THE TANDEM REPORT

Volume XII, Issue 1 January, 2011

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 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:
YEAR CLOSES STRONG, RISK RETURNS TO THE MARKET

The U.S. stock market roared to life in the fourth quarter, posting a gain of 10.2% for the S&P 500. A combination of anticipated Fed stimulus and some less-anticipated positive economic news stoked enthusiasm for risk-taking among investors. While we welcome the positive economic news, we will explore here whether riskier investments are priced appropriately.

Those sectors benefitting most from economic improvement and the Fed's policies led the advance. The Energy (+20.9%), Materials (+18.5%) and Consumer Discretionary (+12.1%) sectors all handily outperformed the broader index. Less economically-sensitive sectors like Utilities (0.0%), Health Care (+3.1%) and Consumer Staples (+5.3%) were left behind.

The Fed has embarked upon a program designed to hold interest rates low and pump money into the economy. In doing so, the hope is to stimulate a greater circulation of money by motivating investors, banks and corporations to take greater risks with their cash.

The economic growth the economy is now experiencing, albeit limited, is obviously a good thing that will ultimately benefit all sectors. On the other hand, financial engineering by the Fed may help kick-start a sluggish economy but the positive effects of such actions are unsustainable. We need only think back a few years to the last time the Fed held interest rates artificially low. Real estate was initially the benefactor and ultimately the victim. There are two things we know about government intervention: it is always done with good intentions and it always has unintended consequences. Artificial stimulus leads to mispriced assets. Assets may remain mispriced for a long

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COMMENTARY:
INVESTORS LACK THE TOOLS NECESSARY TO QUANTIFY RISK

Rising markets can make risk-takers of us all. Falling markets can make us swear off risk for all time, or at least until markets rise again. Greed and fear are powerful influences. Most of us only think of risk in terms of losing money. But risk exists even in profitable investments. Just because we don't perceive risk in winning investments does not mean it doesn't exist.

Intuitively we know that the balance of risk and return should be the key ingredient of every investor's decision-making process. Yet the financial industry does not provide investors with the data necessary to properly weigh the two. We are forced to guess about the level of risk we are taking. We all want maximum return and minimum risk. The order of importance seems to depend upon the direction of the market.

Most individual investors do not have access to the appropriate tools required to assess risk and its relationship to return. It is not their fault. We all know that with added risk comes the potential for both out-sized gains and out-sized losses. Investments are typically only measured by return. There are no other readily available means of comparison. One investment returns an annualized rate of 10% while the other only returns 8%. If this is the

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time, but eventually market forces will drive prices lower to a more sustainable level.

Before we delve into how risk should be priced, perhaps it is best to think of weighing risk and return this way. How much would you risk to make a dollar? Risking $10 to make $1 may not seem attractive. Risking $0.50 to make $1 might. The question is a bit simplistic, but serves a point. Risking $10 to make $1 becomes more attractive to some when money-making choices are limited. The Federal Reserve is limiting our money-making choices.

With interest rates on most savings instruments near zero, investors are understandably seeking higher rates of return. The temporary actions of the Fed are enticing investors to assume risks they might not otherwise contemplate and we are concerned that investors are paying more than potential returns justify. There is nothing inherently wrong with risk as long as it is priced fairly. Consider the three hypothetical investment options equally priced in Table 1 below:

Table 1: *Comparing risk & return in investments*

	Expected Return	Risk*	Return per Unit of Risk**	Initial Price	Expected Value
Option 1	2.00%	2.00	1.00%	$10.00	$10.20
Option 2	10.00%	20.00	0.50%	$10.00	$11.00
Option 3	20.00%	25.00	0.80%	$10.00	$12.00

** Risk is defined as Standard Deviation, a measure of the volatility of returns.*
*** Return per unit of risk is expected return divided by risk.*

As risk increases, so too does the expected rate of return. This is logical - the more risk being taken, the greater the potential return one would expect. Option 1 has the highest return per unit of risk. This is problematic because riskier investments should have rates of return per unit of risk at least equal to that of the less risky assets, if not higher. In Table 1, risk is not being appropriately valued because investors are not being adequately compensated.

Table 2: *Adjusted to appropriately price risk*

	Expected Return	Risk*	Return per Unit of Risk**	Initial Price	Expected Value
Option 1	2.00%	2.00	1.00%	$10.00	$10.20
Option 2	20.00%	20.00	1.00%	$9.17	$11.00
Option 3	25.00%	25.00	1.00%	$9.60	$12.00

** Risk is defined as Standard Deviation, a measure of the volatility of returns.*
*** Return per unit of risk is expected return divided by risk.*

Table 2 illustrates how the assets might be more appropriately priced when the degree of risk is taken into consideration. Expected returns must increase and initial prices must decrease for the riskier assets to be fairly valued.

A risk appropriately priced is a risk worth taking. Investors seeking higher returns can drive valuations beyond those justified by the expected returns. It is unrealistic to expect that Fed action will have lasting positive effects on economic fundamentals. It may have long-term inflationary consequences, but inflation unaccompanied by economic expansion ultimately inhibits economic growth. As the Fed succeeds in driving asset prices higher, risk is once again being mispriced. This represents the unintended consequence of government intervention.

Risk can remain mispriced for very long periods of time. The risks investors seem most interested in taking now anticipate inflation and a declining dollar resulting from Fed and government policy. In our view, fundamentals must ultimately support asset prices because artificially low interest rates cannot. While assets benefitting from the unintended consequences of intervention may continue to surge for some time, eventually reality may differ from perception. Risk mispriced will have to correct.

When artificial stimulus has run its course, organic growth must sustain further advances. Stock prices are driven by corporate earnings and earnings are now back to pre-crisis levels. Stock prices are understandably higher to reflect this rebound. However, until something in the U.S. emerges as an economic growth engine, it is difficult to see how stocks continue to advance in the remarkable manner they did in the 4th quarter. We expect choppiness over the next several years while government intervention untangles itself from the economy so that real economic growth is more apparent. We remain cautious but committed to stocks with visible earnings and dividend growth.

As for the market we are presently experiencing as opposed to what might become of it later, the tremendous surge of the 4th quarter is likely to pause or even retreat soon. From the depths of despair in early 2009, the S&P has climbed back in an impressive fashion. Those stocks most believed to have been in danger have recovered far more dramatically than those that continued to sustain and grow their businesses without government assistance. Eventually stocks must advance for more mundane fundamental reasons.

As the market reaches higher levels as a result of the combination of an improving economy and Fed stimulus, risk increases. We advise investors to pay more attention to the levels of risk they are taking. The potential return is now less. Risk must be appropriately priced.

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only information available to us, we choose the one that returns 10%. But this isn't always an apples-to-apples comparison. It doesn't tell us how volatile the returns may be or what the worst-case scenario is.

Many investors believe they can withstand losses as long as their investments outperform in the long run. This justification of risk ignores the critical role luck can play. An investor hoping to retire in 2009 may have withstood the tech bubble in 2000 but the financial crisis of 2008 came at precisely the wrong time.

With only performance history as a guide, how do we know the risks we are taking? Comparing investment returns simply doesn't give us enough data. We cannot help but wonder if behavior might be different if only risk data were provided. Tandem's Billy Little created the chart below to compare risk across a sample of investments. The notion behind the chart is that professionals have the tools to quantify risk, while most individual investors do not. Professionals use Standard Deviation as a common measure of risk. Standard Deviation can be used as a predictor of the volatility of an investment's returns. Higher standard deviations indicate greater potential swings in returns.

Individuals typically don't think of risk in terms of Standard Deviation. Instead, on a scale of 1 - 10, with 1 being the riskiest, an investor might say "I'm a 7". That same investor, with only past returns to judge an investment's merits, might own a China ETF with a risk of 1.5 on a 1 - 10 scale. The risk of the investment does not match the investors risk tolerance.

Volatility is perhaps the most important, and least understood, component of returns. An investment that returns 100% in year 1 and then loses 50% in year 2 has a 0% return. An investment that gains 10% in year 1 and loses 5% in year 2 has a 4.5% return. We cannot know in advance when the volatility of the first investment will hurt us. For the investor that has no need for the money immediately, it simply means they earned nothing for two years and maybe

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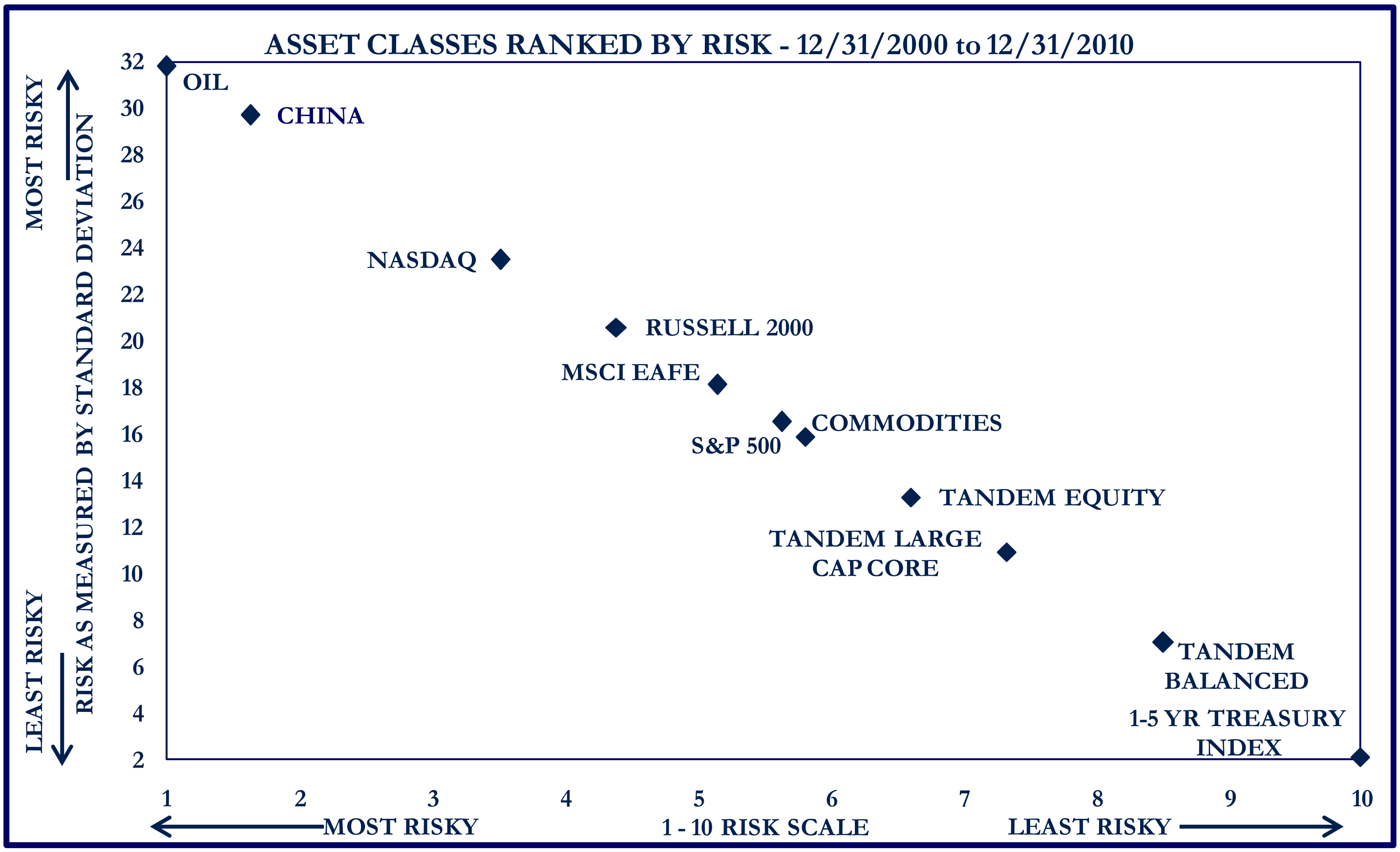

Risk is measured by Standard Deviation using monthly returns (Net of Fees for the Tandem returns) and then converted to a numeric scale of 1– 10. The Citi 1-5 Year Treasury Index represents the least risky asset in this comparison and therefore has a numeric risk of 10. The price of Light Sweet Crude Oil is used for Oil and represents the riskiest asset in this comparison. It therefore has a numeric risk of 1. China is represented by the Shanghai Composite. Commodities are represented by the CRB Index. All index statistics are calculated using monthly returns for the 10-year period ended 12/31/2010. Data used in these calculations were provided by Thomson Reuters and Interactive Data. The data is believed to be from reliable sources but Tandem makes no claim to its accuracy. Tandem data is derived from Tandem Composites comprised of existing, fee-paying Tandem accounts. Individual accounts may experience results that differ from the Composites. A complete disclosure of Composite definitions and returns is available upon request. Past performance is no guarantee of future results.

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year 3 will be fruitful. But for the investor that has to pay for a wedding in year 2, year 3 will come too late.

More importantly, the second investment will need to return less in year 3 than the first investment. This is the power of compounding. Everyone likes big returns, but big losses can do far more damage than big returns can overcome. Losses leave investors with less money to compound in the future. Without adequate information to understand risk, investors are left to *guess* the amount of risk they are taking on.

Gamblers have it much easier. Theirs is a simple calculation, really. Put $100 on a 10-1 bet and there are only two possible outcomes: win $1,000 or lose $100. A gambler knows the risk beforehand.

We believe investors should know the risk beforehand as well. Yet our industry does not make this information easy to provide in a manner that can be readily understood. The chart on the preceding page takes us hours to compile. To do something like this for each client would cause us to abandon portfolio management just to explain the level of risk we accept! We wish there were products available to report to you in such a manner but there is not.

However, Tandem does provide its data to various databases and occasionally they provide us with useful information that we can share. Callan Associates, a leading institutional investment consultant, recently analyzed the returns for our Large Cap Core style through 9/30/2010 and provided us with the following tables. The first table (Return Analysis) provides the data most investors typically see - performance. It ranks Tandem's Large Cap Core Composite performance against Callan's database of Large Cap Core managers. As you can see, we were in the 93rd percentile for the 3rd quarter, the 47th percentile for the past year, the

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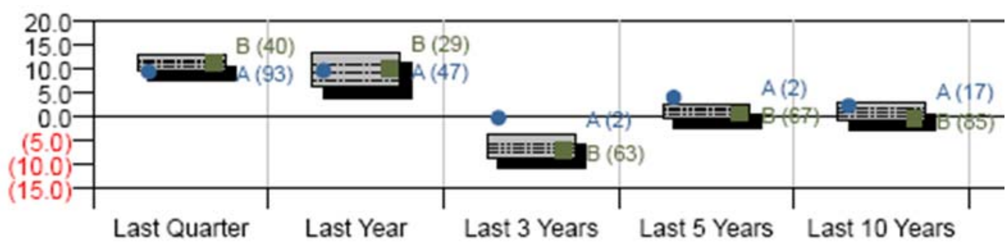
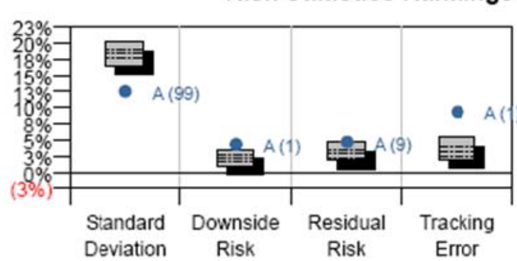
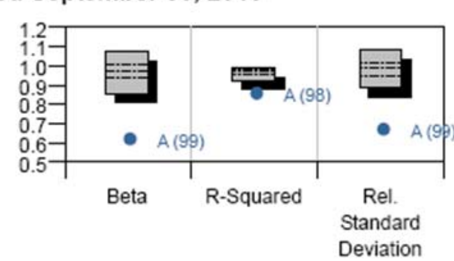
Return Analysis



	Last Quarter	Last Year	Last 3 Years	Last 5 Years	Last 10 Years
10th Percentile	12.76	13.48	(3.63)	2.70	2.88
25th Percentile	11.75	10.93	(5.71)	1.90	1.92
Median	11.11	9.29	(6.51)	1.15	0.97
75th Percentile	10.34	7.56	(7.43)	0.44	(0.02)
90th Percentile	9.71	6.11	(8.70)	(0.28)	(0.61)
Tandem:Large Cap Core ● A	9.44	9.59	(0.25)	4.02	2.28
S&P:500 ■ B	11.29	10.16	(7.16)	0.64	(0.43)

Risk Statistics Rankings for five years ended September 30, 2010





	Standard Deviation	Downside Risk	Residual Risk	Tracking Error
10th Percentile	20.17	3.52	4.66	5.48
25th Percentile	19.03	2.59	3.40	4.00
Median	18.41	2.09	2.88	3.16
75th Percentile	17.70	1.62	2.31	2.36
90th Percentile	16.53	0.98	1.89	1.96
Tandem:Large Cap Core ● A	12.54	4.35	4.71	9.35

	Beta	R-Squared	Rel. Standard Deviation
10th Percentile	1.07	0.99	1.08
25th Percentile	1.01	0.99	1.02
Median	0.97	0.98	0.99
75th Percentile	0.94	0.96	0.95
90th Percentile	0.86	0.93	0.89
Tandem:Large Cap Core ● A	0.62	0.86	0.67

Peer Group: CAI:Lg Cap Core Style

Risk Adjusted Return Measures vs S&P 500 Index
Five Years Ended September 30, 2010

	Alpha	Treynor Ratio	Information Ratio	Sharpe Ratio	Excess Return Ratio
10th Percentile	1.70	0.12	0.57	0.01	0.57
25th Percentile	1.32	(0.71)	0.34	(0.04)	0.31
Median	0.58	(1.46)	0.18	(0.08)	0.18
75th Percentile	(0.24)	(2.21)	(0.10)	(0.12)	(0.07)
90th Percentile	(0.93)	(3.02)	(0.33)	(0.16)	(0.26)
Tandem:Large Cap Core ●	2.28	2.27	0.48	0.11	0.36

Peer Group: CAI:Lg Cap Core Style

Callan Associates compiled this data for Tandem's Large Cap Core Composite gross of fees. While fees have minimal effect on risk, they can diminish returns. For a complete discussion of the impact of fees and other considerations, please see the Composite Disclosures below. Individual accounts may experience results that differ from the Composite. Past performance is no guarantee of future results. Callan Associates is in no way endorsing Tandem Investment Advisors.

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2nd percentile for 3 and 5 years and the 17th percentile for the last 10 years ended 9/30/2010. While we certainly wish we had performed better in the 3rd quarter, taken as a whole these performance numbers suggest that we have performed quite well relative to our peer group over time. The second and third tables tell us what we wish investors could see regularly. They explain the risk we took to generate these returns. While the terms may be Greek to many, these measures indicate that Tandem's level of risk was *substantially* less than our peer group. All of these indicators attempt to quantify the relationship between risk and return. For Standard Deviation, Beta and Relative Standard Deviation, a lower number indicates less risk. Tandem is at the very low end in all of these measures. For R-Squared, a lower number indicates that performance is less predicted by the S&P 500 while a higher number for Tracking Error has a similar indication. For Downside Risk, Residual Risk, Alpha, Treynor Ratio, Information Ratio, Sharpe Ratio and Excess Return Ratio, we would hope to see higher numbers. In all of these categories, Tandem is at or near the top in delivering less risk and higher risk-adjusted returns.

If investors were provided with this information in a manner that didn't require an advanced degree, we could all make better investment decisions. Perhaps one day our industry will get there. Until then, we will continue to try to keep you informed. Risk needs to be an important part of every investment decision. Risk is not bad provided it is understood before it is undertaken. Investors have only past performance returns to guide them. Our pledge is to deliver *Superior Returns with Less Risk*. Third party verification like Callan's hopefully provides some reassurance.

COMPOSITE DISCLOSURE

Tandem Investment Advisors, Inc. ("The Firm") is a Registered Investment Advisor with the U.S. Securities and Exchange Commission (SEC), and, where required, with all state government securities agencies. Tandem's Large Cap Core WRAP Composite (known as Tandem Equity Income prior to 12/31/2009) has an inception date of March 31, 1991, and consisted of fewer than five accounts prior to December 31, 2001, from March 31, 2002 to June 30, 2002 and from March 31, 2008 to June 30, 2009. The Large Cap Core WRAP Composite includes all appropriate actual fee-paying, discretionary accounts with a minimum client contribution of $100,000. Prior to 9/30/2010, some accounts in the Composite were not part of any WRAP program and were subject to trading costs. All net of fees performance presentations in this document include a hypothetical 1.5% WRAP fee plus trading costs incurred by non-WRAP Composite member accounts. Accounts eligible for this composites are included after one complete calendar quarter under management. Performance results are calculated on a time-weighted basis using a minimum of monthly valuation and are geometrically linked. Total return calculations are used with the inclusion of cash and cash equivalents and the reinvestment of dividends. Tandem uses accrual and trade date accounting for performance calculations. No leverage has been used by Tandem to obtain these returns, and no model results are represented. A complete list and description of the composites is available upon request. Client returns will be reduced by the fees incurred in the management of an investment advisory account. For example, assume that a client places $1,000 under management and Tandem achieves for that client a 10% compound annual total return on a gross basis for a period of ten years. If a management fee of 1.5% of average assets under management per year for the ten year period were charged to the account and deducted from the returns, the resulting compound annual total return would be reduced from 10% per year to 8.5% per year, and the ending dollar value of the account would be reduced from $2,593.74 to $2,260.98. Typical WRAP fees for equity accounts vary. A fee of 1.5% per annum of the value of assets under management (plus trading costs where incurred by non-WRAP accounts) has been used to calculate net performance results. A complete description of the investment advisory fees can be found in Form ADV Part II on file with the SEC and is available upon request. These performance results are not to be shown without the proper accompanying disclosures. Results shown in presentations prior to July, 2010 may differ from results presented here. An internal audit revealed the erroneous inclusion of certain accounts in Composites during periods of withdrawals exceeding 5% of portfolio value. By rule, accounts with cash flows exceeding 5% of portfolio value in a calendar year must be removed from composites for one full calendar quarter.

The S&P 500 is used as the primary benchmark for performance comparisons for Tandem's equity composites. Composite Statistics are based on monthly returns and are not relevant for periods less than 3 years. ***Past performance is no guarantee of future results***.

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MARKET REPORT CARD

YIELD TABLE

	Current	3 months ago	1 year ago
3-month Treasury Bill		0.15%	0.05%
5-year Treasury Note		1.41%	2.34%
10-year Treasury Note		2.65%	3.59%
30-year Treasury Bond		3.77%	4.49%
Prime Rate		3.25%	3.25%
Federal Funds Rate		0-0.25%	0-0.25%
Discount Rate		0.75%	0.50%
3-Month LIBOR		0.29%	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

	12/31/10 Close	% Change 1 Year	% Change 5 Years	% Change 10 Years
S&P 500	1,257.64	12.78%	0.75%	-4.74%
Dow Jones Industrial	11,577.51	11.02%	8.02%	6.44%
NASDAQ	2,652.87	16.91%	20.29%	7.38%
Russell 2000	783.65	25.31%	16.40%	62.07%
German Xetra DAX	6,914.19	16.06%	27.85%	7.50%
London FTSE 100	5,899.94	9.00%	5.00%	-5.18%
Shanghai Composite	2,808.08	-14.31%	141.85%	35.43%
Crude Oil	$91.38	15.15%	49.73%	240.97%
Gold	$1,405.50	27.77%	172.38%	419.02%
CRB Index	332.80	17.44%	0.29%	46.07%
U.S. Dollar Index	78.96	1.41%	-13.30%	-27.75%
Dollar/Euro*	133.88	-6.58%	13.50%	42.51%

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

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