Putting Theory into Practice

February 26, 2026

The investment industry has always had a talent for turning questionable ideas into compelling stories. A good narrative, wrapped in smart branding and a bit of emotional appeal, can make almost anything sound timely and necessary. In that environment, it's easy for decisions to drift away from discipline. Greed and envy push investors toward whatever has already run. Fear keeps others on the sidelines until the opportunity has passed. Both paths tend to lead to the same disappointing place.

The antidote is process. A clear strategy, grounded in fundamental research and valuation, creates structure when markets become emotional. It allows us to evaluate businesses based on what they are worth rather than how they are being marketed. By staying anchored to that discipline, our clients participate in an approach that has endured through multiple market cycles and does not rely on chasing trends to generate results.

Truly Active Management

One of Sandhill's active equity strategy core tenets is that excess returns do not come from diversification for its own sake, but from being right in meaningful size. Sandhill focuses on businesses with durable economics, strong cash generation, and defensible competitive positions. Sandhill was built on owning durable businesses for the long haul, often in large, concentrated positions. The goal has never been to resemble an index.

We operate within a public equity framework. As a result, Sandhill's portfolio will tend to be fully invested, more sensitive to equity market cycles, and more visibly volatile relative to the index in shorter periods.

These are all features shared by the most successful active managers in history, including Peter Lynch, Nick Sleep, Steve Cohen, Bill Ackman, and Warren Buffett. Returns for each of these managers were non-linear and significantly departed from index returns over short periods, while producing fantastic returns in the long run.

Indexing is fine, but if you are engaging in an active strategy, concentration just makes sense. Almost anything else essentially replicates the index, but at a higher cost.

AI, Market Rotation, and the Opportunity in Software

From time to time, markets get spooked. Not because something is broken, but because something is new.

Artificial intelligence is arriving in the real economy faster than most people expected. When that happens, investors tend to simplify the story, which goes something like this… "AI will disrupt software. Therefore, software is risky. Therefore, sell."

Since the start of the year, the broad software index has fallen more than 20%. That decline has far more to do with changing sentiment than with collapsing business results.

Markets have always discounted what they don't understand. When investors can't calculate the impact of change, they lower the price of anything that might be affected. Software has become the target of that discomfort.

The concern being talked about most is "disintermediation." The idea is that AI will bypass traditional applications and wipe out the high-margin, recurring revenue streams software companies have built over decades. But it's important to distinguish between software that is convenient and software that is essential.

A great deal of enterprise software is not a casual purchase. It sits at the center of payroll systems, supply chains, billing platforms, compliance processes, and customer records. It connects dozens of other systems. Replacing that is not like changing an app on your phone. It is expensive, disruptive, and risky to an enterprise. Most managers are not eager to tear out systems that are working simply because something newer exists. *In many cases, AI is more likely to enhance these platforms than replace them.* The companies that already control the workflow and the data are in a strong position. These are the companies that we continue to hold and seek out new investments in, with attention to proper diversification across industries.

When fear is broad and undifferentiated, it often creates opportunity. Today, we are seeing high-quality software businesses with recurring revenue, strong cash generation, and mission-critical tech solutions trading at substantial discounts to where they stood just months ago.

Their customers are still paying, products are still embedded and their balance sheets are still sound. We are not dismissing AI. It will reshape industries and create new winners while pressuring weaker players. But it is unlikely to make deeply integrated, high-switching-cost software disappear overnight.

If anything, the firms that are woven tightly into their customers' operations have a head start in incorporating these tools.

Periods like this tend to reward patience.

Sincerely,

John Canty