DF Dent All Cap Growth Strategy

July 2018 Commentary

Portfolio Thoughts

For the last 24 months, the equities in your portfolio have performed well, on an absolute and relative basis. We believe this strong recent performance is mainly attributable to our time-tested research process that enables us to find best-in-class companies that are managed by talented and ethical leaders that have dominant and durable business models, and that generate significant free cash over time that can be prudently allocated for the benefit of shareholders. Regardless of whether the market goes up or down from here, we will continue to stick to our research process (now in its 43rd year) and will continue to do the research blocking and tackling that we believe is necessary for good stock selection and portfolio management.

Since we do not feel that we have the wisdom or the expertise to time the market, we instead will try to manage risk in your portfolio. The most effective risk management tool we have is our due diligence process. In good times and bad, we visit your portfolio companies and other prospective holdings. We meet and talk with their management teams, their customers, and their competitors - trying to find chinks in their armor, emerging competitive threats, management team blind spots, signs of complacency or arrogance. At its heart, this due diligence helps us hone our projections for the long-term earnings growth at these companies, consistent with our core investment philosophy that long-term stock price appreciation is highly correlated to long-term earnings growth.

2018 has been a volatile year in the stock market, but we view volatility as opportunity. We attempt to take advantage of market volatility to add and trim positions. We will manage the position sizes so that the companies with the highest expected returns have higher weights in the portfolio. We also believe that your portfolio is well positioned for a challenging market environment, primarily because it is comprised of companies that we believe will have strong earnings growth over a long period of time and across market cycles.

The following companies were some of the largest contributors to the recent outperformance. We thought highlighting them would give you a sense of not only why we have invested in them on your behalf, but also why they have outperformed recently.

- **Visa Inc. (V)**, the world's largest electronic payment network, reported fiscal second quarter results that exceeded market expectations for both revenues and net earnings. Transaction and payment volume growth were strong, as V continues to lead the global transition from cash and check payments to digital payments. This trend is still early in its migration and has been accelerated by the pervasive growth of ecommerce. Management raised its fiscal year growth guidance to the low-double-digits for revenues and the high 20% range for EPS. The integration of Visa Europe is providing a nice tailwind and is tracking ahead of expectations. We believe this digital payment tailwind, coupled with excellent management execution and a market-leading position in a global duopoly, make V an attractive long-term investment.

- **Red Hat Inc. (RHT)**, a leading open-source software company, has continued to execute above expectations with organic revenue growth in the high teens. RHT's core Red Hat Enterprise Linux (RHEL) business has stayed relatively strong, while its emerging technologies (e.g., OpenShift and OpenStack) have experienced rapid growth. RHT's deal size has also increased steadily over the last few years as customers have been willing to make larger, longer-term commitments to open-source architectures. After a strong year and a half, RHT declined on its last earnings announcement. We think the selloff was a bit overdone, and we believe that RHT has the potential to remain a core holding for a long period of time.

- **Intuitive Surgical, Inc. (ISRG)**, a leading designer and manufacturer of robotic surgical systems, has reported very strong organic growth driven by strong procedure volume growth both inside the U.S. and outside the U.S. In addition, ISRG announced the launch of the da Vinci X system which has been well received by customers. This, combined with the upcoming launch of the da Vinci Sp system and the development of a "flexible robotics" system, set ISRG up for healthy growth over the next several years.

Market Thoughts

How much longer? This is a question that many parents hear when stuck in traffic with their kids in the back seat. It is also a question we are constantly asking ourselves these days in the tenth year of a bull market (with the fundamentals of your portfolio companies as strong as ever). How much higher and how much longer can the bull market go? Not a surprise, but we have no good answer and do not want to let our short- term guesses determine the long-term construction of your portfolio. We do realize that all good things come to an end, but at this time we do not see fundamentals as being the reason for a market decline.

From a technical perspective, market breadth - the number of stocks advancing relative to the number declining - is often a leading indicator of market performance, with declining market breadth signaling weak future performance. Market breadth continues to hit new highs, so it still appears that we are in a bull market. We also have not yet seen the typical early warning signs of a coming recession. However, the overall market environment has been in the process of changing. The market environment has gone from being the beneficiary of a strong expansionary monetary policy and some fiscal discipline to an environment of tightening monetary policy and expansionary fiscal policy (large tax cuts). We believe that monetary policy is a more important driver of stock market multiples (and returns) than fiscal policy. We also fear that the huge fiscal stimulus from tax cuts will boost growth temporarily but will leave the economy with a hangover at some point in the near future. Therefore, we think the current state of affairs probably means we have reached the end of the continued multiple expansion of price-to-earnings ratios that has driven the market higher in recent years. In order for the market to continue to work higher, it is corporate profit growth that will have to carry the day. In fact, we believe that corporate profits (the "e" in "p/e") will grow nicely for the remainder of 2018. Since the market typically discounts economic performance 6-9 months in the future, the key will be earnings growth in 2019 and 2020. Given how long the economic expansion has gone on, the market will be on guard for signs of a slowing or recessionary environment in the next two years. We are keeping a close eye on concerns about rising interest rates, unsustainable valuations, and tariff wars, among other data points.

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