October 12, 2020

To our stakeholders-

Sandhill had a solid but not spectacular first nine months of the year. Our main mission was to get everyone through the initial shock and implications of the onset of COVID–19.

In doing so, we quickly repositioned our equity portfolios for the COVID and post COVID era. In addition, and equally important, we have structured our equity portfolios to handle extreme volatility should we have a contested election.

In our fixed income portfolios, we have kept our duration (effective maturity) short and maintained fabulous credit quality.

The core mission of Sandhill is and will always be to beat the market(s) over time and add meaningful excess return for our clients. As with any disciplined asset manager, there will be periods of underperformance. During these times, it is important that Sandhill does not stray from its beliefs and methodologies that have allowed the firm to outperform the market over time.

For the first nine months of 2020 (1/1/20-9/30/20), Sandhill's Concentrated Equity Alpha (CEA) composite posted a return of +3.83% net of fees vs. a return of +5.41% for the Russell 3000 Total Return Index. Sandhill underperformed due to the third quarter surge in large cap technology stocks.

For the first nine months of 2020 (1/1/20-9/30/20), Sandhill's Corporate Bond composite posted a return of +3.26% net of fees vs. a return of 5.54% for the Bank of America 3-5 Year Corporate Bond Index. Please note that the average duration of Sandhill's Corporate Bond composite is 2.6 years which is significantly less than our benchmark.

The year is far from over

While we trail our benchmarks by a bit, there is still a lot on the table for the remainder of the year. Most importantly, we believe that our portfolios are "buttoned down" with regard to our equity holdings. With our equity holdings, we have prioritized quality. Our bond portfolios are "clean" save one credit issue (which we think is fine).

The main event of the fourth quarter is the possibility of a contested election. This could lead to social unrest. Should we get a Democratic sweep (the key being if the Senate has a Democratic majority), we might have a significant and meaningful change to individual, corporate and capital gain tax policy. The longer "brewing" issue (and most dangerous in my opinion) is the massive deficits in our federal and state budgets which is degrading the economic health and fiscal soundness of our country.

This begs the question – why invest a nickel in the stock market right now? Too dangerous. Too unpredictable. The answer is that the stock market does not care about our foibles and worries. The stock market is simply a mechanism that rewards innovation, honesty, hard work, and economic success. It is the element of human emotion, combined with unforeseen events, that generates volatility and makes investors uncomfortable.

If you think about this year, we have experienced the full range of possibilities in a most remarkable and strange year (a massive understatement). According to common wisdom and the media, our country was enjoying the best economy in fifty years in January. By April, common consensus said we were on the brink of a massive recession or depression. There is an old saw in the investment business – it's never as good as you think and it's never as bad as you think. Through this wild, crazy, and whacky 2020, for all that has been said and predicted, all the hyperbole and vitriol, the stock market is up 5%.

Democracy is messy. Predictions are mostly useless. It is the steady compounding of money through the ownership of high quality, well run, innovative companies that are well positioned for the next decade and beyond through all economic cycles that creates significant wealth.

The problem with the bond market

The bond market is shut. There is no yield. A reasonable single A/triple B five year investment grade corporate bond now yields approximately 1.2%. In accepting this yield, the investor is breaking even with inflation or more likely losing money in real terms. Retirees and savers are being penalized. There is a dark side to low interest rates.

We are fine for the moment, but over the next three years, 62% of the bonds in our Corporate Bond composite will mature. We don't have a great answer on how to replace the bonds/yield except to be patient. Markets can turn quickly, and we will always wait for opportune moments to put money to work. The most important thing that we can do is to not compromise on credit quality to capture yield and put your capital at unnecessary risk.

One solution that we have offered is a private REIT that owns industrial properties (mostly manufacturing plants) that are mission critical to the tenant's business. The private REIT can be custodied at TD Ameritrade (which was important to us). The current yield to our investors is 6.10% net of fees. Dividends are 65-70% tax protected due to depreciation. The dividends are paid monthly in cash. To date, we have placed $17.4 million of client capital with the REIT.

In order to make this investment, you must be an accredited investor, meet suitability requirements, and make a minimum investment of $100,000. Please talk with your advisor or inquire with Sandhill if this product is of interest. We understand that this is not a solution for some of our clients and continue to work on new "yield" products.

Volatility

Without making any predictions on how the market behaves through the election season, we will look at any sharp downward volatility as an opportunity.

As always, the bond market is the best indicator of whether the stock market is going to have a difficult time. When the spread for corporate bonds over the prevailing Treasury rate widens significantly (especially in a short period of time), more default risk is being priced into corporate borrowing and is a leading indicator of trouble in the stock market.

Assets under management

Sandhill currently has $1.83 billion in assets under management. Assets have increased $215 million in 2020. Our asset growth is a combination of positive performance and new business.

A strange year

To be sure, 2020 will go down as one of the strangest years in modern American history. The triple forces of COVID-19, bitterly partisan politics, and mild social unrest have put our country on edge. If you look back over the arc of American history, it is at the most challenging times that America has shone the brightest. I hope that we can say the same for this era and rise to the many challenges we face. Our country needs to begin the process of normalization in 2021 as we work to resolve these issues and bring fiscal stability to our country.

It is my hope that everyone is safe and healthy and enjoyed the bonus this year of spending so much time with their families.

With warm regards,

Edwin M. “Tim” Johnston III
Founder, Managing Partner

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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.

The private REIT offers limited liquidity and investors may need to hold their shares for an indefinite period of time. Timing or amount of distributions for the private REIT are not guaranteed. Past practice of distributions does not guaranty the timing or amount of future distributions.