SANDHILL
INVESTMENT MANAGEMENT

July 12, 2022

To our stakeholders-

This was a comment from my January 2022 newsletter:

“What inflation and interest rates do will be the main event for the stock market”.

This came true as inflation took off, interest rates increased sharply, and the stock market started to sell off.

This was a comment from my April 2022 newsletter:

“Rapidly rising interest rates, runaway inflation, a Federal Reserve asleep at the wheel (and finally waking up), supply chains strained in every corner of the globe, and the Ukraine War is not a constructive back drop for equities.”.

This comment was correct as well as the equity market experienced a sharp sell off in the second quarter.

Here is my comment for this newsletter:

The outlook for equities continues to deteriorate. Most importantly, the demand function of our domestic economy is falling coupled with a slow down in corporate spending, slowing consumer demand, a cooling off of an overheated real estate market, and excess inventories in many industries due to “overbuying” during the pandemic. Implied in this is a loss of confidence for equity investors and the deflating of pandemic era bubbles (stocks, crypto, real estate, bonds). It will be a long, hot summer for investors and the second quarter earnings season that begins this week will bring some wild swings in stock prices.

A land of opportunity

This is exactly the kind of stock market I like. Skittish. Occasionally disorderly. Overreaction to corporate news. Human behavior getting in the way of properly pricing stocks. Stocks were at irrational levels in 2021 and now may overreact on the downside given the deterioration of the economic backdrop.

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Perspective

Investors are greedy. Everyone is wondering why I am getting killed – losing so much money? Investors have forgotten that markets move in cycles and go down as well as up. The mitigating point is that the equity markets go up more than down and produce terrific wealth building returns.

In the last bull cycle, the S&P 500 Index bottomed on March 9, 2009 at $676.53. The S&P 500 Index peaked on January 3, 2022 at $4796.56. **Over the bull cycle, the market's total return was 817.8%**. Remarkable.

From the market peak on January 3, 2022 to June 30, 2022, the S&P 500 Total Return Index has declined 20.5%.

This should tell you one thing and one thing only – stay invested in stocks.

For the record, through the bull cycle, the stock component of Sandhill's CEA composite was up 1084.6% net of fees – handily beating the S&P 500 Total Return Index. The total return of the CEA composite INCLUDING CASH was 775.9% net of fees (this includes the cash held by clients in their CEA accounts in the total return).

Investors are driven by greed in bull markets (bubble in 2000 and 2021) and fear in bear markets (now). Looking at history, investors should not let their emotions guide their investment decisions.

Final point. The bear market has further to go.

The labor market

Don't be fooled by the pundits talking about a strong labor market. A common thread is, "We have nothing to worry about because the unemployment rate is only 3.6% (full employment) and we won't have a recession.".

Part of the reason we have a low unemployment rate is the aging of America (unfavorable demographics) and the unwillingness of certain constituencies in our population wanting to work.

At this point, the slow down in the demand function in our economy will temper or reduce corporate profits going forward. This will weigh on the stock market.

Normalization

As interest rates have normalized from unsustainably low levels, the stock market is doing the same thing. The stock market is trading at 15.5 times 2023 estimated earnings. The average for the last one hundred years is 15 times earnings.

The stock market is now fairly valued. As mentioned, I expect it to overshoot on the downside which will create the opportunity to get set up for the next bull cycle.

The game plan

The third quarter earnings season is going to bring both upside and downside volatility in stocks. We have a number of stocks that we would like to own where we have already done the homework. We will be very disciplined in what we will pay for these stocks. We want to purchase our targeted stocks on our own terms.

We are fully invested in bonds. Last week, for the first time in years, we got 5.00% yield to maturity for a five year corporate bond. Pretty attractive. As the Fed continues to raise rates and the demand function of our economy softens, these bonds will end up being great buys.

Performance

For the first six months of the year (1/1/22-6/30/22), our CEA composite returned -23.1% net of fees vs. -21.1% for the Russell 3000 Total Return Index. Since February 1st, the CEA composite has outperformed the Russell 3000 Total Return Index by 2.9%.

For the first six months of the year, our Large Cap Yield composite returned -13.0% net of fees vs. -15.3% for the Dow Jones Industrial Average.

For the first six months of the year, our Corporate Bond composite returned -8.7% net of fees vs. -7.8% for the Bank of America 3-5 Year Corporate Bond Index. Sandhill's Corporate Bond composite has a duration (effective maturity) of 3.9 years. This is great as our bond positions will recycle to higher yield to maturities relatively quickly.

For the first six months of the year, the Industrial REIT we distribute returned +5.1% net of fees. One hundred percent of tenants were current on rent.

Assets under management

Customer assets under management and advisement on 6/30/22 were $1.92 billion. Assets under management declined $341 million in the first six months of 2022 on lower asset values and a small number of net account losses.

I believe Sandhill portfolios are well positioned. Being patient is hard during a bear market. It can be a long and grinding process. A bear market flushes all the excess out of the system and sets the stage for the next cycle.

It will be a long and bumpy summer, but played well, it will provide the opportunity for meaningful forward return.

With regards,

Edwin M. "Tim" Johnston III
Founder, Co-Managing Partner

Annualized Performance Summary (Net of Fees)

As of 06/30/2022	CEA (Master)	Russell 3000 TR	Corp. Bond	B of A ML 3-5 Year	Large Cap Yield	DJIA
1 Year	-23.9%	-13.9%	-8.4%	-8.5%	-3.3%	-10.8%
5 Year	7.5%	10.6%	1.0%	1.7%	7.5%	7.6%
10 Year	11.83%	12.6%	2.6%	2.5%	8.8%	9.1%