THERE IS LUCK.

AND THERE IS SCIENCE.

Investing is a science.
It requires a plan and
discipline to follow the plan.
Anything short thereof is blind exploration.

Winter 2018—IT'S THE ECONOMY, STUPID

Dear Valued Clients and Friends,

MARKET PERSPECTIVE: The stock market closed out 2017 in very much the same way it began the year, with a very solid performance across the board. Lead by a handful of mega cap stocks, the NASDAQ Composite turned in a strong 29.64% performance followed by the Russell 2000 Growth Index, up 22.17%, and the S&P 500 up 21.83%. Not to be outdone, the Rocket Small Cap Growth composite was up 25.14%. Interestingly, as pundits continued to praise large caps throughout the year—particularly FANGs—and as a flood of new buyers rushed in to bid prices higher, small caps were quietly keeping pace. We believe there is still upside in small caps broadly, with the recycling of gains made in large cap names serving as a possible catalyst.

Much of the outstanding year for equities can be directly attributed to a meaningful improvement in most measures of the US economy, with GDP growth improving toward 3% after a prolonged period of stagnation. With the unemployment rate nearing record low levels at 4.1%, we saw 2.1 million new jobs created in 2017. This in turn led to a burst in consumer optimism and consumer spending which bodes well for further gains in economic growth for quarters and perhaps year to come.

While a stronger economy will certainly lead to higher interest rates over the short, intermediate and long term, if the Fed stays true to their recent course, interest rates will be raised gradually which is likely already priced into the markets. While inflation is always a concern, stabilizing energy prices appear to make a dramatic change in Fed policy unlikely over the near term.

Lastly, the improvement in the economy has trickled down to corporate America as fourth quarter revenue and earnings reports have been very solid and, more importantly, the outlook for both remains encouraging as well. All things considered, we believe the stage is set for the equity rally to continue, but will likely do so with an occasional correction along the way.

TECHNICAL PERSPECTIVE: If I had to describe the technical outlook for the stock market in one word it would be, "Tired". After the tremendous gains that major indexes have seen since early November 2016, the market, not unexpectedly, appears to be running out of gas. What is even more remarkable is that we have not had one, even modest, correction in that time frame.

Our recent technical analyses suggest that the odds heavily favor some type of a modest correction over the near term, while leaving the intermediate and long-term trends intact. Some points of evidence which support this theory are; (1), many individual stocks seem to be moving up sharply after releasing strong fundamental news, only to give those gains back in the ensuing sessions. (2), the indexes themselves have also had large number of higher openings, only to be followed by closes on the lower end of the trading range, and (3), a larger than normal number of charts which have significantly lost momentum while the indexes were making new highs.

On the sentiment side, the weekly Bulls vs. Bears survey as published by Investors Intelligence suggest widespread bullishness with a reading of 66% Bulls and 12.60% Bears. This leaves me wondering, who is left to convince? Our strategy has been to trim positions which have become overextended technically, and to sell or be prepared to sell positions which appear to be breaking down technically. As always, we will continue to search for new stocks to add to the portfolio but are in no hurry to buy.

SECTOR COMMENT: The majority of the leading sectors in the market are those in the information technology sector led by the strength in the Computer-Networking, Telecom-Fiber Optics, and the Computer-Data Storage segments. Semiconductors have also been strong, although recently it appears to have run into some profit taking which is understandable after the outsized gains they have provided.

In healthcare, the Biomed/Biotech and Medical-Systems Equipment manufacturers remain strong. Elsewhere, the other market leaders are those whose fortunes are directly related to the improving economy, such as select online and brick and mortar retailers. We are also beginning to see meaningful buying interest in the once broken-down energy industry led by the Oil & Gas Drillers and Exploration & Production companies. The financial service industry is also worth noting, namely the Finance-Mortgage & Related Services and Finance-Investment Bankers/Brokers.

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PORTFOLIO ADJUSTMENTS: Remaining cautious amidst the large run in equities, we opted to not add any positions during the quarter. We trimmed USA Technologies Inc, (USAT*8.10) and Zagg Inc, (ZAGG*15.90) as they were extremely overextended technically, and exited Teligent Inc, (TLGT *2.89) and Primo Water Corp. (PRMW*12.58) as they were breaking down technically, fundamentally, or both.

COMPANY HIGHLIGHT: Equity Bancshares (EQBK * 36.10), our most recent purchase, is a bank holding company headquartered in Wichita, Kansas. Its wholly owned subsidiary, Equity Bank, provides financial services primarily to businesses, business owners and individuals through 42 full service branches in Arkansas, Kansas, and Missouri. Equity Bancshares has been able to strongly grow both top and bottom line over the last couple of years by expanding its commercial banking franchise organically and by acquisition. It also strives to provide an enhanced banking experience by providing customers with a comprehensive suite of sophisticated banking products and services. Equity Bancshares also features great earnings per share rank, is in a great group and has an excellent chart pattern.

In summary, we are very pleased with our results for the fourth quarter and year end results and remain confident that our disciplined, pragmatic approach to investing will serve us well over the quarters and years to come. After analyzing and investing in the stock market over the last 30 plus years, I can tell one thing that always rings true—that when making money in the stock market seems too easy, it is likely to become more difficult. As always, we welcome your questions or comments and your consideration of Rocket Capital is always greatly appreciated.

Sincerely,

J.D. Hurd
President / Senior Portfolio Manager

Grant Larson
Operations Associate / Research Analyst

The use of the S&P 500 and the Russell 2000 Growth plus indexes is to compare the Rocket Capital Small Cap composite to a large capitalization stock index as a general market proxy and use The Russell 2000 Growth Plus as an index more comparable to the portfolio make up of the Rocket Capital Small Cap composite. All indexes and our composite are reflective of dividend reinvestment. Our composite does not represent all accounts of Rocket Capital Management, just those invested in that strategy. Past performance is not an indication of future returns. Individual investment returns may be different than the composite returns presented.

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