The TANDEM Report

TANDEM Investment Advisors

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Market Analysis:
What's an Investor to Do?

Inflation is back, apparently. Or at least the market is concerned enough about its return to drive interest rates higher and sell economically sensitive stocks. There is talk of a looming recession, or even stagflation! The theory goes that higher borrowing and energy costs will squeeze corporate profits. Even more troubling, consumers, the driving force behind the growing economy, continue to spend more than they make - a game that cannot go on indefinitely. Negativity is plentiful, making this both a difficult and frustrating environment for equity investors.

In our view, there are some positive trends worth noting. GDP, the measure of economic growth, remains robust. Corporate earnings continue to grow at solid levels, with most companies in our universe meeting or exceeding Wall Street's expectations. As a result of steady profit growth over the last few years, stocks are becoming less expensive on a valuation basis. The math is simple. PE ratio, a common valuation tool, is calculated by Price divided by Earnings. If a company earns $1, and sells for $10, it has a PE of 10/1, or 10. If earnings grow 20% to $1.20, and the share price is still at $10, the PE contracts to 8.3. Without the stock even going down, it has become less expensive. How about that? Unfortunately, prices have gone down, magnifying lower valuations.

The frustration for most investors stems from the market's dismissal of the positive. The S&P's five-year return for the period ended March 31 is among the worst five-year periods in the last fifty-five years. In that span, this country has been through the Korean War, Viet Nam, the first Gulf War, double-digit interest rates, runaway inflation, an oil embargo, a presidential assassination attempt and a presidential impeachment trial. Are the

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COMMENTARY:
SUPPLY, DEMAND AND THE WISDOM OF A CHILD

Art Linkletter used to host a television show with a popular segment called "*Kids Say the Darnedest Things*". Mr. Linkletter interviewed children, and their responses provided great entertainment. Some of those responses astonished the audience for their unexpected insight. I was reminded of this show recently by a similarly insightful comment from my eleven-year-old son.

Weary of hearing grown-ups bemoan the high price of gasoline, my son decided it was time I learned how things work. He asked if I remembered a few years ago when gas was $0.89/gallon. I said that I did, and wondered why he asked. Because, he asserted, gas would be cheap again one day. Curious, I asked why he was so certain of this. He explained that when gas was cheap, we used a lot of it, and pretty soon, we needed more than the oil companies could produce. So they raised their prices. When it gets too expensive, we will buy less,

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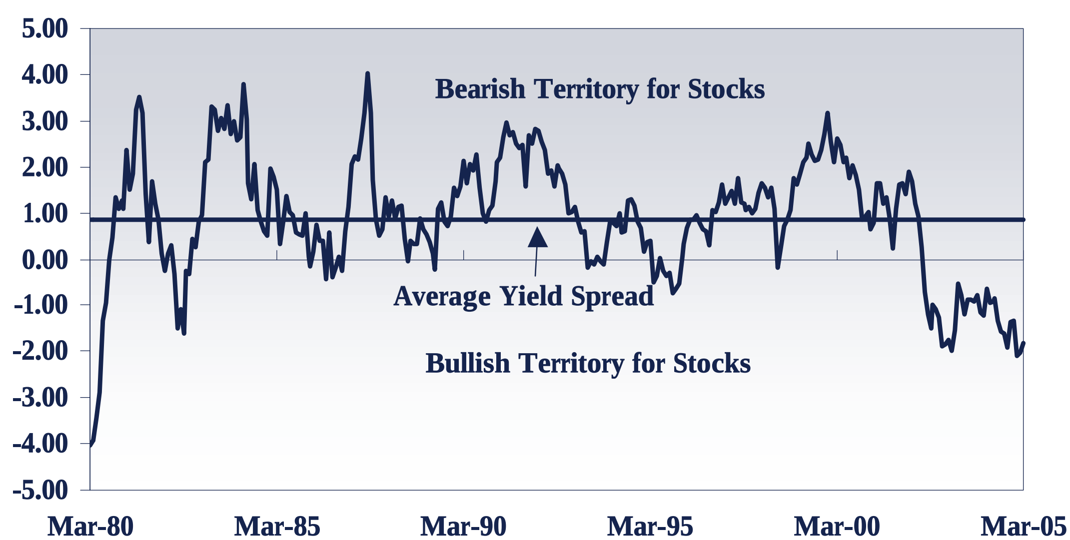
MARKET STATISTICS

Stock Market Indices as of 3/31/2005						
	Close	% Change YTD	% Change 1 Year	% Change 3 Years Annualized	% Change 5 Years Annualized	% Change 10 Years Annualized
S&P 500	1,180.59	(2.59%)	4.43%	0.95%	(4.66%)	8.95%
Dow Jones Industrial Average	10,503.76	(2.59%)	1.41%	0.32%	(0.78%)	9.70%
NASDAQ 100	1,482.53	(8.55%)	3.07%	0.68%	(19.54%)	12.72%

Yield Table as of 3/31/2005				
	Current	1 month ago	6 months ago	1 year ago
3-month T-bill	2.8%	2.6%	1.7%	1.0%
5-year Treasury	4.2%	3.8%	3.4%	2.8%
10-year Treasury	4.5%	4.2%	4.1%	3.8%
Prime Rate	5.6%	5.5%	4.6%	4.0%
Fed Funds Rate	2.75%	2.5%	1.75%	1.0%

Difference in Yield between the 10-Year Treasury Note and the S&P 500 Earnings Yield



Our Top Holdings by Investment Style

EQUITY GROWTH

		3/31/05	Div
Company	**Symbol**	**Price**	**Yield %**
Allied Capital	ALD	26.10	8.7
Altria	MO	65.39	4.5
Amgen	AMGN	58.21	0.0
Applied Materials	AMAT	16.25	0.7
BB&T	BBT	39.08	3.6
Biomet	BMET	36.30	0.6
BP	BP	62.40	2.8
Colgate-Palmolive	CL	52.17	2.2
ConocoPhillips	COP	107.84	1.9
Engineered Support	EASI	53.52	0.1
Exxon Mobil	XOM	59.60	1.8
FMC Corp	FMC	53.45	0.0
FMC Technologies	FTI	33.18	0.0
Fortune Brands	FO	80.63	1.6
General Dynamics	GD	107.05	1.5
General Electric	GE	36.06	2.4
Home Depot	HD	38.24	1.0
Johnson & Johnson	JNJ	67.16	1.7
Microsoft	MSFT	24.17	1.3
T. Rowe Price	TROW	59.38	1.5
Average Yield			**1.9**

EQUITY INCOME

		3/31/05	Div
Company	**Symbol**	**Price**	**Yield %**
Allied Capital	ALD	26.10	8.7
Amgen	AMGN	58.21	0.0
BB&T	BBT	39.08	3.6
Biomet	BMET	36.30	0.6
Boston Properties	BXP	60.23	4.3
BP	BP	62.40	2.8
Colgate-Palmolive	CL	52.17	2.2
Commercial Net Lease	NNN	18.45	7.0
Exxon Mobil	XOM	59.60	1.8
Fortune Brands	FO	80.63	1.6
General Dynamics	GD	107.05	1.5
General Electric	GE	36.06	2.4
Home Depot	HD	38.24	1.0
Johnson & Johnson	JNJ	67.16	1.7
Microsoft	MSFT	24.17	1.3
Pfizer	PFE	26.27	2.9
Piedmont Nat. Gas	PNY	23.04	4.0
SCANA	SCG	38.22	4.1
T. Rowe Price	TROW	59.38	1.5
Wells Fargo	WFC	59.80	3.2
Average Yield			**2.8**

Corrections & Comments

John Higgins, Senior Vice President at Morgan Stanley in Charlottesville, caught an editing error in our last issue. We discussed beta throughout the newsletter, but incorrectly defined it on the first page. The correct definition was given on page 2, in the "What Drives Stocks" article.

John goes on to write that "(g)enerally speaking, the higher the beta, the more risky the investment. But without a high R-squared, a beta statistic can be meaningless. R-squared determines how much an investment's return is correlated to its benchmark. R-squared is a measure of a stocks correlation to the market calculated by comparing monthly returns over the past three years to those of a benchmark. The R-squared number ranges from zero to 100. A score of 100 means a perfect correlation with the benchmark. A score of 85 means an 85% correlation. Generally, a higher R-squared will indicate a more useful beta figure." Well said.

We stand corrected, and also acknowledge that, in the future, we should not attempt to cover such technical information in such few words. Our apologies to our readers, and our thanks to John Higgins.

SUPPLY, DEMAND AND THE WISDOM OF A CHILD (CONTINUED)

(Continued from page 1)

and the price will come back down. Fascinated by his insight into the machinations of the global crude oil market, I naturally asked when I could expect to pay less. His answer, while less than gratifying to my wallet, was instructive nonetheless. He explained that he could not predict when, exactly, but that higher prices would make oil producers increase supply and buyers decrease demand. Whenever supply is once again greater than demand, prices will come down.

I did not learn economics in the fifth grade as my son apparently has. I had to wait for Keith J. Crocker to teach me about the law of supply and demand at the University of Virginia. But it is one the most basic underpinnings of a free market economy. As I contemplate what to make of the stock market's meanderings, this reminder could not have been timelier.

Recently, many clients have asked why the market is going down in spite of a strong economy and growing earnings, or words to that effect. Lacking a definitive answer, I find myself tempted to quip that there are more sellers than buyers. The market just can't seem to find any positive traction. In fact, now more than half way through the decade, the S&P is down 19.65%. By comparison, the worst return for the S&P by decade since 1950 is the seventies, when the index was up a mere 17.25%. The only other decade that realized a gain for the index of less than 200% was the sixties (53.66%). So why can't this market go up?

Certainly every decade is different. As for this one, here is a quick glance at some of our circumstances. GDP rose by 4.4% in 2004 and is expected to rise again this year by more than 3%. S&P 500 earnings increased 23.7% in 2004, and are expected to rise again this year by 10.4%. Corporate dividend increases last year were at or near record levels, and are expected to rise meaningfully again this year. These are heady growth figures. On the flip side, the budget deficit continues to widen, the dollar is weaker against most major currencies and the price of oil is within 10% of its all-time high. All are certainly causes for concern. Which numbers are more important?

Investors are constantly confronted with a group of often-conflicting facts to which they must collectively digest and respond. At various times, similar facts are acted upon quite differently. In the 1990's bad news was greeted as a buying opportunity, while in the 1970's good news was a rare opportunity to sell. The most elementary difference is investor sentiment. In the 1970's, nobody wanted to own stocks. In the 1990's nobody wanted to be left out. As demand decreased, prices fell, and as demand increased, prices rose. Today's investor is no doubt still feeling the sting of the worst three-year period since the onset of World War II. So, at present, it would seem the negative numbers are more important.

The average investor buys stocks in a rising market, and shuns stocks when they decline. This, while not terribly logical, is human nature. Many factors cause stock prices to rise and fall, but none so predictable as greed or fear. In a market such as this, where signals are mixed, investor sentiment carries greater weight.

Stocks have advanced every decade since 1950, yet are falling in this one. Surely they will rise again. Demand will increase and investors will return. What will trigger the necessary change in sentiment is anybody's guess. But my son assures me that it will happen. He just won't tell me when.

JBC

Returns for the S&P 500 by Decade

1950's	**259.60%**	**1980's**	**227.40%**
1960's	**53.66%**	**1990's**	**315.75%**
1970's	**17.25%**	**2000's**	**-19.65%**

Return Comparisons for the S&P 500 since 1950 as of 3/31/2005					
	1 Year Return	**3 Year Return**	**5 Year Return**	**7 Year Return**	**10 Year Return**
Current Return	4.83%	2.89%	-21.22%	7.16%	135.79%
Historical Average	9.12%	28.53%	54.00%	81.57%	130.63%
Best & Worst	53.5% on 6/83 -41.4% on 9/74	120.0% on 3/98 -43.4% on 3/03	220.0% on 12/99 -31.8% on 9/74	237.2% on 12/99 -34.3% on 9/74	370.5% on 8/00 -24.5% on 9/74
Rank among all periods	406 out of 652 1-year periods	519 out of 628 3-year periods	596 out of 604 5-year periods	520 out of 580 7-year periods	264 out of 544 10-year periods
Percentile Rank	38th Percentile	17th Percentile	1st Percentile	10th Percentile	51st Percentile

The above table attempts to lend perspective to the recent returns of the S&P 500. We calculated returns for every 1-, 3-, 5-, 7-, and 10-year period since 12/31/1949 and compared the present return for each time period with the average, best and worst. We also graded the current returns and found them to be among the worst performing time periods analyzed.

MARKET COMMENTARY (CONTINUED)

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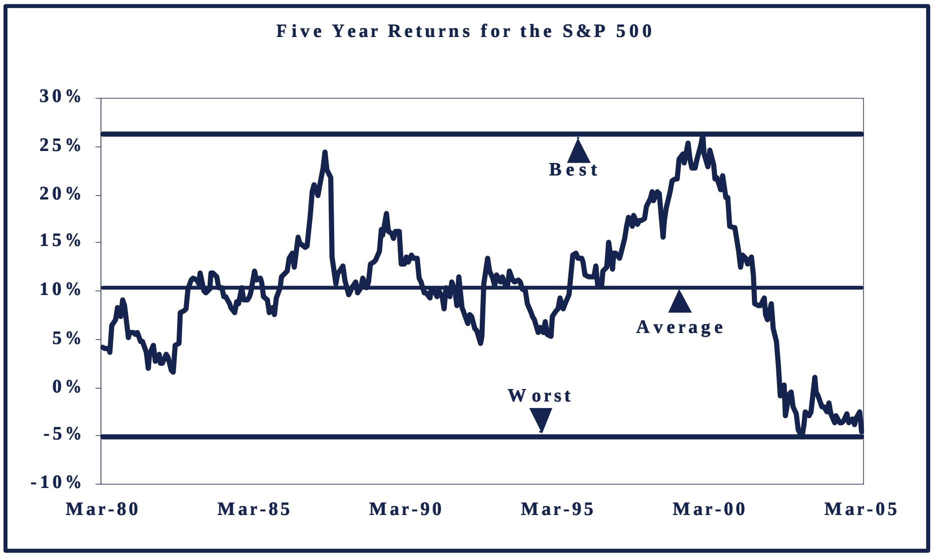
events we face now really more perilous than what we as a nation have previously faced and risen from? Probably not.

The 1970's were a volatile decade, much like the present one. In fact, September, 1974 marked the bottom of a protracted negative period for the market. All of the worst periods listed in the table above culminated in the sell-off of 1974, with the exception of the three-year period ended March, 2003. Yet the market managed to turn positive shortly thereafter, recording a 57% gain for the rest of the decade. The troubling part is that most investors missed this move because they didn't return to the market until 1982.



We do not forecast a similar rebound for the second half of this decade. That would be shear speculation. We simply take comfort in knowing that this stock market has performed poorly, the news is good, and stocks will recover at some point. It is not different this time.

While much of the economic and political news leaves room for improvement, patience with good stocks is advised. Remember, history tells us that the best time to buy is when everyone else is selling.

www.tandemadvisors.com

In Charlottesville:

2 Boar's Head Place
Suite 105
Charlottesville, VA 22903

Phone: (434) 979-4300 or
(800) 527-0101

(This section intentionally left blank)

In Charleston:

901 Daniel Island Park Drive
Suite 201
Daniel Island
Charleston, SC 29492

Phone: (843) 216-3791 or
(800) 303-8316

Tandem Investment Advisors, Inc. was founded in 1990 to provide professional portfolio management with uncompromising service to investors. For more than a decade, we have worked in Tandem with our clients to attain their investment goals. If we can provide further assistance, please contact us.

John B. Carew
Phone: (434) 979-4300
e-mail: jcarew@tandemadvisors.com

Allen Ouzts
Phone: (843) 216-3791
e-mail: caotandem@danielislandmedia.com