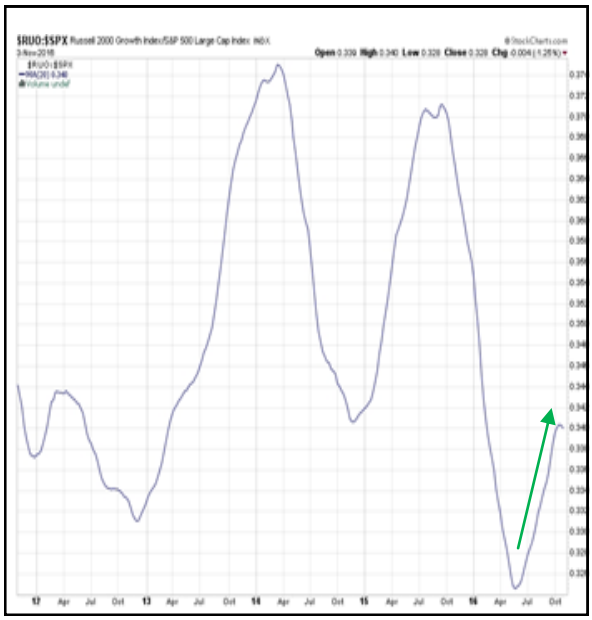
Third Quarter 2016: The Trend is Our Friend

MARKET COMMENT: After a very solid second quarter performance the stock market managed to add to those gains and in the case of some indexes, make marginal all time new highs. As anticipated, and depicted in the updated chart below, the Russell 2000 Growth Index lead the market in the 3rd quarter with gains of 9.02% , and 6.82% YTD. This compares very nicely to the 3.31% gain the S&P 500 posted for the quarter and 6.07% YTD. More importantly, The Rocket Capital Small Cap Composite again outperformed smartly, up 9.82%, and 14.48% respectively for the quarter, and year to date. The market was able to achieve these gains with little or no improvement of outside factors which have been providing headwinds. These include fear of a higher interest rate environment, strength in the US dollar, lackluster economic recovery, and of course the uncertainty created by the upcoming presidential election. I am not sure which the stock market fears more, 4 more years of the same government policies and regulations which ushered in the weakest economic recovery in memory as favored by Hillary Clinton, or the extremely high level of uncertainty created by the prospect of a Donald Trump Presidency. Having said that what really matters to stock investors is the growth of revenue and earnings per share as we are in the heart of the earnings season. Thus far with roughly one third of portfolio holdings having reported and the results have been outstanding. More importantly for the most part, guidance for revenues and earnings has also been robust, which suggests a solid upcoming fourth quarter. Lastly, the cash balance in the portfolio is a little higher than I would prefer but the good news is that I have a number of high quality names that could be added to the portfolio in short order should the near term trend turn positive.



*Russell 2000 to S&P 500 comparison *See summer newsletter.*

TECHNICAL PERSPECTIVE: The technical outlook for the market is currently less than desirable as the stock market appears to have stalled out after a solid uptrend throughout the third quarter. While this type of action is not totally unexpected after the outsized gains in the third quarter, the internal characteristics of the market leave a lot to be desired and suggest that a short term correction may lie ahead. First many of the stocks that have broken out recently have done so on impressive volume only to fail to follow through which suggests a distinct lack of momentum. Second many stocks and indexes are now at or below their 50 day moving averages which also suggests that we may be entering a corrective phase. A number of sentiment indicators are getting near levels that you would expect to see in conjunction with a market bottom, but that is not enough to justify new purchases. Keeping this in mind we will approach the market cautiously using rally's to trim existing positions which are overextended and to sell stocks which breakdown or fail to participate in a rally. That being said, we believe that a decline in the market will be a correction as part of an ongoing uptrend, not the beginning of a major move downward.

SECTOR COMMENT: Without question the best sectors to be overweight in over the last quarter, and the year, have been those in the Information Technology Hardware group. While most subsectors of this group have participated nicely in the uptrend the strongest sectors have been the Telecom-Fiber Optics, Semiconductor Manufacturing and Computer Data Storage. Computer Software is also back in favor after a period of consolidations. The Internet- Network Solutions group remains attractive and contains companies with both hardware and software solutions. The healthcare segment of the market continues to improve but it is too early to determine whether this is the beginning of a new long term trend up, or a rally after a sharp correction. The leading group here is the Biotech-Biomed group. In Finance the regional banks continue to gain ground on anticipation of higher interest rates later this year and beyond.

PORTFOLIO ADJUSTMENTS: Our portfolio activity in the third quarter consisted of 1 buy and 4 sales. Our one purchase was of Lending Tree (TREE). This purchases was made after screening for our technical and fundamental criteria. The positions we sold were Chuy's Holdings, Inc. (CHUY), Stratasys Ltd. (SSYS), HomeStreet Inc. (HMST), and we trimmed MeetMe Inc. (MEET). Aside from MEET, the other 3 sales were executed because they had poor charts, fundamentals, or both.

*Continued on next page.

Ellie Mae (ELLI *103.80) Ellie Mae is a leading provider of innovative on-demand software solutions and services for the residential mortgage industry. Ellie Mae's all in-one Encompass mortgage management solution provides on system of record that allows banks, credit unions and mortgage lenders to originate and fund mortgages while improving loan quality and efficiency. In addition, Ellie Mae's software solutions are delivered to customers on as software as a service, SaaS which enables their customers to pay for their software services only as they use them. This combination of best in class, proprietary technology and a great business model has enable Ellie Mae to growth top and bottom line growth at very impressive rates over the last several years is projected to do so going forward. As importantly Ellie Mae has IBD rankings of 97 and 92 for EPS growth and relative strength, not to mention a terrific chart.

After an extremely challenging start to 2016 it is very gratifying to have achieved a meaningful improvement in performance over the last two quarters and the stage appears to be set for a solid finish to the year. The continued confidence that our investors have shown through this difficult environment is greatly appreciated. As always, feel free to contact us at anytime should you have any questions, comments or concerns.

Most Sincerely,

JD Hurd

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