

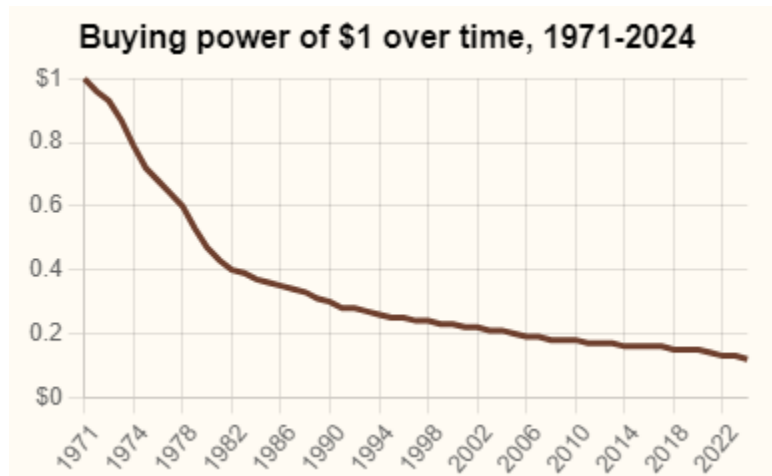


Market Commentary – “Real” Returns

July 2024 Update

You know it's summer in downtown Buffalo when you smell the smoky flavor of grilled Sahlen's filling the streets at lunchtime. \$7.00 cash gets you two dogs and a chilled can of Coke. Seems like a fair deal. I can remember when that same combo cost \$3.50, about 16 years ago. Seemed fair back then, too. Stick around long enough and we all develop feelings of nostalgia around prices of yore.

Since 1971, when the U.S. dropped the gold standard for fiat currency, the purchasing power of a dollar has dropped by approximately 90%. You'd need about \$8 for every \$1 you pocketed in 1971 to keep your budget square in 2024. In my lifetime, the current purchasing power of \$1 will eventually drift to nearly zero.



*Calculated from CPI data compiled at fred.stlouisfed.org

Money itself is a future claim on someone else's labor, effort, or knowledge. It is the storage vessel for one's time spent creating value. In its raw form—cash—money's value is continuously destroyed by rising prices. At 2.5% inflation, purchasing power erodes by 25% within a decade.

That means your accumulation of claims dissolves away, rapidly, if not invested appropriately. There are some popular asset classes like bonds, commodities, and precious metals that tend to keep up with inflation. Over time, none of them have had the same significance in building wealth that U.S. stocks have had.

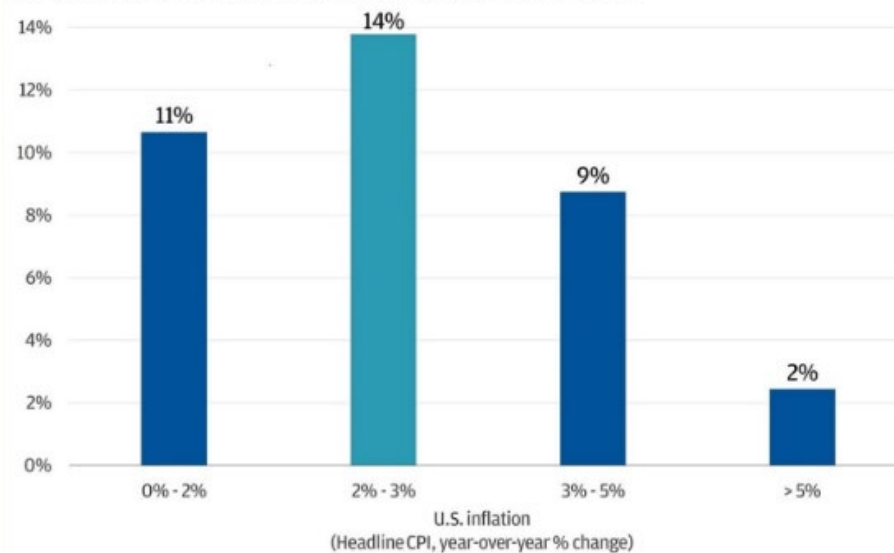
To generate real wealth, you must compound your investment returns beyond the rate of inflation. The most substantial asset class in the world for doing this has been U.S. equities (or perhaps an inflation-proof hot dog business).

U.S. businesses are subject to the same rising expenses as the rest of civilization, but exceptional ones use their capital to grow revenue and expand margins over time. Coca-Cola is a great example. When inflation hits, Coke can pass the higher cost to consumers without hurting demand. If that \$2.00 thirst quencher now commands \$2.10, you'll find the dime, I promise. So will billions of other people. Shareholders, rejoice!

Other high-quality companies are just beginning their growth journey. For example, Intuitive Surgical (ISRG), maker of the DaVinci surgical robot, or TransMedics (TMDX), a company that provides life-saving transplant products to humanity. They both have pricing power, along with total addressable markets that are ripe for expansion. This dynamic of pricing power—coupled with market expansion of one's products—is the secret sauce of wealth creation. It is the most repeatable way to leave the inflation monster in your dust. We love searching for these gems and will gladly buy them when they appear.

Stocks are in a “sweet spot” with moderate inflation

S&P 500 one-year returns in U.S. inflation regimes, % (1950 -2023)



Sources: Bureau of Labor Statistics, J.P. Morgan, Bloomberg Finance L.P. Data as of December 31, 2023.

June Recap

Equity markets rallied once again, with the S&P adding ~4.5% since the beginning of the month. While the pace of market gains can feel unnerving to some, it's important to note that the S&P index performance is unusually concentrated in just a few mega stocks. NVDA alone accounts for nearly 1/3 of the S&P 500's YTD performance.

Sandhill's portfolios do not mimic the index, nor do they have the same type of concentration. While we still currently carry a fair amount of cash, we have initiated two new positions this month—one in a utility component manufacturer, and another in a biotech company specializing in applications of genomic research. Both are in-line with our thematic views on their respective industries and represent leadership in their product offerings.

Bond markets are chopping around the same range, with ten-year treasuries yielding ~4.30%. We continue to buy corporate bonds in the 5.0-5.25% range. For those looking to smooth portfolio returns while generating stable income in retirement, the window for locking in positive longer-term real yields in the bond market is now.

What's Ahead?

Annual inflation fell to 3.3% in May. We'll get June's number later in July. U.S. Core PCE (another measure of inflation) fell to 2.6%. Any rate cuts at this point would buoy both stock and bond markets. Portfolios should be positioned accordingly. The timing of a rate cut remains elusive, but is quite possibly just over the horizon.

Takeaway

U.S. equities are your best chance of creating long-term wealth that improves your purchasing power over time. Prudent portfolio management and asset selection can help achieve this objective. If you feel our services could help you along your investing journey, please don't hesitate to contact me directly.

Happy Summer. Enjoy those hot dogs!

Sincerely,

John Canty

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