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DF Dent All Cap Growth Strategy

January 2020 Commentary

U.S. equities posted strong returns during the fourth quarter of 2019. The S&P 500 gained 9.1% in the quarter, which helped bring the full year to a 31.5% gain. Growth outperformed value for the quarter and the year. Strong 4Q equity returns were due in part to an accommodative Fed and an announcement of a "phase one" trade deal between the U.S. and China. The trade deal will lower some U.S. tariffs on Chinese goods while boosting Chinese purchases of manufactured goods, agricultural goods and energy. The combination of improved sentiment and the fear of missing a year-end rally drove equity appreciation.

Portfolio Thoughts

	4Q19	2019
All Cap Growth (gross)	7.1%	43.9%
All Cap Growth (net)	6.9%	43.1%
Russell 3000 Growth Index	10.7%	35.9%

For the fourth quarter of 2019, D.F. Dent's All Cap Growth strategy underperformed the Russell 3000 Growth Index. Stock selection in the Healthcare sector was the largest detractor, largely from not owning biotech and healthcare insurance stocks. D.F. Dent has avoided investing in businesses in the biotechnology industry (too dependent on binary outcomes like FDA actions of unproven products) and the health care insurance industry (too exposed to government regulation), and those two industries performed well in the fourth quarter. Additionally, consistent with market trends, some of our highest quality companies gave up performance in the fourth quarter after strong performance in the prior two quarters. Those names include Verisk, Ecolab, Roper, Waste Connections, and Vulcan Materials. Slightly offsetting this was strong stock selection in the Real Estate and being underweight in the Consumer Discretionary and Consumer Staples sectors.

For the year, the All Cap Growth strategy outperformed the benchmark. Strong stock selection was broad-based across most sectors, but stood out in the Healthcare, Industrials, Technology, and Financial sectors. Growth strategies dominated the equity markets in 2019 at the expense of cyclicals and value investing. Companies with cutting edge engineering, software, and research were the standouts whether those skills were applied to health care, technology, or even consumer services. This appears to be a very pervasive trend as innovative companies with disruptive technological advances expand their own markets. To benefit from this trend, we seek to identify companies benefitting from a "virtual fly wheel effect" early in their lifecycles.

The All Cap Growth strategy added three new names during the quarter: Marriott International, Twilio, Inc. and Veeva Systems Inc. The strategy did not exit any names in the fourth quarter. The All Cap Growth strategy ended the quarter with 37 names.

Positions Added to the Portfolio:

- **Marriott International (MAR)**, is the leading manager and franchisor of hotels in the world. Marriott has a very strong management team and corporate culture and an asset-light model with enviable returns, margins, and cash flow. MAR is benefitting from secular tailwinds. Simply put, Marriott's growth is supplied by investors wanting to build more Marriott hotels because the hotels generate high returns on capital. The returns are a function of above average revenue, which is driven by Marriott's "Bonvoy" rewards program, distribution, and product quality combined with relatively low expenses. While we acknowledge that the industry is operating near cyclical peaks, we believe that the weakness in the stock price and multiple compression during the last two years is pricing in some degree of industry softness going forward.

- **Twilio (TWLO)**, is the leader in the Communications Platform as a Service (CPaaS) market. Its platform adds functionality within software that enables businesses to communicate with their consumers via text message, voice calls, and email. For example, if you hail an Uber or Lyft, the capability to text or call the driver within the application is powered by Twilio. We believe the CPaaS market is early in its growth trajectory. As more companies undertake digital transformation initiatives and develop new ways to communicate with customers more frequently, Twilio should benefit as its revenue is linked to usage. We believe Twilio can consistently grow its revenues by at least 20% annually for the foreseeable future.

- **Veeva (VEEV)**, is the leading software vendor to the life sciences industry. The company has built a vertically-focused, best-in-class SaaS business with the rare combination of strong growth and profitability. Veeva has two main business segments: Veeva Commercial Cloud and Veeva Vault. The two segments, respectively, help pharmaceutical and biotech companies market and develop their products while maintaining compliance with stringent regulatory requirements. Future growth is likely to come from a higher penetration of its Vault products; expansion into other regulated industries; and, to a lesser extent, continued market share gains in the legacy CRM business where Veeva has over 75% seat share currently. The company is well-positioned to grow its EPS at a 20%+ CAGR over the next several years.

Ticker	4Q19	Contribution To Return
	5 Largest Contributors	**2.67**
V	Visa Inc. Class A	0.60
ANSS	ANSYS, Inc.	0.55
TYL	Tyler Technologies, Inc.	0.54
CBRE	CBRE Group, Inc. Class A	0.50
SPGI	S&P Global, Inc.	0.48
	5 Largest Detractors	**-0.69**
VRSK	Verisk Analytics Inc	-0.22
VMC	Vulcan Materials Company	-0.17
ECL	Ecolab Inc.	-0.13
MKL	Markel Corporation	-0.13
WCN	Waste Connections, Inc.	-0.03

The top three contributors during 4Q19 were:

- **Visa, Inc. (V)**, the world's largest electronic payment network, reported fiscal fourth quarter results that were modestly above market expectations. Management also provided 2020 guidance for the first time which, while consistent with recent results, did not incorporate a deceleration that some feared would materialize. The steady, global transition from cash and check to digital forms of payment continues, aided by the growth of e-commerce. Opportunities are also materializing in new markets such as business-to-business and peer-to-peer payments and underpenetrated geographies such as India and parts of Europe. We believe these digital payment tailwinds, coupled with excellent management execution and a market-leading position in a global oligopoly, make Visa an attractive long-term investment.

- **ANSYS, Inc. (ANSS)**, a developer and marketer of simulation software and services to engineers and product designers, has continued to perform very well operationally. Deeper relationships with ANSS's largest enterprise customers resulted in larger deal sizes and impressive revenue growth and bookings numbers throughout the year, including in the last quarter. ANSS' recent outperformance has been due to three factors: revenue growth above expectations, margin expansion above expectations, and significant multiple expansion. We believe the first two factors might recur in 2020, but the third factor is very unlikely to recur. However, we remain confident in ANSS' long-term growth opportunities and believe that its EPS growth - driven by strong organic revenue growth, some margin expansion, acquisition activity, and stock repurchases - will support above-market stock price appreciation over the long term even without multiple expansion.

- **Tyler Technologies (TYL)**, a leading provider of software systems to state and local governments, reported organic revenue growth of 8.3%, its strongest figure in five quarters. In addition, TYL guided to (1) further organic revenue growth acceleration in 4Q 2019 and (2) year-over-year operating margin improvement in 2020 following two years of investment-driven margin contraction. These catalysts, among other factors, drove improved market sentiment and multiple expansion. We continue to view TYL as an extraordinary business model- with excellent management, a sticky customer base, and high recurring revenues- and an attractive long-term growth story. Given TYL's expanded valuation multiple, however, our future return expectations have diminished. We trimmed our position meaningfully toward the end of the quarter.

The top three detractors during 4Q19 were:

- **Verisk Analytics (VRSK),** a provider of contributory databases and other solutions to the insurance, energy, and banking industries, lagged during the quarter. We attribute the underperformance to (1) an unfavorable court injunction relating to a VRSK product that allegedly infringes another company's patent and (2) a general rotation out of stocks, such as VRSK, that are perceived as "high quality." We view the court ruling as unfortunate but relatively immaterial in the context of VRSK as a whole. We continue to have a positive outlook on VRSK and see it as one of the best businesses in the portfolio, with strong moats, a sticky customer base, and economic resilience.

- **Vulcan Materials (VMC)**, the leading provider of construction aggregates (i.e., rock and gravel) and auxiliary products in the United States, underperformed after reporting a slight 3Q earnings miss that disappointed investors who were expecting a beat given favorable weather. 3Q earnings were impacted by unexpected costs related to plant maintenance and repair, expenses to rent outside ships to temporarily replace a Vulcan ship in dry dock (VMC transports some rock from Mexico by boat), and higher-than-expected liquid asphalt costs in VMC's paving operations. We are not concerned by the 3Q and continue to view VMC as a top-notch business, with little-to-no obsolescence risk, huge barriers to entry, improving pricing power, and a great management team.

- **Ecolab (ECL**), a provider of chemistry-based hygiene, water, and energy-related technologies, underperformed in the quarter. We attribute the underperformance to (1) ECL's reducing the midpoint of 2019 guidance by $.05 due to FX headwinds and slower-then-expected energy business growth and (2) a general market rotation out of "high quality" stocks. We are encouraged that ECL will be selling its energy business in 2020 to energy services company Apergy and see the transaction as favorable for shareholders. We continue to see ECL as a strong business with a sticky customer base and economically resilient end markets. We view ECL as a core position.

Market Thoughts

At the beginning of each year, strategists attempt to forecast the market. Like weather forecasts, they are extremely variable, often wrong, and are not reliable. So we refrain from trying to predict where the stock market will close at year end. We do believe that we will see a very different environment in 2020 than we did in 2019. Last year, the market delivered modest earnings' growth but significant expansion of price to earnings multiples thanks to a more accommodative interest rate environment. We also experienced a steadily increasing stock market with very low volatility (there was not even one 10% correction). This year, we expect limited multiple expansion and much greater volatility.

Aside from the usual concerns about economic growth, corporate profits, trade, etc., we believe there are two other factors which will weigh heavily on investors' psyches. First, the political environment that will emerge at the end of the year will be one of two scenarios. A continued divided government will comfort a lot of investors as it will mean a low probability of major structural reforms. On the other hand, a unified progressive government will likely mean higher taxes (corporate, individual and capital gains) which might unnerve some investors. We have no strong opinion on what the outcome will be at this point. Second is the outlook for inflation. Inflation is below the Fed's target and has been surprisingly low given the 50 year low in the current unemployment rate. Many economists thought low unemployment would have led to sharply higher wages by now, but that has not been the case. Should this positive scenario continue, the Fed will likely remain accommodative. Add to that rising corporate profits, and the market could experience another nice move to the upside. On the other hand, if inflation starts to accelerate at a faster pace than the Fed expects, the Fed might reconsider its current accommodative policy. Fears of a change in policy would not be welcomed by the market (remember the fourth quarter of 2018).

Volatility can be the investor's friend since it can provide good opportunities to add to stocks under pressure and trim stocks benefitting without reason. We expect 2020 to offer plenty of opportunities. At D.F. Dent, we are focused on the businesses that make up the portfolio. We will remain vigilant for opportunities to take advantage of the market volatility.

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