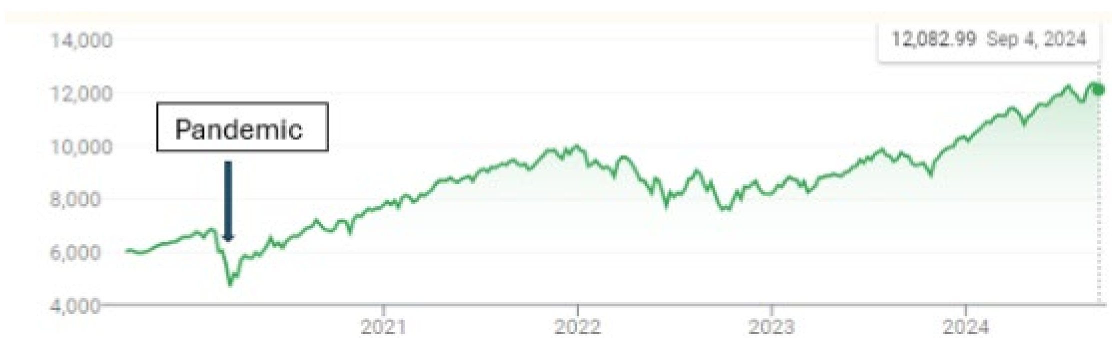
Market Commentary – Bulls & Bears

September 2024 Update

Bull Markets

Tailwinds continued through summer and August to produce positive returns in both the stock and bond markets broadly. Hindsight being clear, investors who have stuck along for the ride were well rewarded. The S&P 500 would have to give up over 44% from current levels to be at a break-even with pre-Covid highs. Simply put, patience is handsomely rewarded in this game.

S&P 500 Total Return Index



Source: Google Finance

After a somewhat choppy ride, August notched another gain for the S&P. VIX (a measure of volatility) spiked early in the month before inflation data came out softer and Fed Chairman Jay Powell indicated a more dovish footing, sending markets higher. Rate cuts are widely expected and will depend on continuing weakness in Jobs and CPI data coming later this month. As we begin September, rate-sensitive sectors are benefiting while large tech growth names are taking a back seat after a period of very strong performance. VIX is once again rising, and the volatility may create opportunities to deploy some more of the cash we have been holding this year. We'll be patient and swing only at the fat pitches.

Bear Markets

What happens if markets exhale? Occasional pullbacks are healthy, but once in a while, we get a legitimate bear market. They tend to be short-lived and are the ultimate buying opportunity for those entering the market. Bull markets, on the other hand, are very long-lived events, so much so that waiting for a short bear market in which to invest can yield terrible long-term investment returns. Prudent portfolio management and asset allocation allow us to take advantage of these events. Once again, patience is handsomely rewarded.

How Active Management Can Help

I have mentioned in the past that Sandhill portfolios **do not look like an index**. As active managers, it is our duty to create a portfolio of securities that we have deep understanding of. Our goal is to select strong growth candidates that will outpace the broader market over long periods of time. Unlike most investment managers, we are not "closet indexers." Our active share remains very high and market volatility opens up an opportunity for us to find mispriced securities—the so-called "baby thrown away with the bathwater." While market swings can produce some heartburn for investors, it's what gives Sandhill the chance to shine.

Dispersion

The blue line below represents periods where active managers, on average, have outperformed indexes. The grey line shows when the index has outperformed (passive). The trends are cyclical and correlate to a phenomenon called "dispersion." You can think of dispersion like this:

Imagine you live on a street where the average home value is $500,000. There are 10 homes in total that range in price from $100,000 to $2mm. Some homes appreciate faster in price than others based on their appeal to buyers. Thus, there is a large dispersion between the price change of each house over time.

Now imagine you live on a street with 10 houses, but each was built exactly like the others and is worth $500,000 (the average). The houses are identical and will appreciate much the same over time. That neighborhood has low (or no) dispersion.

In the first neighborhood example, a talented real estate investor has a chance to outperform other homeowners by selecting the right property. That wouldn't be possible in the second neighborhood.

As of 12/31/2023. Data sources: Morningstar and Hartford Funda, 2/24

In markets with high dispersion, active managers can find value and outperform indexes. When dispersion is low (and correlation of stock returns is high), active managers have a tougher go at generating alpha, or outperformance.

All this said, when markets fall apart, dispersion tends to increase and active managers tend to find their way out better than the index. In fact, of the 28 market corrections over the past 34 years, active managers have outperformed passive 21 times—or 75% of the time!

Dispersion has been relatively low for much of the past decade. If this trend reverses, capturing alpha to the upside should be in the cards. At Sandhill, we accomplish that with a concentrated portfolio of our best ideas.

Thanks for reading. Enjoy the remaining weeks of summer!

Sincerely,

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is a market capitalization-weighted index of 500 of the largest U.S. publicly traded companies. Sandhill's concentrated equity portfolios are actively managed, and the composition of the portfolio may differ significantly from the index. The ability of active management to outperform a passive index varies depending on market conditions and other factors. Dispersion in market returns can provide opportunities for active managers to add value, but there is no guarantee that an active strategy will outperform the market or a passive investment approach. Past performance is not a guarantee of future results. Investing involves risk, including the potential for loss of principal. For a complete list of firm composites or further details about our investment strategies, please contact Sandhill Investment Management at 716-852-0279.