
DF Dent All Cap Growth Strategy

April 2017 Commentary

Most major U.S. stock market indices were positive in the first quarter of 2017, a good start to the year. It was the best 1Q in 4 years for U.S. stocks with the S&P 500 up 6.1%. Equities outperformed most other asset classes led by emerging markets +11.5% in USD and non-U.S. stocks +8.0% in USD. Gold +8.6% was the lone challenger to the equity dominance. Within U.S. stocks, large caps outperformed mid and small cap stocks in 1Q17, reversing the 4Q16 benefit small caps received from the potential policies of the new administration.

Portfolio Thoughts

The D.F. Dent All Cap Growth strategy returned 7.6% for the first quarter of 2017, underperforming the Russell 3000 Growth Index which returned 8.6%. In a reversal from 4Q16, high quality did well which was beneficial to DF Dent's All Cap strategy performance.

Performance for the first quarter was positively impacted by stock selection in the Health Care, Real Estate, Financial, and Technology sectors. Technology stocks, especially software, endured a difficult 2016, especially 4Q16 post election. Our conviction is high in our technology holdings, and we added to many of these names during the course of 2016 when they sold off. These portfolio moves paid off in this first quarter of 2017 as software was one of the largest sources of performance contribution. Performance was also helped in 1Q17 by being underweight the Consumer Staples sector. These positive areas were offset by stock selection in the Consumer Discretionary and Industrial sectors. The portfolio was also adversely impacted by being overweight the industrial sector.

1Q17

Ticker		Contribution To Return
	5 Highest	3.43
RHT	Red Hat, Inc.	0.87
V	Visa Inc. Class A	0.73
MCO	Moody's Corporation	0.62
ROP	Roper Technologies, Inc.	0.61
ISRG	Intuitive Surgical, Inc.	0.60
	5 Lowest	-1.37
SIG	Signet Jewelers Limited	-0.75
TDG	TransDigm Group Incorporated	-0.22
KMX	CarMax, Inc.	-0.16
DFS	Discover Financial Services	-0.12
WAB	Westinghouse Air Brake Technologies	-0.12

The top three contributors during 1Q were:

- **Red Hat, Inc (RHT)**, a leading open-source software company, reported strong earnings and recovered from the weakness of the previous quarter. We had increased the RHT position in the aftermath of last quarter's disappointing earnings report. The stock has outperformed since our addition because several large deals with the federal government have closed (after short delays) and larger deal sizes and longer deal lengths have started to show up in billings and bookings metrics. We think the market will continue to appreciate RHT's highly defensible business model and recognize that its valuation is still fairly reasonable given its long-term growth rate. RHT remains a high conviction name for the portfolio.
- **Visa Inc. (V)**, the world's largest electronic payment network, reported fourth quarter results that exceeded market expectations for both revenues and net earnings. Transaction and payment volume growth were greater than expected as Visa continues to lead the global transition from physical cash and check payments to digital payments. This trend is still early in its migration and one that has been given additional momentum from the pervasive growth of ecommerce. This secular tailwind, coupled with excellent management execution and a market-leading position in an effective global duopoly, make Visa an attractive long-term investment for the portfolio.
- **Moody's Corporation (MCO)**, a leading global provider of credit ratings, research and data analytics, recovered from underperformance in the fourth quarter of 2016. Early in 2017, the company reached a swift settlement with the Justice Department with regard to a civil complaint over specific ratings assignments during the financial crisis. Management continued to execute extremely well, and fourth quarter 2016 earnings and management's guidance for 2017 exceeded most expectations. In spite of recent increases in interest rates, bond issuance trends remain healthy both in the U.S. and abroad. We continue to believe that Moody's will deliver high single digit revenue growth which combined with margin expansion opportunities, tuck-in acquisitions and share repurchases should translate into solid mid-teens earnings' growth.

The top three detractors during 1Q were:

- **Signet Jewelers (SIG)**, the largest jewelry retailer in the U.S. and the U.K., experienced weak stock performance in the quarter due to three principal factors: first, retail stocks broadly underperformed on news that mall traffic in recent months has declined at an accelerating rate; second, Signet released disappointing holiday results, showing that even its market-leading "omni-channel" (i.e., in-store plus e-commerce) approach was not immune to declines in mall visits; and third, news came to light that a previously-disclosed wage discrimination lawsuit may have originally included multiple allegations of sexual harassment. While the company denies any sexual harassment occurred, and notes that no such charges against the company are part of any formal legal suit, the multiple allegations left us uncomfortable investing in this company on behalf of our clients, so we exited our position.
- **TransDigm Group Incorporated (TDG)** a leading supplier of aftermarket aircraft components, underperformed after a short report questioned the company's pricing practice and later a US Congressman requested that the Inspector General of the Department of Defense (DoD) look into TDG's pricing. This will likely remain an overhang on the stock until further context is explained. However, sales to DoD represents only 7% of TDG's total revenue, and the amount DoD spends with TDG and subsidiaries represents only 0.2% of DoD's annual procurement budget. That's why we do not believe the questions around TDG's pricing to DoD represent a major risk to the stock's long-term value.
- **CarMax, Inc. (KMX)**, the leading used car retailer in the U.S., gave back much of its outperformance from the previous quarter on increased fears of a weakening auto market. While CarMax did not report

results within the quarter (it reports fiscal year end results in April), its stock was down in sympathy with other industry players that noted that lower used car prices and weaker volumes were having a negative effect on profits. We expect KMX to be impacted by these pressures but believe its competitive advantages in sourcing, data analytics, scale and inventory turnover should enable it to profitably gain market share over the longer run. We remain confident in the management team and its steady growth plan and recently added to the name.

Market Thoughts

The U.S. equity bull market is entering its ninth year following the Great Recession, and economic data continues to appear favorable. Consensus estimates suggest that the economy's current 2% pace is on track to continue. With headwinds from the strong dollar and energy woes abating, overall earnings growth should accelerate nicely in 2017. In addition, the Trump Administration has promised huge fiscal stimulus, including a trillion dollars of infrastructure, large corporate and individual tax cuts, and no changes to entitlements. These measures, along with an expected streamlining of regulations, have been a boon to financial, energy, and infrastructure stocks, contributing to new record highs for equity indices.

These tailwinds, if realized, would likely be positive for equities. We believe, though, that ultimate outcomes could fall short of many investors' expectations. Scores of stocks have appreciated such that a successful implementation of Trump proposals seems to be priced in. Given the massive trade-offs the Trump team and Congress will have to work through, we expect investors to be disappointed by eventual policy outcomes. We see increasing potential for political (if not geopolitical) variables to spur volatility and a possible correction in equity markets in coming months.

How has D.F. Dent navigated this period? The "Trump Bump" has created opportunities to trim and eliminate some names where valuations reached levels implying a low forward return, particularly among industrial and U.S.-focused holdings. Our team also added to some names, particularly in technology and health care, where stocks traded off and expected returns increased. We remain invested in high-quality companies and stand ready to capitalize on any increased volatility with a goal of maximizing clients' returns in the years ahead.

We appreciate the confidence you have placed in D.F. Dent and Co. We will continue to work diligently on your behalf.

This commentary can be found on our website (www.dfdent.com). We encourage you to refer to our website for other information about our firm and our investment products, including our mutual funds, the DF Dent Premier Growth Fund (DFDPX), the DF Dent Midcap Growth Fund (DFDMX) and our new DF Dent Small Cap Growth Fund (DFDSX)