THE TANDEM REPORT

Volume IX, Issue 1 January, 2008

TANDEM Investment Advisors

"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 on our web-site. Please visit www.tandemadvisors.com. We hope you find this report informative.

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

Ordinarily we might begin this commentary by summarizing the year that was. In light of recent events, last year is ancient history. Global stock markets have begun 2008 with a major sell-off. Fortunately, we were prepared. In fact, we cautioned about this possibility in our April commentary and have been working diligently to protect portfolios ever since.

The volatility the U.S. markets have experienced since last spring has provided opportunity. We have been consistent sellers on up days and selective buyers of stocks we have faith in as they decline. The net result is that we find ourselves in the middle of a major downturn holding more cash than at any time since 2000. Have we avoided the decline? Absolutely not. But we have fared considerably better than the market. And we have confidence that what we own will lead the market higher whenever the inevitable turnaround comes.

What ails the world's stock markets? A debt hangover. Most blame homeowners that assumed mortgages they could ill afford. This is only partly true. While the real estate boom gave way to a real estate bust, the chief culprit, in our view, was a low global interest rate environment that emboldened speculators to take on excessive risk with borrowed money. The low cost of borrowing emboldened many "professional" investors to load up on cheap debt in pursuit of meteoric returns.

COMPARING CURRENT S&P 500 RETURNS AGAINST OTHER ERAS
DATA FROM JANUARY 3, 1950 THROUGH JANUARY 18, 2008

Time Frame	Ended 1/18/2008	Average Return	Best Return (Period Ended)	Worst Return (Period Ended)
1 Year	-7.36%	9.10%	57.65% (6/13/1983)	-43.25% (9/30/1974)
5 Years	46.95%%	52.22%	221.61% (8/10/1987)	-33.10% (9/30/1974)
10 Years	37.82%	128.08%	378.87% (8/14/2000)	-26.85% (9/30/1974)
15 Years	203.87%	238.43%	838.41% (7/12/1999)	8.74% (9/30/1974)
20 Years	437.60%	380.57%	1,408.06% (4/30/2000)	54.13% (3/1/1982)
25 Years	821.23%	556.87%	2,079.08% (11/22/1999)	119.34% (6/28/1982)

For the 1, 5, 10 and 15 Year time frames the S&P's price appreciation is currently well below the average return for these periods. For 20 and 25 years, the market remains above average in its current return. One observation worth noting is that 1982 was clearly the end of a bad market cycle and 1983 experienced the best 1-year return. Also worth noting is the dismal performance of the 1970's followed by dramatic moves up in the 1980's. This table simply puts things in perspective, and supports our argument that the market is not expensive.

Perhaps this is a good time to review the power of leveraging (borrowing). Imagine there are two investors, the Mega Returns Hedge Fund and the Cautious Farmers' Co-op Fund. They each decide they would like to invest $1,000 in November wheat futures (you laugh). One futures contract costs $1,000. The Mega Returns Hedge Fund buys ten contracts for November wheat with only $1,000 of its own money, borrowing $9,000 from the We Loan to Anybody with a Pulse State Bank. The Cautious Farmers' Co-op Fund, being reticent to borrow any money, can only afford one contract. Within a week after making their investments, the price of wheat soars to record levels, and the November wheat futures contract now sells for $2,000. The Cautious Farmers' Co-op Fund is very pleased that their $1,000 investment is now worth $2,000, a gain of 100%. But the folks at Mega are ecstatic! The value of their ten contracts is now

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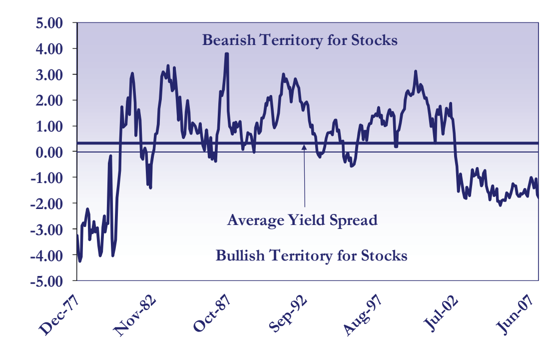
Commentary

As you read this message, I can only imagine that you are concerned about your investments. At the time of this writing, the S&P 500 is down approximately 17% from its October record highs, and you have reason to take notice of recent days' events. I implore you to take a deep breath, consider the facts, and digest what I have to say.

We have worked diligently on your behalf to prepare for the situation we now find ourselves in. While we have not changed in the slightest the way we invest or analyze, we have dramatically renovated our *process* of investing. We have developed the system we call TVM, which is a unique analytical process that has yielded substantial benefit since its implementation nine months ago. Principally, we have removed the human element from the evaluation process and focused it singularly on the "common sense" process. Simply stated, this means that no matter how we feel about the market, no matter what kind of day we are having or which of us is reviewing a particular stock, analysis is systematic. The language of our industry would call this "quantitative" research. We prefer to call it "semi-quantitative" because it blends quantitative and fundamental research in a new and productive manner. The TVM systems identifies from a universe of stocks those that are extraordinary values as well as those that are at risk. The *semi*– part of the process is the review of TVM's output. Collectively, our team enjoys more than 58 years of experience. It is with this background that we review and validate TVM's findings. In your statement that accompanies this report, we report performance for the period since 5/31/2007. This is the date that represents when TVM began to have a measurable impact on your portfolio. We think you will be pleased.

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



I unabashedly proclaim that I am more bullish than I can recall being in my entire 23 year career in this profession. I cannot profess to know when this downturn will end, but having professionally witnessed the crash of 1987, the credit crisis of 1998, the bear market that erased 49% of the S&P's value from 2000 to 2002, several recessions and 9/11, having been a student of markets for the majority of my adult life and simply possessing what I hope to be good common sense, I can say with conviction that this decline isn't like the others (but for regular readers, I am ***not*** professing it to be "different this time"). In past writings, I have loosely compared this decade to the 1970's. I was wrong. Nor is this period like the credit crisis of 1998 brought about by the devaluation of the Thai Baht and the ensuing failure of Long Term Capital. In no way is this market comparable to the post-bubble market earlier in this decade. I see no correlation to 1987. At this time, the most reasonable comparison I can make is to the recession of 1990/1991 that led to a subsequent bull market.

What makes this market different from the others I have cited? In every other circumstance I have witnessed or studied, the market entered bear territory from an overvalued level. A reasonable question to ask is how I define overvalued. As investors, aware or not, we constantly face choices. The purest choice is how much risk we are willing to assume for the likelihood of a certain return. The riskless return that we measure everything else against is the debt of the United States Treasury. When we invest in Treasury obligations, we have no doubt that we will be paid back. Therefore, the Treasury is deemed to be riskless, and its yield is often referred to as the risk-free rate of return. Other investment alternatives carry some measure of risk that we must evaluate against a probable return. Now that I have defined the ultimate benchmark against which we compare risk-bearing investments, I can explain my assertion that this market is not like others entering a decline.

So how does the risk-free rate of return affect our investment decision making? In the 1970's, a 10-year Treasury Note ranged in Yield from about 5.4% to 10.7%. In the 1980's the same Note ranged in yield from 7.0%% to 15.7%. In the nineties, the range was 4.6% to 9.1%. This decade has seen rates as high as 6.8%. As of Friday, January 18th, the 10-year Treasury yielded 3.72%. In light of today's uncertain market, if I could get a risk-free rate of return of 15.7%, 10.7%, or even 9.1%, I would have to think twice about investing in stocks. But the rate I could get today is 3.72%. Therefore, I deem stocks inexpensive, relatively speaking. Further, when contemplating the recent returns of other asset classes including emerging markets, commodities and currencies, I defy you to attempt to persuade me that our stock market is overvalued.

I conclude this appeal for calm by simply stating that, while we may be in for a rough road in the near term, the market enters this decline from a very fair valuation level. The economy, in my view, is not on a precipice. Corporate earnings and consumer health may stumble over the next few quarters, but will return to normal rates of growth in the foreseeable future. Therefore, I am quite optimistic about the market's prospects whenever its logical and justifiable ascent returns. Thank you for your indulgence.

~ JBC

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$20,000, and they only invested $1,000. That is a return of 1,000%. While the brain trust at Mega is busy congratulating themselves for their brilliant insight, China and India announce that they have formed the Sino-Indian Wheat Alliance, and plan to flood the world with Asian wheat. The price of a wheat futures contract immediately plummets to $500 (again you laugh). Well, the Farmers have lost $500, but they don't mind owning wheat. The Mega Fund has no interest in owning wheat. After all, they live in Manhattan. What could they possibly do with all those bushels of wheat they just bought? But the value of their investment has dropped from $20,000 to $5,000, and the We Loan Bank wants their money back. Mega owes them $9,000. Their wheat investment is only worth $5,000, so even if they sell it, they still owe We Loan Bank $4,000 more dollars. What does Mega Fund do, you ask? They sell stock.

# Wheat Contracts	Capital Invested	Capital Borrowed	Purchase Price	Purchase Cost	Current Price	Current Value	Net Value	% Return
Cautious Farmers' Co-op Fund								
1	$1,000	$0.00	$1,000	$1,000	$1,000	$1,000	$1,000	0%
1	$1,000	$0.00	$1,000	$1,000	$2,000	$2,000	$2,000	100%
1	$1,000	$0.00	$1,000	$1,000	$500	$500	$500	-50%
Mega Returns Hedge Fund								
10	$1,000	$9,000	$1,000	$10,000	$1,000	$10,000	$1,000	0%
10	$1,000	$9,000	$1,000	$10,000	$2,000	$20,000	$11,000	1,000%
10	$1,000	$9,000	$1,000	$10,000	$500	$5,000	-$4,000	-500%

To be sure, this is an oversimplification of a complicated situation. Investors are clearly frightened, concerned that the U.S. is headed for a recession. Perhaps these fears are valid. But our markets have weathered recessions before, and will do so again. What makes this market decline noticeably different from previous recession-related bear markets or corrections (whichever this may be) is that stocks did not enter this decline at an expensive level. By all historical measures we believe to be relevant, stocks were inexpensive at their all-time highs in October, and they are even less expensive now. While this market will go wherever fear may take it in the short-term, it remains fundamentally sound. Fundamentals make this retreat radically different from the bear market of 2000-2002, the crash in October of 1987 and even the dismal decade of the 1970's. Interest rates are exceedingly low, as is inflation, and stock prices are fair if not cheap.

The consumer, which accounts for approximately 70% of our Gross Domestic Product (GDP), is essential to any economic or stock market recovery. The real question is whether we, as consumers actually suffering, or are we merely afraid because the news is so bad? We suspect the latter to be the case. No doubt some are struggling.

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Politics & Economics

With the political season in full swing, we thought we would offer up our wish list for the candidates. Not that we hold any hope of reason prevailing, but just because we thought you might enjoy it.

Our first wish is that the tax rate reductions on dividends, capital gains and estate taxes be made permanent. This seems to us a reasonable wish, and one you might share. If the capital gains rate reverts back to a higher rate at the end of 2010, there will be selling pressure to capture the lower tax rate before it reverts, and this could depress the stock market. The dividend rate is essential as well. If we pay less in taxes for our dividends, we will pay more for our stocks. If we pay more in taxes, we will logically pay less for our stocks. And lastly, the estate tax at reduced rates creates less selling to pay taxes.

Our second wish is even less likely to come true. We wish that Republicans would realize that tax cuts don't solve the nation's problems and that Democrats would realize the same about tax increases. Enough about taxes (other than the ones cited in our first wish). Rather than bickering about revenues (taxes), a sincere effort to control expenses would be more fruitful.

Our third wish is for no more economic stimulus packages. Short-term fixes inevitably lead to long-term problems. The best of intentions have unforeseen consequences. Buying votes is not a winning economic plan.

Whatever the outcome of the primaries and general election, we are confident the market will adapt. We wish your candidate well.

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However, unemployment is only 5%, inflation is very low and our borrowing costs are falling (thanks to another rate cut by the Fed on the day of this writing). The American consumer is a resilient sort, and we believe that any slowdown/recession will be short-lived. All of this sets up for a very rapid recovery in stock prices once the bottom is found.

The new year is off to a rough start, but that doesn't mean it will finish the year that way. If you are nervous, please don't be. This downdraft will run its course. We are in possession of an abundance of cash to buy with discipline what others will sell with fear. We find ourselves at this tumultuous time in the position of the vulture, not the meat. Take heart. The best course is to set a plan of action, not reaction. The glass is half-full, to be sure.

MARKET REPORT CARD

STOCK MARKET INDEX DATA

Stock Market Indices	12/31/2007 Close	% Change 1 Year	% Change 5 Years	% Change 10 Years
S&P 500	1,468.36	3.53%	66.89%	51.31%
Russell 3000 Growth	2,711.43	11.40%	79.59%	45.62%
Dow Jones Industrials	13,264.82	6.43%	59.02%	67.73%
NASDAQ 100	2,084.93	18.67%	111.81%	110.43%
Russell Mid-Cap	5,703.01	5.60%	130.87%	157.32%
Russell 2000	3,276.77	-1.57%	112.26%	98.24%
GLOBAL MARKET INDEX DATA				
Hang Seng	27,812.65	39.31%	198.38%	159.38%
Shanghai	5,261.56	96.66%	287.55%	NA
Nikkei 225	15,307.78	-11.13%	78.43%	0.32%
Brazilian Bovespa	63,886.00	43.65%	466.97%	526.52%
London FTSE 100	6,456.90	3.80%	63.86%	25.73%
German Xetra DAX	8,067.32	22.29%	178.89%	90.97%

YIELD TABLE

	Current	3 months ago	1 year ago
3-month Treasury Bill	3.25%	3.94%	5.04%
5-year Treasury Note	3.28%	4.25%	4.65%
10-year Treasury Note	3.90%	4.56%	4.66%
30-year Treasury Bond	4.35%	4.80%	4.76%
Prime Rate	7.25%	7.75%	8.25%
Federal Funds Rate	4.25%	4.75%	5.25%
Discount Rate	4.75%	5.25%	6.25%
3-Month LIBOR	4.68%	5.24%	5.36%

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.

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10-Year Chart of the S&P 500