SANDHILL INVESTMENT MANAGEMENT

March 25, 2020

To our clients-

Quality wins. Every time.

We have had an extreme shock to our nation's economy. The crisis should peak over the next month or two. We are in a bear market. The repercussions will be felt for the next two years.

I have not seen this good an investment climate since the 2008-2009 financial crisis.

We are resetting our view of the world quickly. We are in a severe recession. It's not coming – we are in it. We have gone from the lowest unemployment rate in fifty years two months ago to a staggering reduction in the U.S. workforce in a matter of weeks. Unemployment claims will be in the millions when the data is released next week.

The stock market will not go straight back up. It will heal over time. Corporate bonds retreated over 10% in three weeks. Never seen it. Total buyer's market in the corporate bond market – really attractive. Mutual funds are receiving large redemptions and the funds are dumping the bonds to meet cash calls.

The road to recovery will be fourfold. First, it will be medical. Second, the bond market will settle down and spreads will tighten. Third, America will get back to work. Fourth, corporate America and the stock market will recover – even prosper. For investors, the purchase of attractive assets and patience will win the day.

What we have been doing:

Whenever there is a shock this dramatic, everything gets hit hard. The good stuff will recover. Those who owned bad or marginal assets will suffer permanent capital loss. This is what we want to avoid.

In a shock this swift and severe, you need to measure default risk quickly through your equity and fixed income portfolios.

Equities: Swapped American Airlines for Delta. Delta has a better balance sheet and much higher operating margins.

Spoke with the CFO of U.S. Foods – a $27 billion dollar food distributor. Half of U.S. Foods customers are restaurants. We discussed default risk. We are comfortable there is very little default risk even though the company is under extreme pressure.

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Sold Aptar and bought Diageo. This swap is only partly done as Diageo has run up too quickly in price. Diageo a great opportunity. One of the world's premier spirits companies. Brands include Ketel-One, Smirnoff, Johnnie Walker, Crown Royal, Casamigos, and Guinness. Global distribution. Strong balance sheet. Attractive dividend. Stock has gotten hit hard because of the impact to travel and leisure. Great opportunity.

Bonds: I have been talking about what a lousy deal the bond market is for some time (covered in recent newsletters). We tightened credit at Sandhill last year. We stayed short on the curve. Glad we did. I have been buying high quality bonds aggressively over the last two weeks. Buying longer maturity bonds. Credits we have bought are Wells Fargo, Expedia, J.P. Morgan, Martin Marietta Materials, American Express, Booking Holdings, and Keurig Dr. Pepper.

Total portfolios: We have moved to fully invested. Every nickel on the table. The road to recovery will be slow. But this too will pass. The whole point is that we own sound companies that will stand up to the massive dislocations through our economy. I feel strongly about this – **true risk is found in asset quality** – not volatility.

The three risks that I am watching:

- Our deficit. $6 trillion in spending by the Federal Government and the Treasury is a gaping hole in our federal budget for years to come. Want to make sure the world does not lose faith in our Treasury market.
- COVID-19 goes away and then comes back.
- The bond market comes unglued. When stocks teeter, I don't get overly concerned. When the bond market teeters, I know we have serious problems. Liquidity, debt, and access to funding drive our economy. If liquidity dries up for a prolonged period, we could have a Depression. I do not think this will happen – but I would be foolish not to admit the possibility.

All in, here is where I stand. I am a buyer of stocks and bonds. You normally get one really good shot a decade. This is it. I don't know where the bottom is – but my guess is we have already made it or somewhere between 15,000 and 18,000 on the Dow. Sandhill tends to match the market on the way down and outperform on the way up.

The investment team has been in the office every day through this swift downturn. We are responsible for preserving your capital and making sure that everyone comes out of this bear market well positioned and in a good place. Quality and patience will win.

Thank you for placing your trust in our firm.

With regards,

Edwin M. Johnston III
Founder, Managing Partner