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D.F. Dent All Cap Growth Strategy

July 2020 Commentary

While this year's first quarter was damaging to markets, the second quarter provided some welcome relief. The S&P 500 returned 20.5% in the second quarter in a momentous rebound amidst intense uncertainty. Growth outperformed value and small cap outperformed large cap. Where we stand today, it seems that the Federal Reserve and the U.S. Government (along with other central banks and governments) will do everything in their powers to support the economy. They are working to ensure that a recovery, however anemic, takes hold. The long-term consequences of these actions appear to not be of immediate concern since the objective is to get the economy on a firmer footing at all costs. As such, we may experience one of the shortest recessions on record, albeit one of the deepest. However, it may be some time before the economy recovers to its 2019 highs in GDP and corporate profits, and risks remain as COVID-19 cases are on the rise in some areas, certain virus-related economic benefits and stimulus are set to expire at the end of July, and the U.S. presidential election is on the horizon amidst a growing partisan divide.

Through June 30, 2020, your D.F. Dent equities have performed well. While the S&P 500 has had negative performance year-to-date, your equities are in positive territory. The portfolio was able to outperform during the pandemic correction in February and March, led by our Health Care and Technology holdings, and also participated in the market rally during May and June.

Market Thoughts

COVID-19 has introduced a lot of uncertainty into our lives and into the investment landscape. The dispersion of potential outcomes is wide. There is a downside case where COVID-19 will be a disruptive force for years. There is also an upside case where a vaccine will be found and people can get back to their daily routines. In our view, these two scenarios would result in starkly different outcomes for individual stocks and for the markets. We don't know enough to predict confidently which case is more likely, so we are taking a balanced approach. We want to have a portfolio of best-in-class companies run by talented and ethical people. Some of these companies are COVID-19 beneficiaries that stand to lose investor attention if we return to normalcy - certain software and healthcare stocks, for example. Other holdings are COVID-19 victims that stand to recover if we return to normalcy - real estate and travel-related stocks, for example.

We always strive to do well for clients. In our opinion, now is not the time to make aggressive moves in the portfolio. We do not think it would be prudent to make a one-sided gamble that, to use a speed-skating analogy, could earn the gold medal but could also result in tripping and falling down. We shy away from binary bets and prefer having multiple ways to outperform for our clients.

When COVID-19 appeared, the first thing we did was to evaluate how the pandemic would impact the companies in the portfolio. Specifically, for each company, we asked ourselves the following questions:

- Is anything permanently impaired?
- Are a company's sales lost or deferred?
- How does our thesis change when the business is stress-tested with a new set of assumptions?

- What happens when we stress test the balance sheet?

We focus on owning strong, high-quality companies that will attract investor capital and offer high returns to our clients. When markets retrenched, we sought to be opportunistic and to take advantage of irregularities and dislocations we saw, making some portfolio changes based on the criteria above. Our incremental actions have fallen into two buckets.

First, we have trimmed positions in companies that have held up well and where, in our estimation, future returns have diminished. Proceeds were redeployed into what we view as great companies where we believed the expected return going forward had increased.

Second, we bought positions in extraordinary companies with strong long-term appreciation potential where we wanted to establish initial positions, knowing that it would be difficult to time entry points perfectly. The market pullback offered what we saw as compelling initial entry points.

Our strategy has been to take incremental actions rather than to make huge bets one way or the other. Simply put, given the high degree of uncertainty, we do not feel like we are smart enough to make big bets and eventually unwind those bets at just the right time. We prefer to continue our time-tested approach of having a balanced portfolio of quality long-term holdings. We will continue to stay on top of the situation and adjust our positions accordingly.

We hope that you, your families, and friends are staying safe and healthy. We are available for a conference or video call if you would like to discuss your portfolios or have anything else on your mind. Please feel free to call or email us at any time. We know these are very trying times, and we are here to help and support you in any way we can.

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We are pleased to welcome Noelle Savage as the newest member of the D.F. Dent team. Noelle has 14 years of experience in the investment industry and is a CFA Charterholder. She will serve and guide our clients in her role as a client relationship manager. Noelle is already demonstrating her poise in overcoming the challenges of starting a new job in the middle of a pandemic, and we are excited to have her on our team.

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