lot of these companies, and we think now is a really good time to be owning Sotheby's when absolutely everybody hates it in a very deflationary environment and it could jump up pretty quickly.

George Young: And I might say that I think Bob was probably right. It's more of a showdown in China than a slowdown, but we'll leave that to be said.

Moderator: **All right. We have another question– this time from Susan. "How are you playing the extreme volatility in the price of oil?"**

George Young: Oil is a difficult one because it's obviously commodity-based. So if you can tell me if oil is going to go to $20.00 and stay there, or go to $40.00, then I can make you a pretty good bet on which oil companies you should be buying into. That being said, we believe long term that the value of oil is inherent to this economy. Alternative energies have not made much of an inroad. With oil being where it is right now, alternative energy, since it's basically tax-supported in this country, probably won't make a whole lot of headway for some period of time. The big culprit is demand internationally, and as Sandy mentioned earlier about the slowing Chinese economy, that's part of what is driving down the price of oil. There are many other geopolitical factors that come into play: war in the Middle East, cooperation between Iran and Russia – no one knows where it's going to go.

That being said, the oil sector or energy sector represents about six percent of the S&P economic weightings, so it's very important that we do keep some sort of presence there. What we've done right now is to have some weighting towards larger cap. We own Oceaneering, which is a company that is in the oil service business and it operates remotely-operated vehicles to do maintenance and perform testing on different wells that really no others can do. So, although oil service stocks have been down because the demand for their services is off, we think that's somewhat temporary. It may take until 2017, but we think it is an important sector to be invested in.

Sandy Villere III: I was going to add, Susan, we're trying to upgrade our energy stocks so that the ones that have the very best balance sheets survive a protracted downturn. If oil went back up to $45.00 by year end, the smaller-leverage names will dramatically outperform the more conservative companies obviously, but we believe that we're positioned to capture 70 percent of that upside in some of these small or midcap names that have very good balance sheets versus some of the majors. We think we're set up pretty well for a recovery and also a protracted downturn.

Moderator: **Great. We have some time for a couple more questions so please get them in if you have them. The next question comes from Tony. "Is it time to get out of the market completely?"**

Lamar Villere: I'll take that. The short answer is no. You know, we never think that getting out of the market completely makes sense, and I think we illustrated that on what I referred to as both the Chiclet slide. That chart shows that if you were out of the market for the best 40 days over that 10-year period or longer, you went from having 10 percent positive returns to actually negative returns. So there's a huge amount of danger in getting out of the market entirely. You know, if you're not perfect about when you get out and when you get back in, you could really hurt yourself and hurt your returns. We think somebody should remain pretty fully invested as a constant.

Moderator: **All right. Next question comes from Preston. "Small caps have underperformed large caps now for two years. Why do you keep holding them?"**

Sandy Villere III: I'll take that one. It's Sandy. Really we always try to look through the windshield rather than through the rearview mirror. Today's losers are typically tomorrow's winners. With many of our companies trading near all-time low valuations, we believe that our names are setting up to really outperform as fear can turn into greed fairly quickly. We're just stocking with our knitting and looking forward and not jumping onto that tech bandwagon.

It's ironic because the names that have really carried the S&P in fact are the Netflix and the Facebook and the Google Alphabet and the Amazons of the world. If you didn't own those stocks in the last few years you've had a tough time outperforming. We did not own those stocks, but we're not out buying those names today. We're buying the younger growth-year names that have been washed out and could be tomorrow's winners.

Moderator: **Great. It looks like that's all the questions that we have from the attendees. Now if there's anybody that came on late or have any other questions, are they able to reach out to you guys directly?**

George Young: Sure. We're happy to entertain any and all questions. One thing I didn't mention, but that I think that is important is that our fund is a little bit different than a lot of the other big funds out there. As portfolio managers we're happy to take any calls that some of our investors may have. Remember this is not Fidelity – I'll pick on Fidelity for a minute. You can talk to the managers directly, and I think that's very important.

You might want to make a note that our website is www.Villere.com, and in the presentation you've got our e-mail address and you can certainly e-mail us or you can give us a call anytime you like.

Moderator: Great. And with that, that concludes our webinar. Thank you for attending and have a great day.

Sandy Villere III: Thanks, everybody, for listening.

Important Disclosures

Past performance is no guarantee of future results.

Investments involve risk; principal loss is possible.

The Villere Balanced Fund. Investments in smaller and medium sized companies involve additional risks such as limited liquidity and greater volatility. The Balanced Fund will invest in debt securities. Investments in debt securities typically decrease in value when interest rates rise. This risk is usually greater for longer-term debt securities. Investments in lower rated and non-rated securities present a great risk of loss to principal and interest than higher rated securities

The Villere Equity Fund. Equity investments are subject to market risk. The Fund may invest its assets in securities of foreign issuers in the form of ADRs, which are securities representing securities of foreign issuers. Foreign investments involve additional risks, including currency fluctuation, political and economic instability, lack of liquidity and differing legal and accounting standards. Investments in small- and mid-cap companies are subject to greater volatility and may have limited liquidity. The Fund's ability to invest in initial public offerings (IPOs) involves a higher degree of risk than more seasoned companies.

Assets under management as of 12/31/15: $2.1 billion.

P/E Ratio is the weighted average of the price/earnings ratios of the equities held by the Fund. P/E ratio is a company's current stock price divided by its estimated next 12-months' earnings per share.

Free Cash Flow is a measure of the cash produced by the firm in a given period on behalf of equity holders.

Cash Flow measures the cash generating capability of a company, calculated by subtracting total liabilities from total assets.

Smart Beta defines a set of investment strategies that emphasize the use of alternative index construction rules to traditional market capitalization based indices.

30-day US Treasury bill is a short-term debt obligation backed by the U.S. government with a maturity of less than one year.

20-year US Government bond is a long-term debt security issued by a government with a maturity of 20 years.

Ibbotson Large Company Stocks Index is represented by the S&P 500 Composite Index (S&P 500) from 1957 to present, and the S&P 90 from1926 to 1956.

Ibbotson Small Company Stocks Index is represented by the fifth capitalization quintile of stocks on the NYSE from 1926 to 1981 and the performance of the Dimensional Fund Advisors (DFA) Micro Cap Fund thereafter.

MSCI EAFE Index is an unmanaged index considered representative of stocks of Europe, Australasia and the Far East. The index is computed using the net return, which withholds applicable taxes for non-resident investors.

S&P 500 is an unmanaged index which is widely regarded as the standard for measuring large-cap U.S. stock market performance. The stock index does not incur expenses and is not available for investment. Basis Point (BPS) is commonly used for calculating changes in interest rates, equity indexes and the yield of a fixed-income security and is equal to 1/100th of 1%.

The consumer price index (CPI) is a measure that examines the weighted average of prices of a basket of consumer goods and services, such as transportation, food and medical care.

Yield is the income return on an investment and refers to the interest or dividends received from a security; is usually expressed annually as a percentage based on the investment's cost, its current market value or its face value.

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Index performance is not illustrative of fund performance. One cannot invest directly in an index. Please call 1.504.525.0808 for fund performance.

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