THE TANDEM REPORT

Volume XVII, Issue 2 April 2016

"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 useful.

Respectfully,

John B. Carew
President,
Chief Investment Officer

In This Issue

All performance figures, charts and graphs contained in this report are derived from publicly available sources believed to be reliable. Tandem makes no representation as to the accuracy of these numbers, nor should they be construed as any representation of past or future performance.

MARKET COMMENTARY:
Volatility Returns

It was a good quarter for our clients, but the stock market certainly got off to a wild start for 2016. In fact, the S&P 500 experienced its worst beginning to a new year ***ever***. Things were so bad that by February 11th, the S&P was down 10.59% for the year.

The sell-off in stocks coincided with a collapse in the price of oil. To be sure, oil prices had been on the decline for some time. But as fears of a global recession took hold, the decline accelerated and brought stock prices down as well. The price of a barrel of crude oil fell from $37.13 at the end of 2015 to a low of $26.19 just six weeks later. Coincidentally, oil bottomed the same day the S&P 500 did.

Just as oil and stocks had fallen together, they began to rally together. From the February 11th low through quarter's end, the S&P gained 12.6% while crude oil surged 38.8%.

By March 31st, after the big sell-off and

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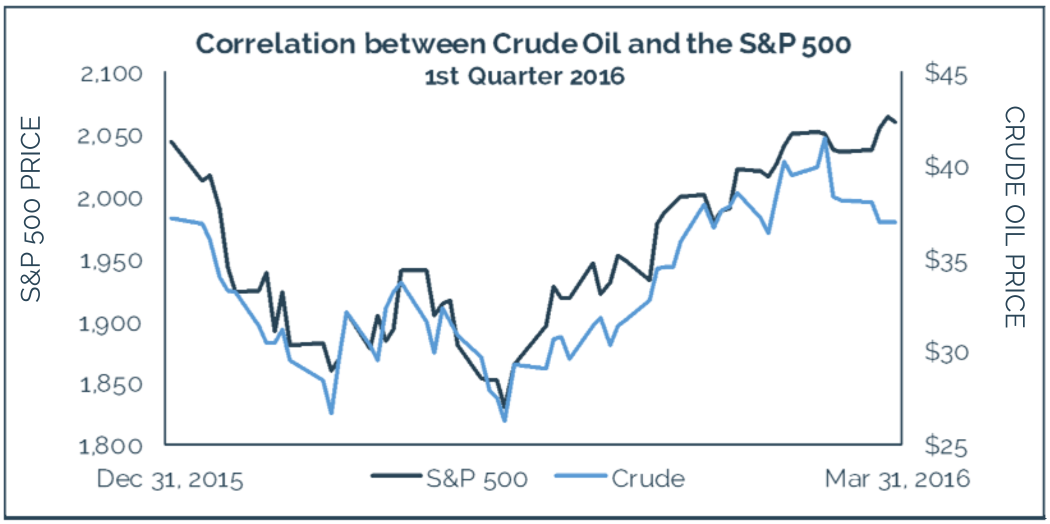

COMMENTARY:
This Market has a Fundamentals Problem

The stock market has a fundamental problem. Or perhaps better stated, the market has a problem with its fundamentals.

Historically, stocks have been valued based on the expectation of their future earnings. When earnings and earnings expectations rise, stock prices generally follow. Sometimes, in more speculative times, prices rise in anticipation of future earnings growth yet to materialize. Either way, it has typically been reasonable to presume that earnings and price enjoy some sort of relationship with one another. That no longer seems to be the case. At least for now.

The harsh reality is that Corporate America is in the midst of an earnings recession and no one is talking about it. If we use the S&P 500 as a proxy, 12 month corporate earnings have de-

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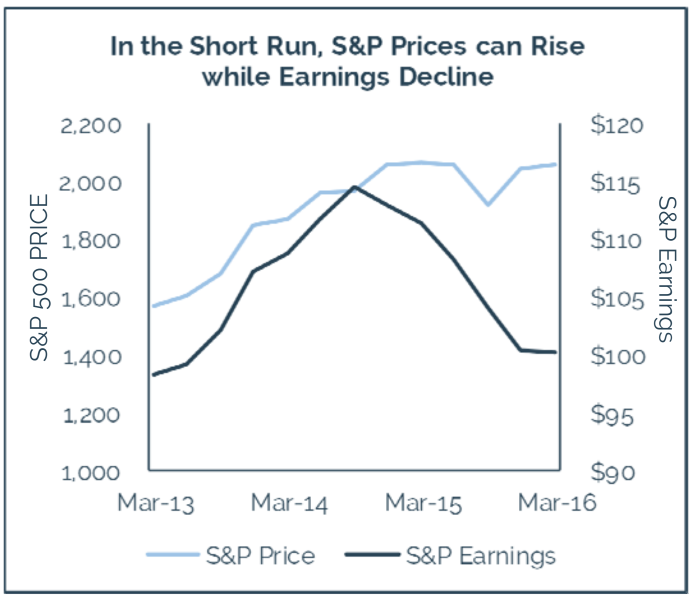
clined for 6 consecutive quarters. After peaking in September, 2014 at $114.51, earnings have declined each quarter since. The most recent projection, for the quarter ended in March, is expected to come in around $100.32. This represents a decline of 12.39%. Over the same time frame, the price of the S&P has actually risen by 4.43%. That is a disconnect. Worse, for the past 3 years earnings have only increased by 1.05% while price has increased by 31.26%. This is not sustainable.

There appears to be little improvement on the horizon. The table above to the right displays earnings expectations for this year and next at 3 month intervals. One year ago the S&P was expected to earn $135.03 for all of 2016. After steadily declining over the ensuing 4 quarters, estimates now stand at $117.78 for 2016. This number will likely continue coming down. And while there certainly are not a lot of data points yet, the trend for 2017 seems to be more of the same.

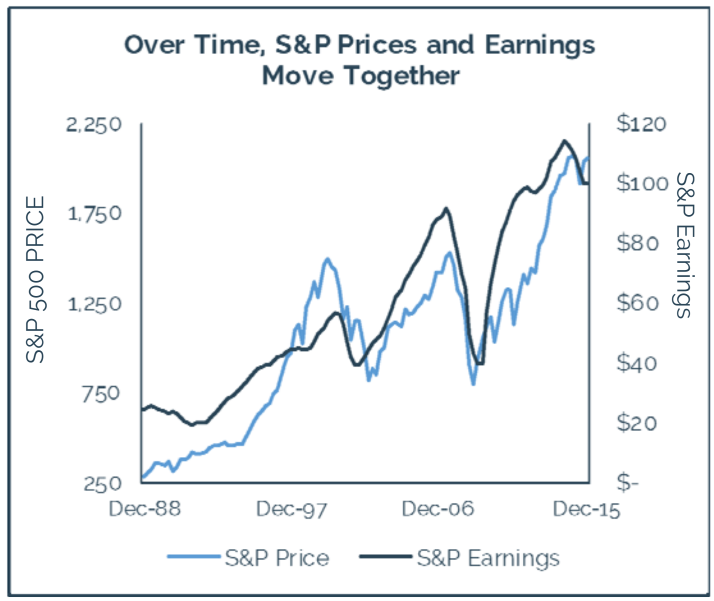
S&P 500 Earnings Estimates for 2016 and 2017

OBSERVATION	2016 EST	2017 EST
3/31/2015	$135.03	
6/30/2015	$132.36	
9/30/2015	$129.37	
12/31/2015	$125.56	
3/31/2016	$118.12	$135.95
Current	$117.78	$135.60

Source: www.standardandpoors.com



Source: www.standardandpoors.com



Source: www.standardandpoors.com

Ordinarily earnings recessions of this duration are accompanied by economic recessions. This is a meaningful earnings recession, not in terms of the magnitude of its decline, but certainly in terms of its persistence. Yet it has largely been ignored by the market. Why? Why are we not seeing signs of mean reversion?

We may actually be in a recession right now. Who knows? Maybe the Federal Reserve and their counterparts around the globe have so distorted things that recessions are masked. Maybe there can be no more recessions as long as Central Banks intend to keep asset prices inflated by forcing interest rates to zero and below. Maybe there really is something different this time. Maybe there really is no alternative to stocks.

That's a lot of maybes. We prefer certainties. One thing we are certain of is that it is never different this time. The Fed or some other external factor can confound markets in the short run, but never in the long run.

The Fed's distortion of markets cannot be overstated. To that end, we uncovered some interesting data and share it with you now in the chart immediately to the right at the bottom of page 3. Since October 9, 2007, the S&P's price has increased 31.6%. If we remove the days that the Fed FOMC met over that time period, the price change is –13.8%. Wow. Can the Fed really account for more than 100% of the market's gains?

Stock prices can stay higher than fundamentals warrant for a long time if Central Banks continue their current policies. We will continue to invest based on fundamentals. In time, they will matter again. In time, prices and earnings will revert to their historic relationship.

Cash Levels Revisited

Cash levels in our portfolios have reached record amounts. Higher even than in 2008. Reactions have been interesting and we have had more than a few conversations about this.

Most have been very positive. They express some measure of appreciation that there is ample cash held in reserve as prices are near record levels. No one has been negative, but some have had some questions. So let us revisit this topic.

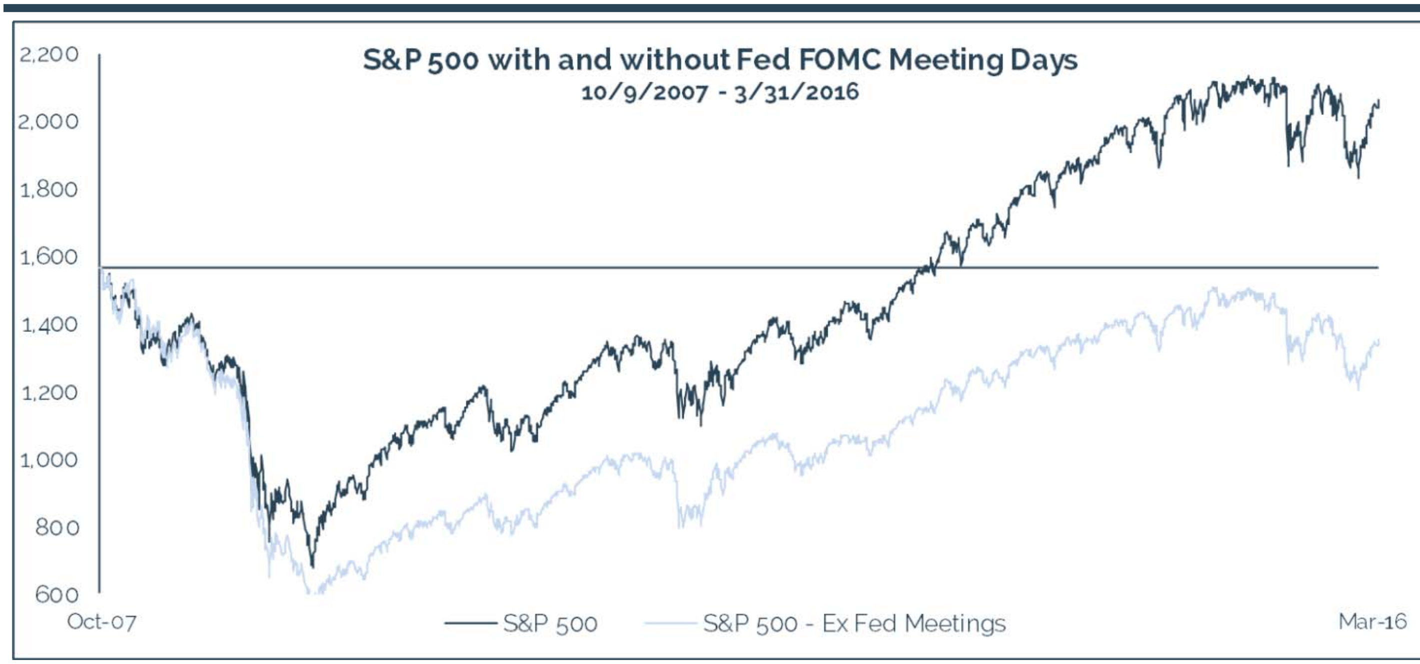
Rather than answer the questions already asked and anticipate some others, it might be more instructive to revisit our process and to discuss how the cash came to be in the first place and why it is a key component of our discipline even if we earn zero on it. Before we go there, let us clarify one thing. We do not actually hold "cash" in portfolios. The cash is invested a money market fund. However, money markets currently pay essentially 0% so it is as if we were holding cash in that sense. If rates ever rise, the interest earned on this portion of a portfolio will presumably also rise.

Every decision we make is done on a stock-by-stock basis. We have no view of "the market" that influences the decisions we make. Sometimes we find ourselves with more stocks to buy than sell. This could be dubbed a buyer's market. In such a market, when we buy more than we sell, cash levels (money market) will decline.

Presently we find ourselves in a seller's market that began at the end of 2013. If you read the rest of this newsletter this revelation should come as little surprise. This has been a wonderful time to take some profits in overvalued stocks. Additionally, some stocks have ceased growing and no longer meet our criteria. They get liquidated. As a result of having more things to sell than buy, cash has been on the rise.

Having that cash available when needed is critical. If we were to invest the cash in a higher yielding alternative, it is possible that we could put the principal at risk or make it so that when the time comes to use the cash the alternative vehicle has lost value or can't be sold. A CD, for instance, is not liquid without penalty. Then our hard work would be for naught.

When the time comes to buy, we will have cash available to buy stocks and decrease cash reserves. Isn't this the way it is supposed to work? We buy low and sell high. The best time to buy and the best time to sell don't happen at the same time. Sometimes we need to be a little patient. The earnings lost on cash in the short run should be more than made up in the long run. We think this is how smart portfolio management works.



The chart above depicts the S&P 500 Price with the dark blue line. The time period represents the current market cycle, beginning when the S&P made historic highs in October 2007 before the financial crisis and ending in March 2016. The light blue line shows the S&P 500 Price for the same time period removing the 124 days of Federal Reserve FOMC meetings and counting those days as a zero return. The results are staggering. The dark blue line shows a gain of 31.6%. The light blue line shows a **loss** of –13.8%. In other words, if there were no Fed actions and announcements, stock market returns would presumably be negative since 2007. The market is clearly being driven by expectations of continued Federal Reserve support, not corporate and economic fundamentals.

Sources: FactSet for prices and www.federalreserve.gov for Fed FOMC meeting days.

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ensuing rally, prices had barely changed for the year. Oil was down 0.51% and the S&P was up 0.77%. With all of that drama, prices ended changed less than 1%. If you weren't watching, the 1st quarter was a non-event. However, if you *were* watching, you knew that volatility was back in the markets. And we took advantage of it for you.

It was indeed a good quarter for our clients, as we produced solidly positive returns without assuming an aggressive posture. As you know, we are supposed to buy low and sell high. With this amount of volatility, we had the opportunity to do both.

When the market sold off so aggressively at the start of the year, we got the opportunity to establish a new holding in Intercontinental Exchange in our Large Cap Core and Equity strategies, while adding to our holdings in Scripps Networks and Cerner in their relevant strategies as well. These have been profitable buys.

As the market recovered sharply, we parted company with some old friends like Colgate, Piedmont Natural Gas and Praxair. Piedmont is being acquired while Colgate and Praxair have stopped growing and no longer meet our criteria.

We also had the opportunity to take a little profit in some solid but overvalued names. While we still hold all of these in our various portfolios, we sold 25% of our holdings in Dollar Tree, Fiserv, O'Reilly Automotive, T. Rowe Price, TJX Cos., Ross Stores and Wal-Mart.

S&P 500 Sector Performance Q1 2016		
Sector	**% of S&P 500**	**1st Qtr Return**
Consumer Discretionary	12.90%	1.20%
Consumer Staples	10.40%	4.90%
Energy	6.76%	3.10%
Financials	15.63%	-5.60%
Health Care	14.28%	-5.90%
Industrials	10.13%	4.30%
Information Technology	20.83%	2.20%
Materials	2.83%	3.00%
Telecommunication Services	2.79%	15.10%
Utilities	3.45%	14.50%

Source: www.standardandpoors.com

We used volatility to our advantage. At the market's lows we put money to work. As the market approached its old highs, we took profits. We bought low and we sold high - precisely the way it is supposed to work.

The return of volatility left many investors shaken and looking for a safe haven. The best performing industry sectors in the S&P 500 for the 1st quarter were Telecommunications Services and Utilities, two sectors generally considered to be defensive and dividend oriented. The worst performing sectors were Health Care and Financials, two sectors that can be more economically sensitive.

Our safe haven isn't a sector but rather a discipline. We seek to take advantage of the market's volatility while limiting the volatility in our clients' portfolios. Volatility can cause investors to make poor decisions. When the market keeps going higher, many investors chase it and buy more at ever higher prices. We blame this reaction on a phenomenon called FOMO, or Fear Of Missing Out. Others might call it basic greed. Either way, investors see stocks going up and don't want to be left out. On the flip side, when prices are falling, investors oftentimes get scared and want out. This is basic fear.

Both reactions are mistakes. We all know rationally that we want to sell when prices get expensive and buy when they get cheap. It is just so hard to put that kind of discipline in place for most folks when volatility rears its head. Emotion is the investor's worst enemy, and volatility loves to play on human emotions.

As the 1st quarter ended, oil and stock prices seemed to have stabilized. Perhaps the worst is now behind us and stocks will continue to rally. On the other hand, the economic news has been mixed at best and corporate earnings have really taken it on the chin. The lack of fundamental support for higher stock prices certainly confounds us, and likely many others

It has been 10 months since the S&P 500 reached a new high. We have seen two 10% pullbacks but prices have recovered both times, even as fundamentals deteriorate. How can this be? Long-time readers of ***The TANDEM Report*** will recall that we have often said that it is not different this time. It is never different. History may not repeat itself but it certainly rhymes. History tells us that stock prices cannot remain at these lofty levels without the underlying support of improving fundamentals. And there is little sign of improvement on the horizon (see *Commentary* on page 1). Yet stock

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prices are proving resilient.

There is something different this time though. Never before have Central Banks around the globe all acted so aggressively to keep asset prices inflated. And to their credit they have thus far succeeded. How long can this continue? Who knows? It has never been attempted before.

Perhaps continued Central Bank increases in global liquidity can keep prices higher indefinitely, or even permanently. Maybe economic conditions no longer even matter when interest rates are essentially zero and stocks are one of the only investments that can produce a real return. Perhaps prices will just keep going higher because there is no alternative.

Perhaps not.

Annual Dividend Growth for Tandem's Holdings by Strategy
from Q1 2015 to Q1 2016

Large Cap Core 1 Yr. Dividend Growth

Company	Dividend Growth
Abbott Laboratories	8.33%
AbbVie	16.33%
Accenture Plc	7.84%
Aptargroup	7.14%
Becton, Dickinson	10.00%
Brown & Brown,	9.09%
Brown-Forman Corp Cl B	6.25%
Coca-Cola	6.45%
Costco	11.11%
CSX	12.50%
Dominion Resources,	8.33%
Ecolab	6.06%
Expeditors International	12.50%
W.W. Grainger	8.33%
Intercontinental Exchange	15.38%
ITT	9.09%
Microsoft	16.13%
National Retail Properties	4.76%
NextEra Energy	5.48%
T. Rowe Price	18.18%
QUALCOMM	14.29%
Republic Services	7.14%
ResMed	20.00%
SCANA	3.77%
Scripps Networks Cl A	15.00%
J. M. Smucker	4.69%
Stryker	8.57%
TJX Companies	16.67%
Tractor Supply	25.00%
United Technologies	8.47%
Wabtec	33.33%
Wal-Mart	2.08%
Walgreens Boots Alliance	5.88%
Waste Connections	7.69%
Average	**10.94%**

The list of holdings above for Tandem's 3 strategies are as of 3.31.2016. These lists do not constitute investment advice, nor do they represent performance of any Tandem investment product. FactSet is the source of data for the above calculations.

Equity 1 Yr. Dividend Growth

Company	Dividend Growth
Abbott Laboratories	8.33%
AbbVie	16.33%
Accenture Plc	7.84%
AMETEK	0.00%
Aptargroup	7.14%
Becton, Dickinson	10.00%
Brown & Brown,	9.09%
Brown-Forman Corp Cl B	6.25%
Cerner	NA
Coca-Cola	6.45%
Cognizant Technology	NA
Costco	11.11%
CSX	12.50%
eBay	NA
Ecolab	6.06%
Expeditors International	12.50%
FMC Technologies,	NA
W.W. Grainger	8.33%
Intercontinental Exchange	15.38%
ITT	9.09%
MEDNAX	NA
Microsoft	16.13%
NextEra Energy	5.48%
O'Reilly Automotive	NA
PayPal Holdings	NA
T. Rowe Price	18.18%
QUALCOMM	14.29%
Republic Services	7.14%
ResMed	20.00%
Scripps Networks Cl A	15.00%
Signature Bank New York	NA
Stryker	8.57%
Thermo Fisher Scientific	0.00%
TJX Companies	16.67%
Tractor Supply	25.00%
United Technologies	8.47%
Wabtec	33.33%
Walgreens Boots Alliance	5.88%
Waste Connections,	7.69%
Average	**11.23%**

Mid Cap Core 1 Yr. Dividend Growth

Company	Dividend Growth
AMETEK	0.00%
Aptargroup	7.14%
Becton, Dickinson	10.00%
Brown-Forman Cl B	6.25%
Brown & Brown	9.09%
Cerner	NA
Cognizant Technology	NA
Dollar Tree	NA
Ecolab	6.06%
Expeditors International	12.50%
Fiserv	NA
FMC Technologies	NA
W.W. Grainger	8.33%
ITT	9.09%
MEDNAX	NA
National Retail Properties	4.76%
O'Reilly Automotive	NA
ResMed	20.00%
Ross Stores	20.00%
Republic Services	7.14%
Signature Bank New York	NA
SCANA	3.77%
J. M. Smucker	4.69%
Scripps Networks Cl A	15.00%
Stryker	8.57%
Thermo Fisher Scientific	0.00%
T. Rowe Price	18.18%
Tractor Supply	25.00%
Wabtec	33.33%
Waste Connections	7.69%
Yum! Brands	10.82%
Average	**10.76%**

Wabtec is the leading dividend grower over the past 4 quarters in all 3 Tandem strategies, posting an increase of 33.33%. Tractor Supply, another company found in all 3 strategies, is the 2nd leading dividend grower with an increase of 25.00% . ResMed and Ross Stores grew their dividends by 20.00% since last year.

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Yield table			
	Current	3 months ago	1 year ago
3-month Treasury Bill	0.29%	0.23%	0.03%
2-year Treasury Note	0.88%	0.98%	0,64%
5-year Treasury Note	1.38%	1.70%	1.52%
10-year Treasury Bond	1.89%	2.24%	2.04%
30-year Treasury Bond	2.68%	2.97%	2.63%
Prime Rate	3.50%	3.37%	3.25%
Federal Funds Rate	0.36%	0.24%	0.11%
Discount Rate	1.00%	0.87%	0.75%
30 yr Fixed Mortgage	3.69%	3.96%	3.77%

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				
	3/31/16 Close	% Change 1 Year	% Change 3 Years	% Change 5 Years
S&P 500	2,059.74	-0.39%	31.26%	55.35%
Dow Jones Industrial	17,685.09	-0.51%	21.31%	43.55%
NASDAQ	4,869.85	-0.63%	49.04%	75.11%
Russell 2000	1,114.03	-11.07%	17.08%	32.06%
German Xetra DAX	9,965.51	-16.72%	27.84%	41.53%
London FTSE 100	6,174.90	-8.83%	-3.69%	4.50%
Shanghai Composite	3,003.92	-19.85%	34.31%	2.59%
Crude Oil	37.55	-21.48%	-59.60%	-63.49%
Gold	1,234.20	4.32%	-22.61%	-14.23%
CRB Index	170.52	-19.51%	-42.47%	-52.56%
U.S. Dollar Index	94.58	-4.14%	13.72%	24.33%
Euro/Dollar*	1.14	6.05%	-11.23%	-19.67%

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