THE TANDEM REPORT

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"It requires a great deal of boldness and a great deal of caution to make a great fortune, and when you have it, it requires ten times as much skill to keep it."

~ Ralph Waldo Emerson

Dear Clients,

Tandem is committed to the preservation of your wealth by minimizing risk while adding value through superior investment performance. This issue of *The TANDEM Report* provides a summary of our views pertaining to the investment landscape and subjects that influence our decision making. More information about our firm, including our investment style and process, is available at www.tandemadvisors.com or upon request. We hope you find this report informative.

Respectfully,

John B. Carew
President,
Chief Investment Officer

In This Issue

MARKET COMMENTARY:
OLD PLAYBOOKS DON'T WORK IN THIS MARKET

Sometimes we must appreciate the market we have rather than hope for the market we want. For each of the past three years, the market has begun the year with a lift born of the hope of sustained economic growth. In each case, that hope had failed us by summer. Expectations of positive events gave way to fears of a Euro crisis or other headwinds that could lead to less robust expansion. While not mirror images, the chart below displays some amazing similarities.

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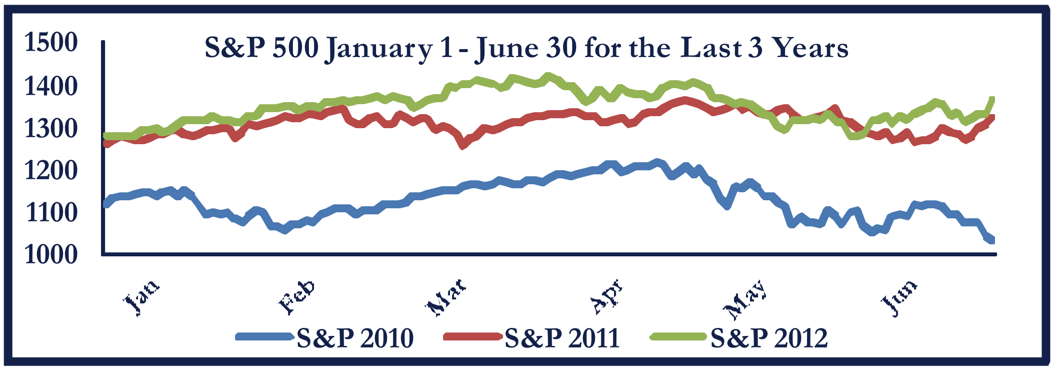

COMMENTARY:
IS THE WORLD REALLY COMING TO AN END?

You are living a desperately isolated existence if you don't know at least one person with an annoyingly convincing argument that some pretty bad stuff awaits us. You have to have heard it. Your neighbor, your co-worker, your spouse or your friend has told you with conviction why we are headed for the abyss. Maybe you're that person? Regardless, you know how it goes. Our government is so hopelessly divided that we are headed for a fiscal cliff. There is no way the U.S can ever pay off its debts. The Euro will collapse and banks will fail. Central Banks can't fix the problem and politicians won't. Unemployment, housing, inflation, the Middle East, the debt ceiling, another financial crisis, Barack Obama, Mitt Romney or something else is a ticking time bomb. Sound familiar?

The fear we felt in 2008 is still with us and colors our interpretations of where the world stands now. Collectively we wait for the next shoe to drop. Our financial behavior remains shaped by the experience. We favor anything that *preserves* our money because the fear of another crisis outweighs the greed that guides us in more normal times.

The Great Depression had much the same effect on the psyche of the public. An entire generation grew to distrust banks and the stock market. Many refused even a checking account, electing to pay bills in person with cash. They fully expected the next shoe to drop at any moment. And it never did. For this generation, the crisis they lived through would shape their behavior for the rest of their lives.

Seeing the world through a prism of catastrophe, while understandable, is in fact as harmful as the prism of optimism proved

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to be in 2006. Recent history cannot be allowed to supplant the common sense that comes from a broader, less selective historical perspective.

Rarely, if ever, does disaster strike when we are prepared. The most tragic events are the ones that take us by complete surprise. A tornado with no warning results in a natural disaster measured by human loss. A well-anticipated tornado is measured instead by property loss. While both are bad outcomes, the second is far more palatable because those impacted were prepared.

In the case of the economy, it has often been said that the stock market does whatever most people least expect. Much like the unanticipated tornado, the Crash of 1929 and the ensuing Great Depression befell an unsuspecting public. Black Monday of October, 1987 saw the stock market plummet 25% in a single day. Few anticipated such an event. The Tech Bubble burst in 2000, leading to a loss of 50% in stock market value over the ensuing two years. Most investors were blindsided. And finally, the Financial Crisis of 2008 also wrought a 50% market decline, albeit in a much shorter time frame than in 2000.

What do these four events share in common? First, our economy withstood them all and resumed growth in time. Second, and more importantly, they all came about at a time when few expected the good times to end. How is this even remotely similar to our current predicament? The world in which we find ourselves today is one that is not only prepared for, but in fact anticipates, disaster.

The next time you visit your local mall or drive past a strip shopping center, notice the number of stores that are no longer there. As you view a city's skyline, note the number of construction cranes that are missing from the scene. Or in the suburbs, count the subdivisions not being developed, replaced by signs indicating large tracts of land for sale.

Our behavior has changed in lots of little ways that add up to a change in societal behavior that says we are hunkered down. We spend a little bit less, we travel a little bit less, we make do with a little bit less. If we can, we build up our cash reserves for a rainy day and we pay down credit card debt. We will not be caught off guard if we lose our job or our standard of living takes another hit. We are being proactive. All these subtle changes in our daily lives are the result of our most recent experiences.

As a result of our experiences and altered perspectives, we are easy prey for the doomsayers that tell us the world as we know it will end. Most of us try to act rationally, but the pervasive negativity takes its toll. Individual investors are pulling money out of the stock market regularly. Corporations are building massive cash reserves. Banks are building fortress balance sheets. New business start-ups are tragically missing from an economy that desperately needs them. And on the less rational side, sales of Armageddon items like gold coins and guns have gone through the roof. We are preparing for the worst.

It is by no means our intent to encourage optimism. We have used these pages countless times in the past to rail against euphoric expectations. We simply hope to point out that human behavior tends to go to extremes. The Tech Bubble and the period leading up to the Financial Crisis of 2008 were extremes. Similarly, today's despair, in our view, is an extreme.

Economic history teaches us that unsustainable excesses will be dealt with by market forces. The process is painful but necessary. It also teaches us that once dealt with, the economy moves forward and those prepared for success are most likely to harness the economic growth to their advantage. Some of our nation's greatest entrepreneurs emerged when conditions seemed least likely to produce them. Steve Jobs and Bill Gates came of age in a time of economic malaise, political partnership and high unemployment.

We encourage realism. The economy is bad. The landscape looks bleak. *But we already know all of this.* This tornado has been widely predicted. We no doubt face many strong headwinds as the economy heals its wounds. It will be a bumpy road to the eventual recovery, and things may in fact get worse before the recovery inevitably occurs. But again, who doesn't already know this, and who isn't prepared for it?

Our message is one of patience. To the couple that can't sell their home, the retiree that suffers 1% interest rates or the recent college grad that can't find work, patience is in limited supply. Understandably so. But intellectually, we all must realize that the last 12 years represent a period that our economy has experienced countless times before and will emerge from once again.

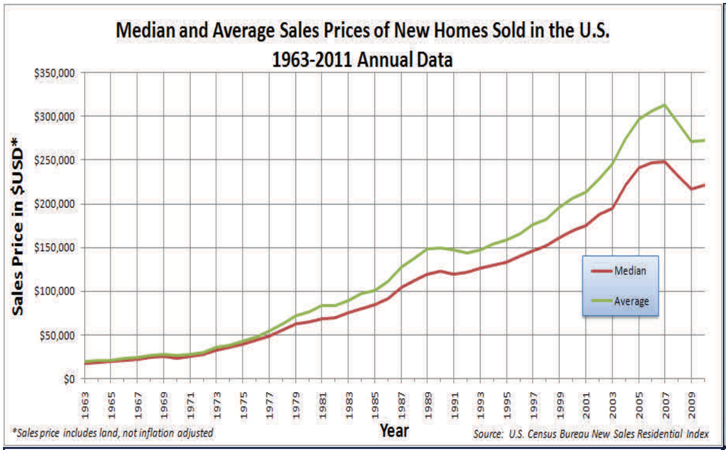
This is not a pep talk. As professional money managers, our clients have made money in this period even when the broader stock market has not because we avoided extreme sentiments. There are always sustainable opportunities for the realist. We cannot bury our heads in the sand and succumb to the gloom that surrounds us any more than we should have used our home equity as an ATM.

Expect the best and be prepared for the worst. Invest in things you understand. Spend wisely. Live in the real world, not in the fear of what may happen. Disaster cannot be just around the corner if it cannot catch us off guard. Have patience. The world is not coming to an end.

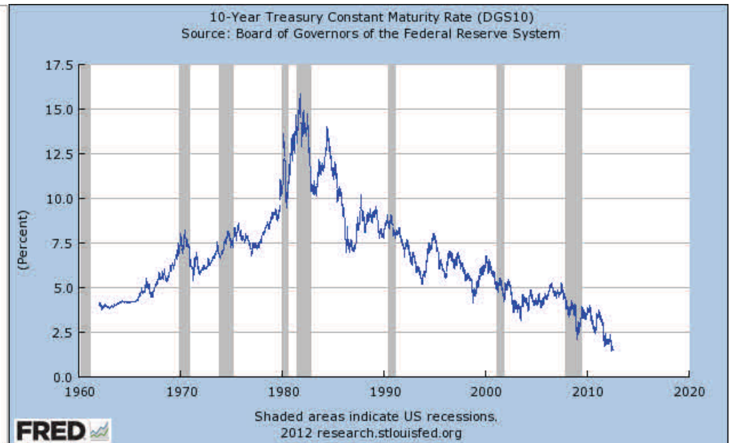
IMPORTANT ECONOMIC INDICATORS

The charts below paint a very clear picture that our behavior has changed. The first, representing the change in sale prices of new homes, illustrates the shock we all felt recently as home prices fell (something many thought could never happen). While the price decline was severe, it appears the bubble has burst and we are back on the long term trend line of price growth.

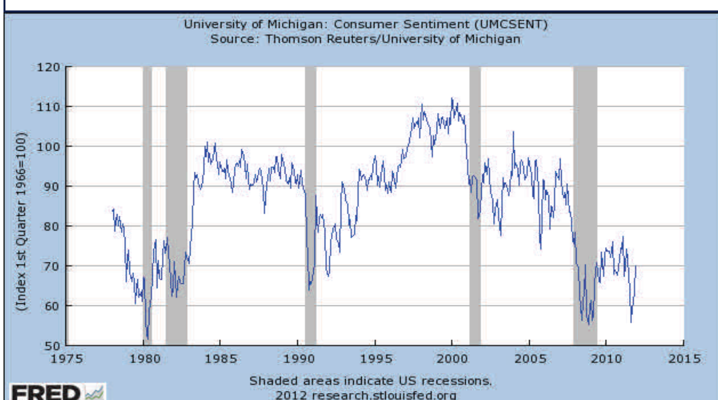
The other 5 charts show how our behavior still reflects the fear that overwhelmed us 4 years ago. The demand for safety has pushed Treasury yields to historic lows. Consumption and consumer sentiment remain at recessionary levels while indicators of economic activity like velocity of money and new business formation are at levels that cannot produce an economic recovery.



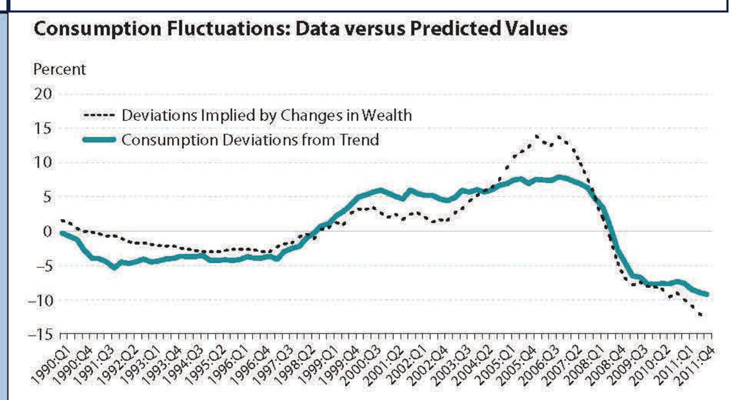
From a longer term perspective, the above chart indicates that home prices are back at sustainable trend levels after having bubbled earlier this decade.



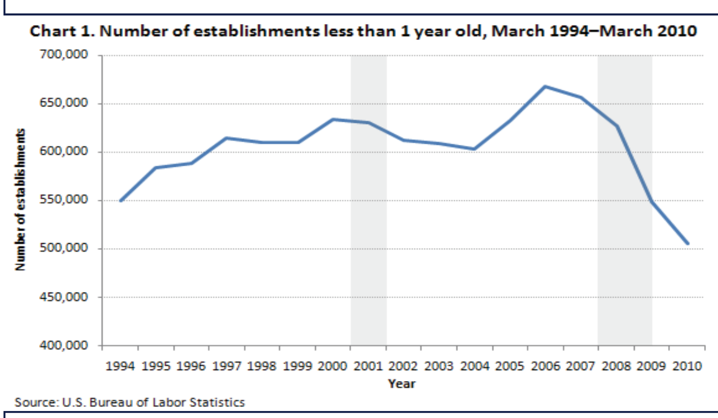
Clearly interest rates have been in steady decline since 1980, but today's historically low levels indicate the preference for safety over return.



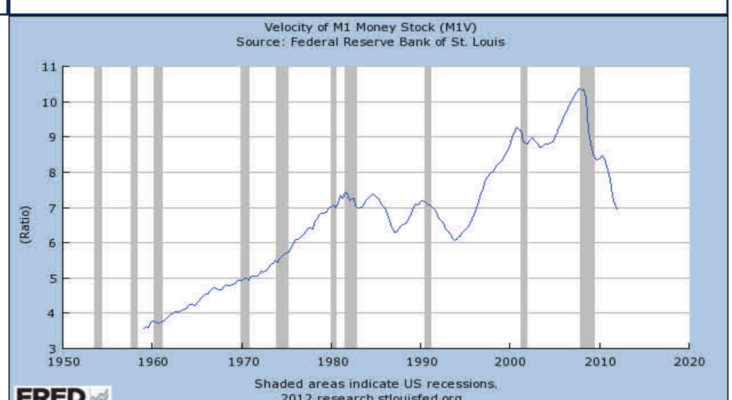
Consumer Sentiment remains mired at recession-era levels, indicating we expect more bad economic news.



Consumption levels are still low, showing no signs of any change in behavior post recession.



New business formation has fallen to historically low levels and continues at a steep rate of descent.



Volatility of money is an important indicator. The pace at which a dollar changes hands has dropped sharply.

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Rather than accepting that the economy is likely to move in fits and starts for the foreseeable future, investors resort to old playbooks based on growth or contraction. The result is a whipsawed market contorted by the tug-of-war between gloom and boom. The problem, as we see it, is that the old playbooks don't work in this market.

A great bull market began in 1981 and lasted either until March, 2000 or October, 2007, depending on your definition. For our purposes we use the S&P 500 in the chart above through the end of 2007 because for the entire period until the last top, no matter when investors bought, even in 2000, their patience was rewarded with a higher valuation in the market. The great bull market was followed by a sharp decline in 2008 and 2009 followed by a dramatic climb, as depicted below. If we were to study these two charts in isolation, we might conclude that markets are nearly always one-directional. Most investors rely upon past experience to address the market they think they are in. And for most, the predominant experience is that markets either go up or down.

What happens when they do neither, or both? We believe it requires a different perspective and a different playbook. The old frame of reference dictates that when markets go up, the key is to own the companies most likely to benefit, which are the most volatile. These are known as high beta stocks. You will recall that beta is a measure of price movement predicted by the market. The S&P 500 is said to have a beta of 1.00. If a stock has a beta of 1.00, it will move with the market. If it has a beta greater than 1.00 it will move more dramatically than the market, both up and down. A stock with a beta less than 1.00 will move less dramatically than the market. So high beta stocks, in theory, should outperform an up market.

Conversely, when stocks are going down, the traditional

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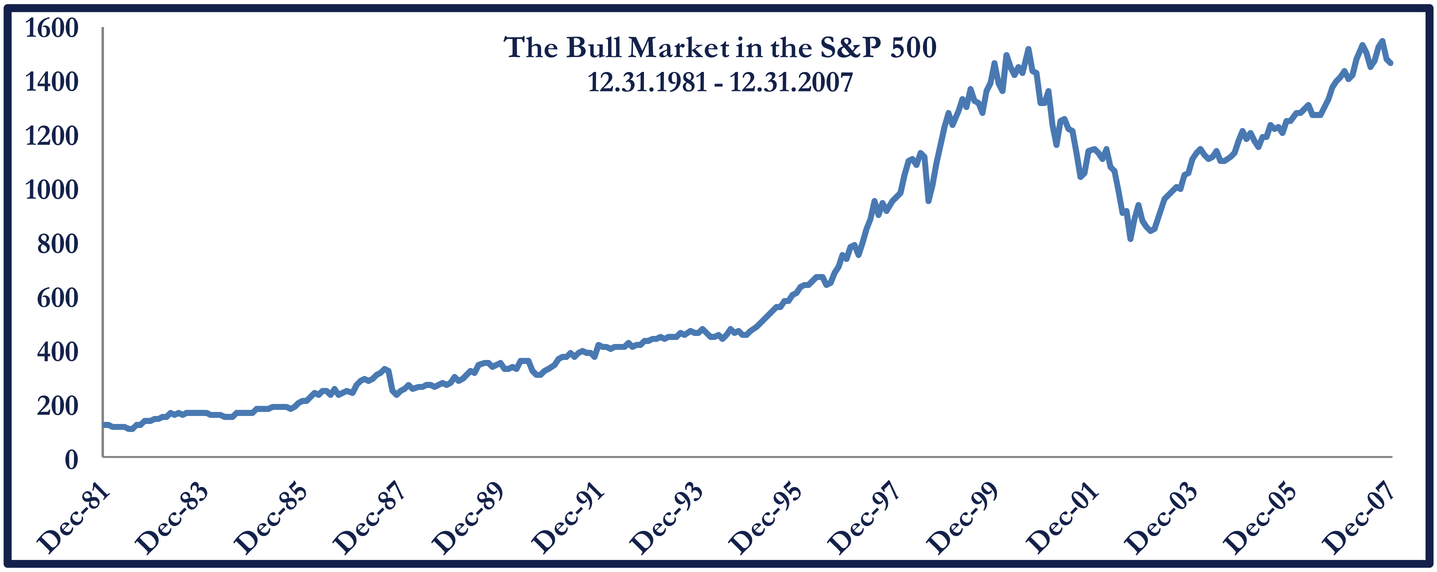

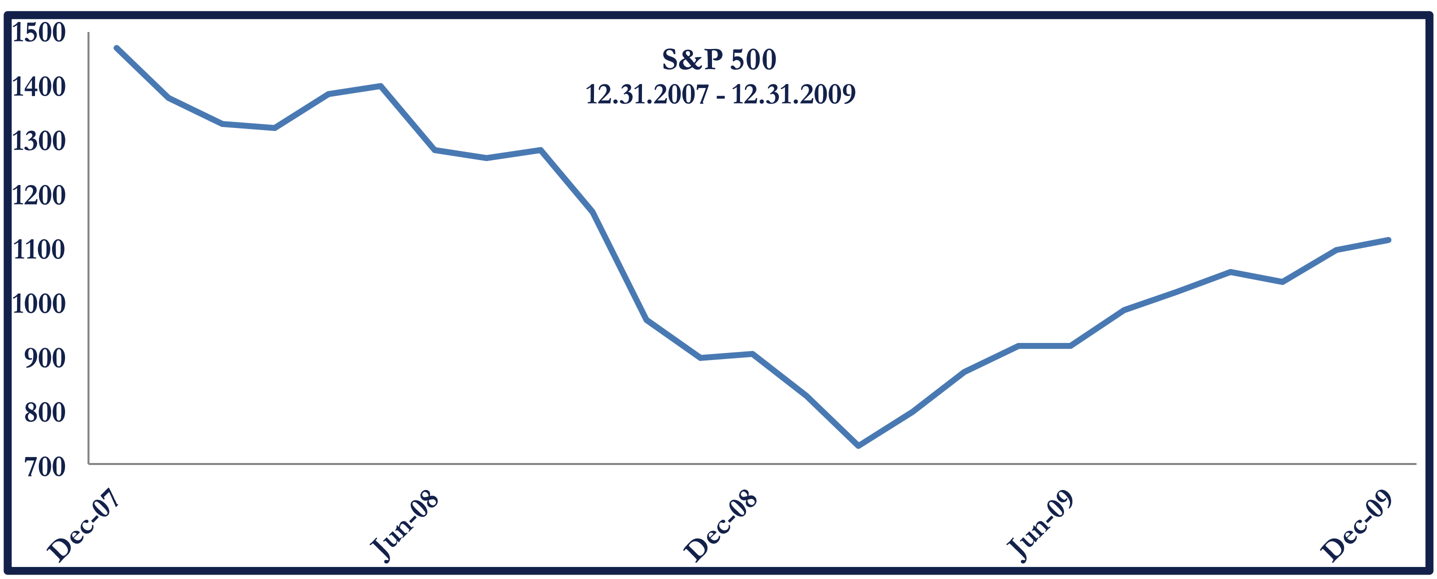

TANDEM NEWS

The news from Tandem is not nearly as joyous this quarter as it was last. Wilmot B. Ouzts, Jr., passed away June 27, 2012 after a long illness. Mr. Ouzts, father of Allen, was a man of many accomplishments. He was a decorated Alamo Scout in the Pacific Theater, a successful businessman, a pillar of his community and a loving husband, father and grandfather. We grieve with the family for their loss and celebrate a full and meaningful life. May Mr. Ouzts rest in peace.

In other news, Allen Ouzts has decided to retire after a 26 year career in this crazy business, the last 15 with Tandem. Allen has decided to pursue his first love - farming. Those of you that have worked with Allen over the years will no doubt want to join us in saying thank you for your dedicated service and we wish you the best in your new life. Allen is a great friend and we will miss him at Tandem. Farming has always been in Allen's blood and John Deere will no doubt welcome his new avocation.

MARKET COMMENTARY (CONTINUED)

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thought process has been to flee for safety in stocks with high dividend yields. The theory is that you get paid to wait out the market in these "safer" names. Sadly for investors relying on these strategies for the last 5 1/2 years, neither high beta nor high dividend yield has worked.

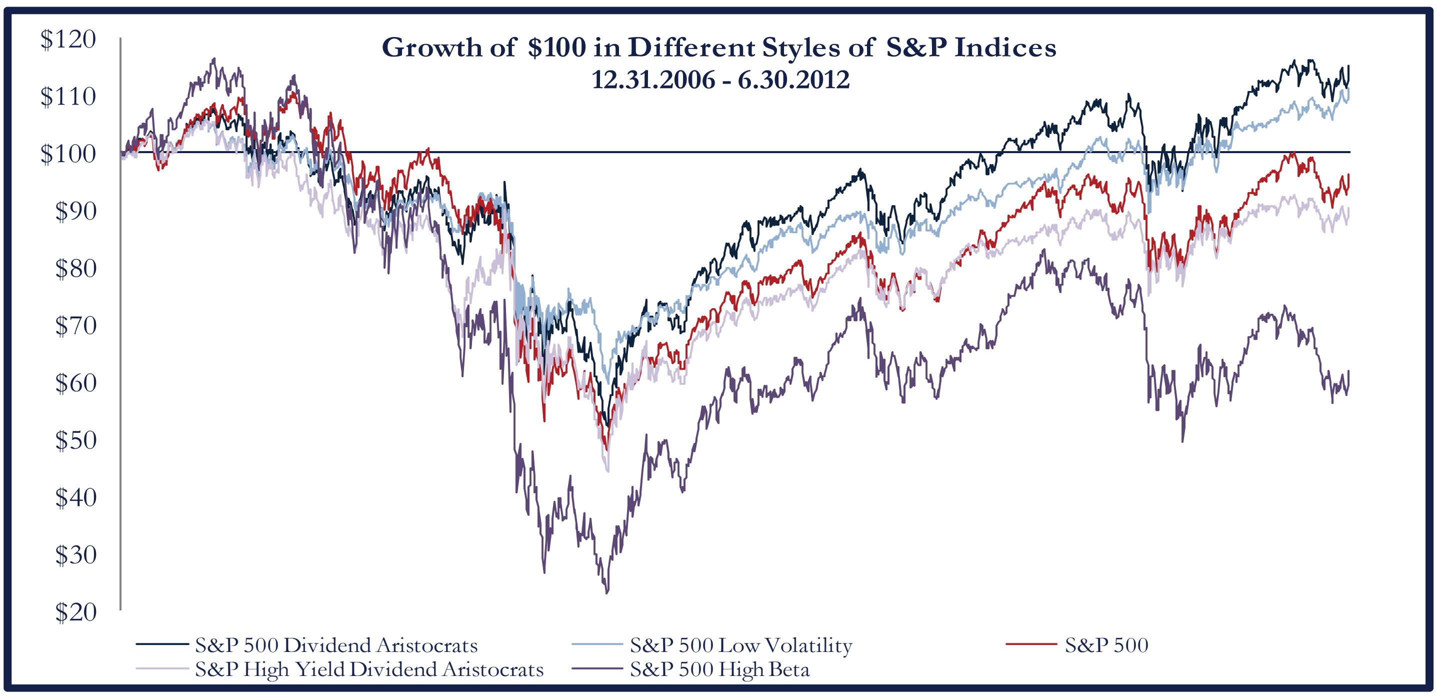
As the chart below indicates, the S&P 500 Index of High Beta stocks has woefully underperformed the S&P, even though the market (as indicated by the red line) is essentially flat. Similarly, the S&P 500 High Yield Dividend Aristocrats has failed to provide the safe haven that many sought.

Interestingly, despite a 50% decline in the S&P 500 from October, 2007 through March, 2009, investors choosing dividend growth (not dividend yield) and low volatility actually experienced positive returns. The S&P 500 Dividend Aristocrats and Low Volatility Indices have provided nearly identical positive returns during a time in which the market went both up and down but ended up in the same place. And this is the market we have, even if it's not the market we want.

We have advocated many times the merits of owning healthy companies that grow their earnings and dividends in any economic environment. The chart below shows why. Two newsletters ago we presented the history of the Dow since 1928 and illustrated that nearly all of the Dow's gains have come in only 3 time periods. The rest of the time the market just muddled along, directionless. Well, the market is muddling now.

We have also discussed the influence of the direction of the unemployment rate on the direction of the market, along with many other factors that must be in place before a sustained market advance can materialize. Until then, we must deal with a market that is definitely not one-directional. Old playbooks based on clear market direction don't work.

The only way we see to make money today is to own low volatility portfolios that grow their dividends. And that's all we have ever done. This may not be the market you hope for, but it is still a good market.



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MARKET REPORT CARD

YIELD TABLE			
	Current	3 months ago	1 year ago
3-month Treasury Bill	0.09%	0.08%	0.02%
5-year Treasury Note	0.71%	1.02%	1.76%
10-year Treasury Bond	1.62%	2.17%	3.16%
30-year Treasury Bond	2.70%	3.28%	4.37%
Prime Rate	3.25%	3.25%	3.25%
Federal Funds Rate	0.16%	0.13%	0.04%
Discount Rate	0.75%	0.75%	0.75%
3-Month LIBOR	0.43%	0.47%	0.25%

The data used to compile the above tables come from publicly available sources. Tandem believes it to be reliable, but makes no such assertions. Such data is not meant to imply past or future performance for Tandem or any securities market.

KEY MARKET DATA	6/30/12 Close	% Change 1 Year	% Change 3 Years	% Change 5 Years
S&P 500	1,362.16	3.14%	48.17%	-9.39%
Dow Jones Industrial	12,880.09	3.75%	52.48%	-3.94%
NASDAQ	2,935.05	5.82%	59.94%	12.75%
Russell 2000	798.49	-3.50%	57.10%	-4.22%
German Xetra DAX	6,416.48	-13.01%	33.43%	-19.87%
London FTSE 100	5,571.15	-6.30%	31.11%	-15.69%
Shanghai Composite	2,225.43	-19.43%	-24.80%	-41.75%
Crude Oil	$84.96	-10.96%	21.56%	20.20%
Gold	$1,598.50	6.18%	71.05%	145.73%
CRB Index	284.19	-15.93%	13.69%	-9.99%
U.S. Dollar Index	81.60	9.69%	1.80%	-0.39%
Dollar/Euro*	126.58	-12.71%	-9.80%	-6.51%

** Negative return represents dollar strength, positive return represents dollar weakness. Returns are cumulative, not annualized.*

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