NOTTINGHILL INVESTMENT ADVISERS, Ltd.

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# An Update

## SCORECARD

| | 2021 QI-QIII | One Year | Three Years | Five Years | 10 Years |
|---|---|---|---|---|---|
| S&P 500 Index | 15.92% | 30.00% | 16.00% | 16.89% | 16.63% |
| 10-Year Treasury Note | -4.32 | -5.68 | 6.36 | 2.36 | 2.95 |
| Gold | -8.53 | -8.39 | 13.39 | 5.75 | 0.68 |

All multi-year returns are annualized, and all returns are associated with time periods ending September 30, 2021

## 2021 QIII — The Long Road Back...Challenging As Expected

After COVID's many trials and tribulations, something unexpected came out of left field, and became a roadblock on the path toward business-as-usual. We are referring to the so-called Delta variant, which, on a smaller scale (thankfully), is causing many of the same hardships that we saw in early-2020. Granted, most of the eligible population has received one of the miracle vaccines, but the old fears die hard. As a result, the consumer frenzy about which we wrote in the August Update has been muted somewhat, and playing it (relatively) safe once again has become the thing to do in many quarters. Combine that with a shortage of labor and supply chain problems, and we get a slowing economy. But, no surprise. The long road back always was going to be challenging. For now anyway, those challenges appear to be manageable, and the recovery ultimately should get back on track.

Along with the economy, U.S. equity prices stumbled a bit in the third quarter. Nothing dramatic — the pace of the year's first two quarters simply could not be sustained. In fact, that pace was sustained in July and August, but then came September, traditionally the stock market's worst month. The catalysts for some September drama this time were the problems of a large Chinese property developer and uncertainty regarding the above-referenced supply chain issues, but, after 18 months of gains from the March 2020 lows, something was bound to interrupt the stock market's tranquility. Bonds? They fell in price as yields rose. More specifically, the yield of a Treasury note maturing in 10 years went from the 1.43% of June 30 to the 1.48% of September 30, which made for an investment return of -0.59% (-4.32% for the nine-month period). Gold also was something of a third quarter casualty. The per-ounce price of Engelhard industrial bullion declined 1.25%, which means that the nine-month price change is -8.53%.

The current state of affairs? We do have a few thoughts, as usual.

- **Worldwide Economy**
  A strange thing happened on the way to business-as-usual. For a number of reasons, the vaccination rate stalled, and COVID's highly contagious Delta variant began circulating. At the same time, a number of well-publicized supply bottlenecks have yet to be resolved, and labor is in short supply everywhere. Manageable problems, we believe, but problems that must be managed nonetheless.

- **Equities**
  Equities here and abroad clearly have attracted a following, and "compelling value" as a market descriptor does not apply. However, Cyclical/Value stocks remain inexpensive relative to Growth stocks in general and certainly relative to the large capitalization NASDAQ favorites. Regarding the latter, some exposure makes sense, but we believe Cyclical/Value deserves the emphasis.

- **Interest Rates**
  The urge to forecast interest rate behavior is not part of our DNA, however, we do believe that the era of extraordinary monetary ease and interest rate suppression is drawing to a close. That said, we also believe the Fed will take great pains to ensure that things do not move too fast.

As always, our advice to one and all: Stay well-diversified with an asset allocation structure appropriate for your (or your institution's) circumstances, with an adequate Rainy Day Fund.

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And now, let's talk about R-E-S-P-E-C-T, or lack thereof.

### *About the Firm*

Nottinghill Investment Advisers, Ltd., is a registered investment adviser founded in May 1996.

Nottinghill is owned by the seasoned professionals serving its clients, and effectively managing the assets of those clients, taxable as well as tax-exempt, is the Firm's only business. The twin results are commitment and focus.

Total Portfolio Management, or TPM, is Nottinghill's largely passive, balanced approach to the management of a client's overall portfolio, and Indexed Total Portfolio Management, or ITPM, is the totally passive variation. In both cases, portfolios contain three sectors: Equities, U.S. Fixed Income, and the Alternatives Group. TPM and ITPM are two complete, widely diversified answers to any client's investment needs.

Seasoned investment professionals. Commitment and focus. Two complete, widely diversified answers. Nottinghill is your ideal partner.

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# No R-E-S-P-E-C-T

C'mon, admit it...you hate bonds. We know you hate bonds. We know you hate bonds because everybody we talk to, client and non-client alike, tells us that he/she hates bonds. Palpable hostility that, frankly, we don't quite understand. However, we've narrowed the possible motives down to a select few. Here they are:

**1) Bonds traditionally underperform equities**

No matter that bonds are far less volatile than equities and have far different roles to play, bonds are considered the poor cousins in the performance derby. But wait! Some interesting research (Edward McQuarrie, Santa Clara University) going back into the 1800s indicates that representative indexes of bonds, not just the high-quality, low-yielding Treasuries of most analyses, outperformed equities in 25% of the 191 30-year periods examined. Twenty-five percent! Even Jeremy Seigel (he of 1994's famous <u>Stocks for the Long Run</u>, which also included 1800s data) was impressed. His reaction: "Should we never expect to find periods when bonds out perform equities? No, no, no. We should expect to find that, absolutely." Bottom line: Bonds aren't the guaranteed loser over <u>every</u> period, even 30-year periods.

**2) Adding value to the passive bond market indexes is even harder than adding value to the passive equity market indexes**

Difficult? Yes, and we'll throw out one comparison from days gone by: Over the 2002-2011 period, only 11% (!) of all active, domestic bond mutual fund managers outperformed their passive benchmarks. So, it was, and continues to be, difficult. But impossible? No. In our TPM portfolios, we employ the Select Four approach consisting of three active managers, each with a certain management specialty, and a group of intermediate-term Treasuries. Assuming equal-weighted positions and annual rebalancing, the 2000-2020 record is provided in Figure 1. The value-added is 0.78% per year, net-of-our annual management fee (0.25% of assets). That's big in the world of bonds, so we'll call adding value to the passive indexes difficult, but not impossible.

**Figure 1**

**The Select Four Approach**
**2000-2020**

| | Annualized Return |
|---|---|
| **Select Four*** | **5.81%** |
| Bloomberg Barclays US Aggregate Bond Index | 5.03 |

**Net-of-the management fee*

*The data above are the product of research conducted exclusively by Nottinghill Investment Advisers, Ltd., and are not actual portfolio sector returns achieved by Nottinghill. Under no circumstances should the above be considered indicative of future performance. Additional information regarding the calculation of these returns is available upon request.*

**3) In an inflation-adjusted sense, guaranteed confiscation**

This one routinely made the rounds in the bad old 1970s, which may have been the Golden Decade of Cinema (check out the 50 1970-1979 Best Picture nominees sometime), but clearly was not the Golden Decade of the U.S. Economy. Inflation was a serious problem. And, as the CPI's annual advance went from high to higher, bond yields never quite caught up, so the purchasing power of those interest payments <u>decreased</u> at a pretty good clip. But, that's one atypical decade among many. As a rule, bond yields in general actually exceed the rate of inflation, so what's being confiscated?

**4) Bonds are boring**

We saved the best for last because those of us who watch stock and bond quotes all day have seen exciting, and have seen boring; and, we'll take boring any day. Successful investing is all about intelligently gathering a diversified list of securities, sticking with the plan, and then compounding a decent investment return over an extended period of time. We have nothing against Tesla or any of the other current whiz-bang NASDAQ beauties, but the entertainment part of one's portfolio should be small and very well-defined. "Boring" is a good thing.

So, bonds aren't always the poor cousins in the performance derby; adding value to the passive indexes <u>is</u> possible; the bond investment return doesn't always fail the inflation test; and finally, boring isn't all bad. Should bonds be all or most of the typical portfolio? No, the second of our four Fundamental Beliefs is that <u>equities</u> in general and <u>Value equities</u> in particular should be the cornerstone of any portfolio. But, as we are quick to point out, the first and most important of these Fundamental Beliefs is that diversification and discipline are <u>the</u> key elements of long-term investment success. In other words, bonds belong in the mix, and, within that mix, have three roles to play.

First, bonds <u>stabilize</u> the pattern of portfolio investment returns. Equities may be the more glamorous asset class, but they come with some baggage: twice as much volatility. A bond component within the overall portfolio dampens that volatility.

Second, bonds occasionally provide some much-needed <u>sanctuary</u>. Treasuries in particular are the go-to asset class during times of stock market stress. In other words, they typically act as a shock absorber that helps the investor stick to the plan when all seems hopeless. That was the case in 2008 when the S&P 500 Index investment return was -37% and in COVID's 2020 QI (-20%). The 10-year Treasury investment return in 2008 and 2020 QI: +19% and +12%, respectively. In the past, we've referred to this as the healing power of Treasuries, but "shock absorber" applies as well.

Finally, bonds should make money for us in a total return sense, but, within that context, bonds are expected to provide the portfolio with most of its current <u>income</u> needs. Over the last 13 years, of course, the Fed's top priority has been repairing the economy in the wake of the Great Recession and then the COVID crisis, and interest rates have been kept at ultra-low levels. We're guessing, however, that someday the interest rate levels of 2008-2021 will be viewed as an aberration and bonds will have resumed their income-producing role.

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The economist, John Kenneth Galbraith, once said that economic forecasting is the science that made astrology respectable. We agree, and put all attempts to forecast interest rates in the same boat. No one can do it, and yet, that's where the really big money in bond management is to be made. But, no one can do it. That's OK — we'll take stability, sanctuary, and income. Not much on <u>that</u> list to inspire the kind of bond market loathing we frequently encounter. In fact, seems like there's a lot to like. Bonds don't belong at the center stage in most situations, and likely will not be major contributors to total portfolio performance in the next decade. But, bonds do belong in the mix. In other words, they deserve at least some R-E-S-P-E-C-T.

# Total Portfolio Management

## *Portfolio Structure*

Total Portfolio Management, or TPM, is a largely passive, balanced approach to the management of a taxable individual's or tax-exempt institution's overall portfolio. TPM portfolios consist of three sectors: Equities, U.S. Fixed Income, and the Alternatives Group. An active approach governs the large company component of the Equities sector, which also includes three other, passively managed ETF components. The U.S. Fixed Income sector is a combination of three actively managed bond mutual funds and intermediate Treasuries. And finally, positions in three alternative asset classes (ETFs) constitute an Alternatives Group that adds yet another layer of diversification. The result: a complete, largely passive destination for all of the taxable individual's or tax-exempt institution's investment needs.

## *Investment Objectives*

- **A positive inflation-adjusted investment return** — A Life of the Strategy investment return greater than the inflation rate of the overall U.S. economy
- **A structure-consistent investment return** — A Life of the Strategy investment return consistent with the component investment returns weighted in accordance with the portfolio's asset allocation structure
- **Low, structure-consistent volatility** — Life of the Strategy investment return volatility consistent with that of a low-volatility structure and one weighted in accordance with the portfolio's asset allocation structure

## *Investment Return Summary*

| | 2021 QI-QIII | 2010-2021 |
|---|---|---|
| **TPM Baseline*** | **8.69%** | **10.25%** |
| S&P 500 Value Index | 15.27 | 11.70 |
| Bloomberg Barclays US Aggregate Bond Index | -1.67 | 3.67 |

*65% equities

*Nottinghill Investment Advisers, Ltd., is an independent investment adviser utilizing a number of large capitalization equity and widely diversified balanced strategies. The above Total Portfolio Management - Baseline performance data are associated with the Total Portfolio Management - Baseline model portfolio. While the data associated with the strategy incorporate the model and actual investment returns associated with strategy components, such data, even when combined in accordance with the Baseline structure, do have certain inherent limitations. First, unlike an actual performance record, such data do not reflect actual trading. Second, since trades have not actually been executed, results may contain an under– or over-compensation for the impact, if any, of certain market factors. These data are provided net-of-assumed transaction costs and net-of-assumed management fees. Furthermore, the data are associated with time periods ending September 30, 2021, are annualized for the multi-year period, are expressed in U.S. Dollars, and are compared to the value-oriented, all equity S&P 500 Value Index and the all-fixed income Bloomberg Barclays US Aggregate Bond Index. Whether simulated or actual, past performance is no guarantee of future results. A complete list of Nottinghill performance composites and model portfolios and additional information regarding the calculation and reporting of Nottinghill performance are available upon request.*

## *Investment Strategy Advantages*

- A seasoned team of investment professionals
- The complete, largely indexed answer
- Low, fully disclosed investment expenses
- Solid performance at a low level of risk

Now, ITPM...

# Indexed Total Portfolio Management

## *Portfolio Structure*

Indexed Total Portfolio Management, or ITPM, is a totally passive, balanced approach to the management of a taxable individual's or tax-exempt institution's overall portfolio. ITPM portfolios consist of three sectors: Equities, U.S. Fixed Income, and the Alternatives Group. A total of nine components within those sectors, and all nine consist of ETF positions performing in line with an associated equity market index, bond market index, or commodity price. ITPM portfolios combine the traditional performance advantages of passive management, along with ultra-low transaction costs and management fees. The result: a complete, totally passive destination for all of the taxable individual's or tax-exempt institution's investment needs.

## *Investment Objectives*

- **A positive inflation-adjusted investment return** — A Life of the Strategy investment return greater than the inflation rate of the overall U.S. economy
- **A structure-consistent investment return** — A Life of the Strategy investment return consistent with the component investment returns weighted in accordance with the portfolio's asset allocation structure
- **Low, structure-consistent volatility** — Life of the Strategy investment return volatility consistent with that of a low-volatility structure and one weighted in accordance with the portfolio's asset allocation structure

## *Investment Return Summary*

| | 2021 QI-QIII | 2010-2021 |
|---|---|---|
| **ITPM Baseline*** | **8.68%** | **8.26%** |
| S&P 500 Value Index | 15.27 | 11.70 |
| Bloomberg Barclays US Aggregate Bond Index | -1.67 | 3.67 |

*65% equities

*Nottinghill Investment Advisers, Ltd., is an independent investment adviser utilizing a number of large capitalization equity and widely diversified balanced strategies. The above Indexed Total Portfolio Management - Baseline performance data are associated with the Indexed Total Portfolio Management - Baseline model portfolio. While the data associated with the strategy incorporate the model and actual investment returns associated with strategy components, such data, even when combined in accordance with the Baseline structure, do have certain inherent limitations. First, unlike an actual performance record, such data do not reflect actual trading. Second, since trades have not actually been executed, results may contain an under– or over-compensation for the impact, if any, of certain market factors. These data are provided net-of-assumed transaction costs and net-of-assumed management fees. Furthermore, the data are associated with time periods ending September 30, 2021, are annualized for the multi-year period, are expressed in U.S. Dollars, and are compared to the value-oriented, all equity S&P 500 Value Index and the all-fixed income Bloomberg Barclays US Aggregate Bond Index. Whether simulated or actual, past performance is no guarantee of future results. A complete list of Nottinghill performance composites and model portfolios and additional information regarding the calculation and reporting of Nottinghill performance are available upon request.*

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