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# DF Dent Small Cap Growth Strategy

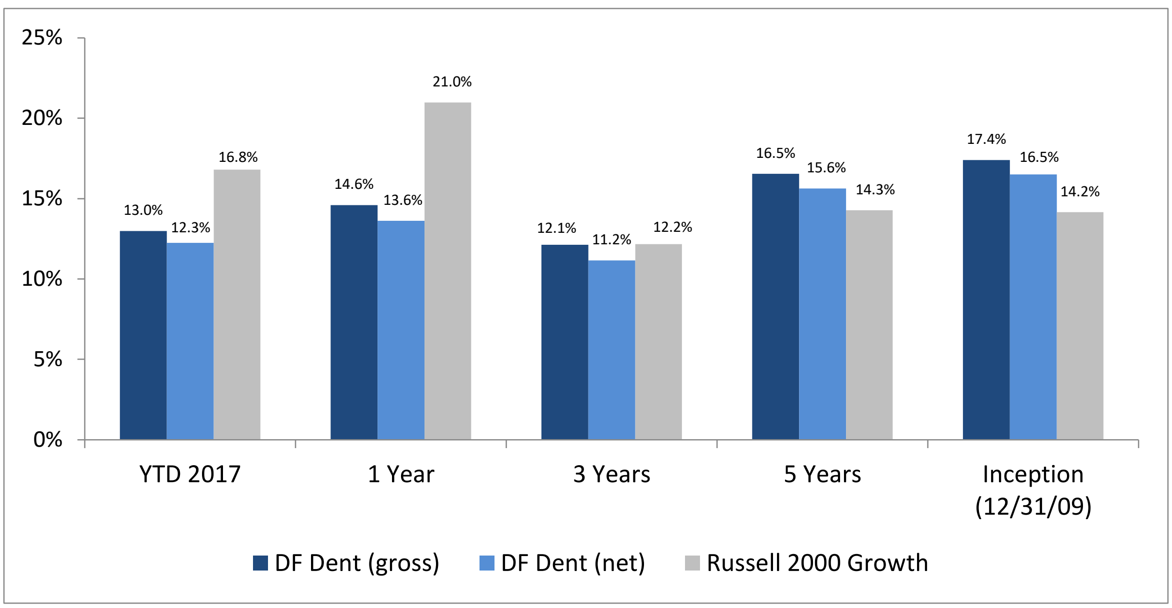
**October 2017 Commentary**

## Portfolio Thoughts

With the U.S. economy slowly gaining ground, solid corporate earnings producing few major scares, and oil prices on the rise after a weak first half of 2017, the major stock indexes all produced modest single-digit gains for the quarter, with both the S&P 500 and Russell 2000 trading at or near all-time highs. Although there was plenty of disturbing news, including devastation from hurricanes and incessant political turmoil in Washington, D.C., the markets mostly shrugged it off.

For the third quarter of 2017, D.F. Dent's Small Cap Growth strategy returned 4.61% vs. the Russell 2000 Growth Index total return of 6.22%. For the year-to-date through September 30, 2017, the total return from D.F. Dent's Small Cap Growth strategy is 12.99% vs. the Russell 2000 Growth Index total return of 16.81%.

**Small Cap Growth Strategy Performance** (as of 9/30/17)




Performance for the third quarter was negatively impacted by stock selection in the Technology, Health Care and Financial sectors. Technology stocks had been strong contributors for the portfolio for the first half of 2017, but took a breather in 3Q17. Technology stocks continue to be a positive contributor to performance for the year. Performance was positively impacted by stock selection in the Consumer Discretionary, Industrial and Telecom Services sectors. Consumer Discretionary stocks had been a drag on performance for the first half of 2017 and that reversed in 3Q17.

| 3Q17 | | Contribution To Return |
|---|---|---|
| | **Total** | **4.66** |
| | **5 Highest** | **3.42** |
| ENV | Envestnet, Inc. | 0.81 |
| LAD | Lithia Motors, Inc. Class A | 0.70 |
| HEI.A | HEICO Corporation Class A | 0.68 |
| AAC | AAC Holdings, Inc. | 0.65 |
| MNRO | Monro Inc. | 0.59 |
| | **5 Lowest** | **-2.40** |
| ELLI | Ellie Mae, Inc. | -0.96 |
| DXCM | DexCom, Inc. | -0.63 |
| PRO | PROS Holdings, Inc. | -0.37 |
| WAGE | WageWorks, Inc. | -0.23 |
| PRAA | PRA Group Inc | -0.22 |

The top three contributors during 3Q were:

- **Envestnet (ENV)**, a leading provider of software and investment products to financial advisory firms, reported strong 2Q results. ENV reported high levels of client asset inflows onto its platform. The company also hinted that it was once again evaluating "consolidating" acquisitions, which played out on September 25 with the acquisition of FolioDynamix. Given the stock's strong run and higher valuation, we trimmed the position shortly after quarter-end.

- **Lithia Motors (LAD)**, one of the largest automotive retailers in the country, outperformed the market in the third quarter after it reported healthy results for the second quarter and increased full year 2017 guidance amid a relatively weak market backdrop. In addition, the company raised $300M in debt and stated that its acquisition pipeline was very full. This should allow the company to have strong acquisition driven growth on top of its healthy organic growth. We expect this trend to continue in the next several quarters.

- **Heico Corporation (HEI.A)**, a leading manufacturer of aftermarket aircraft parts and electronic components for the defense and aerospace industries, performed well in the third quarter as it reported strong second quarter results, beating market consensus. Management also increased full year guidance implying that business momentum would accelerate in the second half of 2017 and into 2018. In addition, the company announced the largest acquisition in its history, a deal with strong strategic fit and very good earnings accretion. Furthermore to finish off a strong third quarter, the company announced a large contract win from the US government.

The top three detractors during 3Q were:

- **Ellie Mae (ELLI)**, a leading cloud based software provider which improves the efficiency, compliance and quality of the mortgage lending process, underperformed the market in the third quarter. The company reported a large revenue and earnings miss for the second quarter and lowered its full year guidance. The main reason behind this weakness was a large drop in mortgage refinancing volume as the Fed raised interest rates. The fact that Ellie Mae was also slow to implement some large customers also played a role. However, despite the cyclical decline in mortgage refinancing volume, the company continues to sign up large customers at rapid pace and it remains a best-in-class technology provider in the mortgage lending industry.

- **Dexcom Inc. (DXCM)**, a leader in continuous glucose monitoring (CGM) technologies, experienced a price drop near the end of the third quarter because Abbott's competing product received a surprisingly strong approval label from the FDA. Even though Dexcom still has the best technology in the market and will likely remain the market share leader, this FDA approval created a legitimate competitor that will likely slow down Dexcom's growth in the next 12 months. We continue to believe that in the long run, Dexcom will be the leader in a vast and rapidly growing market. In the next 12 months, however, the competitive dynamic in CGM technologies will become very complicated as Abbott's product enters the market with a strong FDA label. We will continue to monitor and analyze the various factors driving this market and will make our investment decisions accordingly.

- **PROS Holdings (PRO)**, a provider of pricing and revenue optimization software, gave back some gains after a strong second quarter. There were no clear headwinds other than speculation that Hurricane Harvey, which struck PRO's home base of Houston, may have caused a lull in sales activity. PRO reported solid second quarter results and announced the tuck-in acquisition of Vayant, a provider of shopping, pricing, and merchandising technology to the travel industry. We took advantage of the weakness to slightly increase positions.

## Market Thoughts

The strong year-to-date performance in the US equity markets has come as a surprise to some after nine years of excellent returns. The strength has been backed up by strong corporate earnings, 2Q17 GDP growth of 3.1%, low unemployment, potential tax reform, and a global economic environment that appears to be gaining steam. Interestingly, the recent earnings season was the strongest we have seen in a while as 90% of your DF Dent portfolio companies beat consensus earnings estimates. This compares favorably to the long-term average of 65%-75%. We expect the continued strength in corporate profits will provide fundamental support for U.S. stocks next year.

While the near-term picture still looks mostly positive, there may be some clouds on the horizon. The S&P 500 Index has not had a 5% correction in over 330 days, the third longest period in history. This party may not last forever so we are constantly on the lookout for signs it is ending. Markets are at or near all-time highs, valuations are stretched, the climate in Washington, D.C. is bitter, and volatility is at historic lows. While inflation has been held in check, if it moves above the Fed's target, we could see greater increase in the pace of rate hikes than the market is currently expecting. Any shock to the system could cause volatility to spike and upend stock prices. We will remain focused on economic fundamentals and the long-term growth prospects for your portfolio companies.

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On November 1, 2017, D.F. Dent will launch a new institutional share class mutual fund for our Midcap Growth and Small Cap Growth strategies and will be geared toward institutional buyers. Please contact our Client Service team at 410-837-2544 if you would like to learn more.

Finally, we'd like to welcome our newest employee, Brooke Hrimnak. Brooke recently joined the firm with fourteen years of experience in the investment industry. Prior to joining D.F. Dent and Company, she served as Head of Institutional Equity Sales at Wunderlich Securities, Inc. and Vice President of Corporate Services at Ferris, Baker Watts, Inc. Brooke will serve as a client relationship manager.

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.*