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DF Dent Midcap 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
Midcap Growth (gross)	5.8%	41.3%
Midcap Growth (net)	5.7%	40.7%
Russell Midcap Growth Index	8.2%	35.5%

For the fourth quarter of 2019, D.F. Dent's Midcap Growth strategy underperformed the Russell Midcap Growth Index. Stock selection in the Industrials, Healthcare, Financials and Materials sectors detracted from performance. 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. The portfolio's overweight position in the Materials and Real Estate sectors were headwinds as well. This was slightly offset by strong stock selection in the Real Estate and Communication Services sector and an underweight position in the Consumer Discretionary sector.

For the year, the Midcap Growth strategy outperformed the benchmark. Strong stock selection was broad-based across most sectors, but stood out in the Technology, Industrials, Materials, and Real Estate 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 Midcap Growth strategy added three new names during the quarter: Old Dominion Freight Line, Twilio and Veeva. The strategy exited three names in the fourth quarter: Healthcare Services Group, SEI Investments and TransUnion. The Midcap Growth strategy ended the quarter with 31 names.

New Positions in the Portfolio:

- **Old Dominion Freight Line (ODFL)** is the leading Less-than-Truckload (LTL) carrier with respect to revenue growth, profitability, and management. The company's growth has been driven by its ability to deliver a superior service product at a fair price. Old Dominion's profitability has been driven by their operational expertise and superior service (allowing them to obtain better pricing than their competitors). We believe the company has room to continue growing via market share gains and should benefit from the slow but steady trend of LTL industry consolidation.

- **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.

Positions Exited in the Portfolio:

- **Healthcare Services Group (HCSG)** provides housekeeping, laundry and dietary services to long-term care facilities. HCSG shares continued to underperform in the quarter because the company continues to suffer from some customers experiencing financial difficulties, and HCSG had to walk away from some business. Our long-term view on the quality of HCSG's business significantly changed for the worse and our confidence in management's credibility also diminished.

- **SEI Investments Company (SEIC**) provides technology, manager-of-manager and fiduciary solutions, and related offerings to banks, investment advisors, investment managers, and others. We sold our position after seven years of ownership in order to fund other ideas from which we expect higher returns. During our holding period, we developed great respect for SEIC's management team. We similarly are drawn to SEIC's focus on serving clients and long-term approach toward its businesses. Despite these positives, we sold our SEIC position to fund additions to competing investment ideas that we believe offered more favorable long-term prospects.

- **TransUnion (TRU)** is a leading information services company with advantaged, legacy credit bureau assets. We conducted extensive due diligence on TRU over two years before buying the name in 2018. We met with upper management, spoke with customers, visited TRU's headquarters, met with a competitor, and engaged in product demonstrations. However, after attending TRU's first investor day earlier this year and meeting with additional business unit leaders, our conviction in TRU's risk-adjusted return potential was reduced. As a result, we exited the position in the fourth quarter when we found opportunities that better met our investment criteria and had acceptable return prospects.

Ticker	4Q19	Contribution To Return
	5 Largest Contributors	**3.05**
ANSS	ANSYS, Inc.	0.70
MCO	Moody's Corporation	0.62
CBRE	CBRE Group, Inc. Class A	0.62
TYL	Tyler Technologies, Inc.	0.60
TDG	TransDigm Group Incorporated	0.52
	5 Largest Detractors	**-1.03**
VRSK	Verisk Analytics Inc	-0.35
VMC	Vulcan Materials Company	-0.23
MKL	Markel Corporation	-0.19
ECL	Ecolab Inc.	-0.14
VEEV	Veeva Systems Inc Class A	-0.11

The top three contributors during 4Q19 were:

- **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.

- **Moody's Corporation (MCO)**, a leading provider of credit ratings and related research, data, and analytical tools, reported strong 3Q results driven by a strong issuance environment, a favorable customer mix of infrequent issuers, and to a lesser extent cost savings from the restructuring program. Management again raised FY19 revenue and EPS guidance to account for higher than expected YTD strength in the Moody's Investors Service (MIS) segment, a continued favorable issuance backdrop and an easier year-over-year comparison in the fourth quarter. The stock continued to react positively to positive earnings surprises throughout 2019.

- **CBRE Group (CBRE)**, the leading commercial real estate services firm, reported mixed headline results for 3Q due to the delay of real estate development gains, which resulted in the stock declining ~4% when CBRE reported earnings. We believe that the underlying trends in CBRE's business remain strong and the delay of real estate gains was noise. After the earnings report, the stock rallied throughout the rest of the quarter, which we would attribute to some combination of the easing of macroeconomic concerns and the market's eventual comfort with CBRE's 3Q results. While we acknowledge CBRE's cyclicality, we continue to like the management team, the company's industry leading position, opportunities for continued market share gains, and the natural mix toward the less cyclical Global Workplace Solutions segment.

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.

- **Markel Corp (MKL)** is a holding company with insurance and investment operations. MKL underperformed in the quarter despite reporting solid 3Q and year-to-date results. All three of MKL's "earnings engines"- insurance, Markel Ventures, and investments- performed well during both the 3Q and year-to-date periods. Given the stock's weakness and MKL's sound performance, we increased our positions late in the 4Q at what we believe were attractive valuations.

<u>Market Thoughts</u>

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.