NOTTINGHILL
INVESTMENT ADVISERS, Ltd.

Vol. XXVII No. 2 May 2024

Quarterly Update

ABOUT THE FIRM

Nottinghill Investment Advisers, Ltd., is a registered investment adviser founded in May 1996. A long history of achievement.

Nottinghill is a team of seasoned professionals serving taxable and tax-exempt investors, as well as other investment advisers. Asset management and otherwise serving asset management clients are the Firm's only business. The twin results: commitment and focus.

Nottinghill is a manager of large capitalization equity and widely diversified balanced portfolios. The Firm can serve in a specialized role, or as a client's sole adviser.

Nottinghill's equity and balanced investment strategies constitute the Firm's Yield Plus Approach to investing. The Yield Plus Approach is a straightforward, all-encompassing investment philosophy and a set of well-defined investment processes. Precision and discipline.

A long history of achievement. Commitment and focus. Specialization, or single-manager responsibility. Precision and discipline.

Nottinghill is your ideal partner as you go down the financial path ahead.

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SCORECARD

	YTD	One Year	Three Years	Five Years	10 Years
S&P 500 Index	**10.56%**	**29.88%**	**11.50%**	**15.05%**	**12.96%**
10-Year Treasury Note	**-1.22**	**-1.16**	**-3.59**	**-0.37**	**1.35**
Gold	**8.55**	**12.94**	**9.84**	**11.47**	**5.62**

All multi-year returns are annualized, and all returns are associated with time periods ending March 31, 2024

2024 QI — Which Is It?

The primary reason why we make no attempt to forecast the economy and the markets is that coming up with consistently accurate forecasts is beyond the capabilities of mere mortals. We cannot do it, and neither can anyone else. Way too many variables, with way too many constantly changing relationships among those variables. Take early-2024, for example. Following the interest rate fantasyland of the 2010s and the pandemic period, the Fed attempted to get us back to something like reality by aggressively raising interest rates in 2022-2023. Econ 101 says that monetary tightening to this degree is a threat to growth and the recession risk increases. But, one year after the last Fed interest rate hike, unemployment remains low, and consumer spending remains healthy. Still, one steady drumbeat is that the recession risk has not gone away and that rates should be slashed in 2024. Which is it…all the graph lines moving in the right direction and inflation on the wane, or le déluge just over the horizon? We lean toward the former, but thankfully, our investment work does not depend on forecasting the unknown and, frankly, the unknowable.

Instead, of course, our investment work in each case is geared toward what we call "circumstances," i.e., client characteristics, and we stick with the designated program until those circumstances change. That said, the state and behavior of market prices are of great interest to us, and we do not like surprises. Glad to say, there were very few in the first quarter. The large company, value-oriented indexes (equity) had investment returns in the 8-9% range, while most small company indexes had slightly lower returns. On the fixed income side, a Treasury bond maturing in 10 years, our proxy for the market as a whole, was due for a pause (-1.22%) after a good 2023. Gold, on the other hand, experienced no such pause. The barbarous relic returned 8.55% for the quarter and closed at an all-time record high. Bottom line: The surprises, we are happy to say, were few and far between during the first quarter, and mostly pleasant.

THE CURRENT SITUATION — Just Fine for Now

- **Worldwide Economy**
  Overall, workers are working, consumers are spending, and price pressures are coming down. Of course, not all countries and economic sectors are benefiting uniformly – they never do – but many trends are moving in the right direction. In the words of Ray Bradbury, does something wicked this way come? We never say "never," however, the here-and-now appears to be just fine.

- **Equities**
  To some extent, the unhealthy concentration in a few Growth/Technology names (about which we have railed for some time) continues, but there has been broader participation when stocks rally. That is a healthy sign, augmented by decent valuations within the non-Growth/Tech sectors.

- **Interest Rates**
  To cut, or not to cut? That is the question. Either some sort of hiccup is inevitable, and the Fed should head it off at the pass by cutting rates; or, the situation is just fine (and likely to remain fine) and the Fed should leave rates alone. Tough call, totally dependent on the data as they emerge. We suspect that any interest rate cutting (if it happens) will be at a measured pace. Tough call.

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And now, what do ExxonMobil and Walgreens have in common?

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May 15, 2024

Perspective

Walgreens and the Dow…
"A Blessing in Disguise?"

"If it's in the newspapers, it's in the price."
-William Miller

Four years ago, with ExxonMobil flat on its back at $40 per share, the Index compilers at Dow Jones decided that, after 92 years, the time was right to say goodbye. Salesforce was chosen to replace Exxon in the Dow Jones Industrial Average, and why not? Salesforce was an entirely reputable New Economy stock, and, after all, anything involving fossil fuels was a guaranteed loser. In the midst of this drama, we wrote "Exxon Mobil and the Dow… 'A Blessing in Disguise'." Now, with Walgreens getting the boot (February 26), the time is right to resurrect and re-work that earlier piece.

The message then and now: Beware of broad consensus. Long ago, one of us earned his spurs at a large investment firm run by some of the best and the brightest. The research effort was extensive, with portfolio stocks selected from a candidate list known as the Guide, about 400 of the most well-known U.S. companies/stocks. But, the Guide was ever-changing. Analysts continually would evaluate their industry groups and cull their lists, i.e., eliminate Guide companies thought to have subpar prospects and replace those Guide companies with others thought to be budding corporate superstars.

Well, we can't say that cynicism is a noble virtue, but we bow to its inevitability. Whenever a company/stock was removed from the Guide, those who actually had to pick stocks for portfolios always chuckled because too many of the rejects seemingly went on to become winners. In other words, the scorned companies' problems and dicey outlook (?) were well-recognized, and their stock prices already reflected this negative consensus. Admittedly, we never saw any raw data, but strongly suspected that <u>buying</u> Guide rejects in fact was the thing to do. As to the second part of this trade, the replacements' seemingly superior prospects also were well-recognized, and fully reflected in <u>their</u> stock prices. So, an important maxim around here: Beware of broad consensus. Which brings us to Walgreens.

Once upon a time, when all the streets were lined with trees and Donna Reed was thought to be parenting's gold standard, Mr. Gower-type drug stores with their neighborhood charm and wonderful soda fountains dotted the landscape. Then, all that changed as the advantages of scale became evident and the urge to consolidate and standardize became all-encompassing. Walgreens saw the handwriting on the wall and decided to become a consolidator. Soon, Walgreens stores (without the neighborhood charm and the milk shakes) were the ones dotting the landscape, and the company grew and prospered. In 2018, that growth and prosperity evidently meant that the stock had passed the DJIA selection committee test: "While stock selection is not governed by quantitative rules, a stock typically is added only if the company has an excellent reputation, demonstrates sustained growth, and is of interest to a large number of investors." Not exactly the mathematical precision we prefer, but Walgreens made it, i.e., became a full-fledged member of a very exclusive club.

Walgreens' stay in that club turned out to be a short one, actually the shortest stay in the DJIA's history. We're talking six years because, on the one hand, Walgreens and CVS had moved toward more of a healthcare model at the wrong time and were getting squeezed; and, on the other hand, DJIA index compilers (dare we say stockpickers?) now could focus on a retailing alternative long on their wish list: Amazon. So, in that hushed, solid oak sanctum, the logic was simple: A is having a few fundamental problems, and we like B better anyway. And,

to top it off, for the quirkiest of reasons, absolute price matters in the construction of the DJIA. Amazon at $3,000 per share was a distinct no-go, but the stock split 20-1. Amazon at a post-split $150 per share was eminently doable. Walgreens' fate was sealed.

Amazon? Please believe us, we are not suggesting that that juggernaut somehow will grind to a halt. Not likely. What we <u>are</u> suggesting is that anything getting kicked out of an index (or removed from a Guide) deserves a second look. Nothing better reflects a broad consensus. Beware of broad consensus.

Want some more proof? One study by Professors Cai of Drexel and Houge of Iowa focused on the stocks of the most popular <u>small</u> company index in the period between 1979 and 2004. Cai and Houge found that a portfolio of stocks kicked out of this index outperformed a portfolio of additions by nine full percentage points per year. Nine full percentage points per year!

Remember, price matters. When the analysts of the old Guide were culling their lists, the companies' seemingly poor fundamentals in most cases were very well known and almost always fully reflected in the stocks' valuations. And, the forces of Capitalism in many cases already were on the march. New management teams were being assembled, new ideas formulated, new products developed, etc., etc. In other words, these were times of <u>opportunity</u>, rather than times to throw in the towel. The stocks getting kicked out of arbitrarily compiled stock market <u>indexes</u>? Same thing.

Two footnotes…

First, when Exxon Mobil was kicked out of the DJIA in August 2020, Mark Hulbert, a well-known market letter writer, referred to it as "a blessing in disguise" for Exxon's shareholders. He had observed the same <u>index</u> phenomena we stockpickers had observed in those long ago days of the Guide. And, he had the data to back up his contention.

Second, as an aside reported by Hulbert, IBM was kicked out of the DJIA in 1939 when the company's prospects appeared to be a bit dicey, and was added <u>back</u> to the DJIA in 1979 when the company was cranking on all eight cylinders. If IBM had been in the DJIA over that 40-year period, the Index would be at 75,000 today. That's 75,000, not 39,000. Turns out 1939 was a good time to pick up a few IBM shares.

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Peter Lynch of Magellan Fund fame once said that, when it comes to investing, the key organ is the stomach, not the brain. We couldn't have said it better. When a company/stock is removed from a candidate universe or a popular stock market index, you can bet that some sort of broad consensus already has pushed down the price of the stock. Going against that consensus takes courage, and yet, all too often that's the right move. Exxon's problems already were "in the newspapers" of August 2020; Walgreen's (and admittedly, they are some big ones) are today. Yet both stocks were cast adrift by the DJIA compilers (er, stockpickers), one after 92 years. The companies' shareholders? The odds suddenly were/are in their favor. Beware of broad consensus.