

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.

## 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 1<sup>st</sup>, 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%

This report has been prepared for informational purposes only and is neither a solicitation to buy or sell securities. Third-party information in this report has been obtained from sources believed to be accurate; however, Sandhill makes no guarantee as to the accuracy or completeness of the information. Sandhill Investment Management ("Sandhill") is a registered investment adviser with the Securities and Exchange Commission that is not affiliated with any parent company. Individual results may vary. Investments may not be suitable for all investors. Performance may be materially affected by market and economic conditions. Investment strategies have the potential for profit or loss. The U.S. dollar is the currency used to express performance. Performance presented net-of-fees is reduced by investment management fees, trading expenses, and administrative fees. Interest, dividends and capital gains in these Composites are not immediately reinvested. The Concentrated Equity Alpha Composite includes all discretionary non-wrap fee paying accounts in the all-cap core strategy which may hold large, mid, and small capitalization U.S. common stocks, American Depositary Receipts (A.D.R.'s), domestic ETF's, sector ETF's, and cash. The Russell 3000 TR Index is a market cap-weighted index of 3000 of the largest US common stocks which represents 98% of the US equity market. The Large Cap Yield Composite consists of all discretionary non-wrap fee accounts invested in U.S. common stocks, American Depositary Receipts (A.D.R.'s), domestic ETF's, sector ETF's, and cash in solely large capitalization companies. The Dow Jones Industrial Average (DJIA) is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange (NYSE) and the NASDAQ. The Corporate Bond Composite consists of all discretionary non-wrap fee paying accounts invested solely in individual Corporate Bonds and cash equivalents. The Corporate Bonds will generally be rated single B to single A and will have maturities of three to nine years. The Bank of America Merrill Lynch 3-5 year Corporate Bond Index is a subset of the Bank of America Merrill Lynch US Corporate Master Index tracking the performance of US dollar denominated corporate debt publicly issued in the US domestic market. Referenced benchmarks are not available for direct investment. For a full performance presentation and/or the Firm's list of composite descriptions, please call 716-852-0279. Private REIT Disclosure: Accredited investors only: Non-Traded Private REIT is only offered and sold to individual investors and certain entities which are "accredited investors" under the Securities Act and the rules of the SEC, and who provide us with information we require to verify their status as accredited investors. Individuals are accredited investors only if they meet certain minimum net worth or sustained annual income thresholds. Entities are accredited investors only if they hold sufficient assets or are completely owned by accredited investors. Limited Liquidity: Investors may need to hold their shares for an indefinite period of time. Royal Oak's share redemption program is limited in amount, may be terminated or suspended from time to time, and is only available after shares have been held for a required period of time, except upon death. In addition, Royal Oak's ability to redeem its shares may be limited. Determined Share Value set by Royal Oak's Independent Directors Committee: The Determined Share Value (DSV) is the price at which Royal Oak sells its common stock and is set by the members of the Independent Directors Committee of Royal Oak's Board of Directors. In setting the determined share value, the Independent Directors Committee considers, among other factors, annual valuations by an independent valuation firm, real estate appraisals and the purchase prices of recently acquired properties and tenant compliance with leases. There may be variations from time to time in how Royal Oak's independent directors apply or weigh the criteria in setting the "determined share value" or stock price. Royal Oak is not required by law to follow any particular methodology in setting the stock price. Distributions with respect to Royal Oak's common stock are only made if and when declared by the Board of Directors, and are subject to state law limitations on sources of funds and Royal Oak's ability to pay distributions and certain contractual commitments, including financial covenants. Royal Oak's past practice of distributions does not guaranty the timing or amount of future distributions. Royal Oak's dividend is comprised of ordinary income (taxable) and return of capital (tax deferred).