THE TANDEM REPORT

Volume XIV, Issue 4 January, 2013

"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

Market Commentary: déjà vu All Over Again as We are About Back to Where We Began this Crazy Odyssey 5 Years Ago 1

Commentary: What Type of Investor Are You? 1

MARKET COMMENTARY:

DÉJÀ VU ALL OVER AGAIN AS WE ARE ABOUT BACK TO WHERE WE BEGAN THIS CRAZY ODYSSEY 5 YEARS AGO

The S&P 500 recorded its fourth consecutive annual gain in 2012, landing the index approximately where it was when the financial crisis began five years ago. Following a decline of 37.00% in 2008, the subsequent years have yielded returns of 26.46%, 15.06%, 2.11% and 16.00%. Yet few recognize that this has been a good market. And possibly even fewer have participated.

Perhaps the failure to appreciate this market is because the journey has been anything but smooth. The market has withstood many downdrafts the past four years caused by debt ceiling debates, credit ratings downgrades, fiscal cliffs, tax hikes, elections and so on.

Some would argue that each ensuing ascent has been the result of interference from the Federal Reserve or other forms of government meddling rather than an appropriate reflection of fundamentals. Many question the market's ability to remain at these levels.

Some are bullish and believe 2013 will see major market indices reach historic highs. This is what makes for a choppy market - differing views. When neither bulls nor

(Continued on page 2)

COMMENTARY:

WHAT TYPE OF INVESTOR ARE YOU?

A few years back a group of psychologists from Princeton University decided to use brain scanning on a group of volunteers to study brain activity when presented with two options: immediate and deferred gratification. The subjects were offered either a $15 gift card today or a $20 gift card in two weeks. In a majority of the subjects the brain activity stimulated by immediate gratification was sufficient to supersede the activity that might favor the more reasoned option. Most of the subjects opted for the $15 card.

Of interest to us is not why humans select the present over the future, if we may take that leap, but rather that they simply often do. Why is the now seemingly more important to so many of us? Immediate gratification comes in many forms. It isn't always a case of one reward over another. It is often the case of a known outcome versus a less certain outcome. I *need* to get there fast. I *may* get a speeding ticket. I *will* take my lottery winnings in a lump sum. I *may not* live long enough to collect it as an annuity. I *will* get out of the market now. It *may* go lower later. Choosing the immediate over the future will almost always have consequences. Sometimes it is the right decision and sometimes it is not. Far too often, luck, not reason, determines.

Since this is a newsletter about investing and not psychology, we will get to the point: what type of investor are you? Would you rather have the $15 gift card now? In the 1990's too many chose the immediate reward of a market that went up every day and neglected to sufficiently weigh the future outcome of a 50% decline. Now having lived through two 50% declines in a relatively short span, are too many investors opting for the immediate security of risk aversion at the expense of likely future gains? Of course this choice

(Continued on page 4)

(Continued from page 1)

bears can sustain the upper hand, the market becomes more volatile. The tug-of-war that we have experienced, swift advances followed by periodic retracements, is actually how most healthy markets advance. There is an old Wall Street adage that says the market climbs a wall of worry. Well there certainly seems to be plenty of worry as the market climbs its wall.

As we discuss in our *Commentary* this issue, too many investors stayed around long enough to get burned in 2008 and have not come back into the market sufficiently to recapture their losses. Those that stayed have been rewarded. Those that fled have missed out. But who can blame those that had enough and got out? The chart above shows the value of the S&P 500 for the last five years. There are six separate moves exceeding 10%. Four of them exceed 20%. Each up leg has been followed by a meaningful move lower. It's enough to cause whiplash.

Much has improved since the last time the S&P attained these levels. As the table below indicates, dividends, dividend yield, earnings and the PE ratio (a standard measure of valuation) are all more attractive today than they were five years ago, making the market less expensive now. Bulls believe the market is attractive and the economy is improving.

S&P 500	2007	2012
Dividends Paid	$27.23	$31.25
Dividend Yield	1.85%	2.19%
Earnings	$86.20	$101.33
Price/Earnings Ratio	17.03	14.07

However, much is different in a less positive way as well. The Federal Reserve is printing money at an alarming rate, the Federal budget deficit has exceeded $1 trillion four years in a row and counting, the Federal debt has grown from $10 trillion to over $16 trillion and rising and the credit quality of the U.S. has been downgraded, to name but a few. These circumstances cause bears to question future growth as the economy appears unable to stand on its own.

It is our belief that the market has gotten ahead of itself and will most likely correct again in 2013 but that things are incrementally improving and the worst is behind us. There is money to be made in the stock market for the prudent investor. That said, we see no economic growth engine on the horizon to drive the market sustainably and substantially higher. Any push higher will likely not come for economic or fundamental reasons. Rather, we believe that rising interest rates (at some point) will cause a major reallocation among individual and institutional investors away from bonds and into stocks (see *Commentary* in this issue).

While we cannot place a time frame on when such a reallocation might occur, we believe that when it does it will not mark the beginning of the next great bull market. That will occur only when fundamentals justify it. Instead, investors forced out of bonds and into stocks will cause stocks to become expensive again. And as we have seen in the chart above, this will likely lead to a continuation of the pattern of dramatic swings.

At Tandem, we embrace markets such as the one we find ourselves experiencing. This volatility creates opportunity to sell overvalued stocks at higher levels while finding bargains during market corrections. Our methodology leads us to identify companies that forge their own destinies regardless of economic and market conditions.

We offer two main styles of portfolios for our clients. We call them Large Cap Core (LCC) and Equity (clever names). We also offer a Mid Cap strategy but that should be left for another conversation. Each requires that companies grow earnings and cash flow in any economic environment. If dividends are paid, they must grow every year. LCC requires that dividends be paid. In either strategy, when companies

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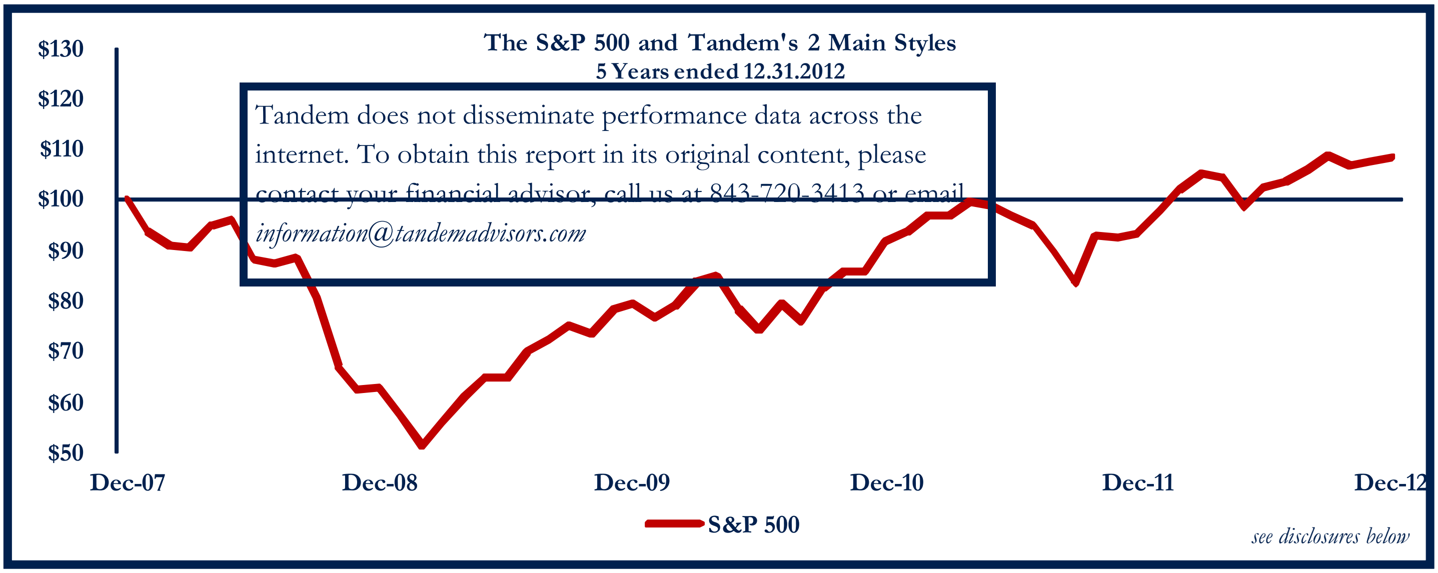
MARKET COMMENTARY (CONTINUED)



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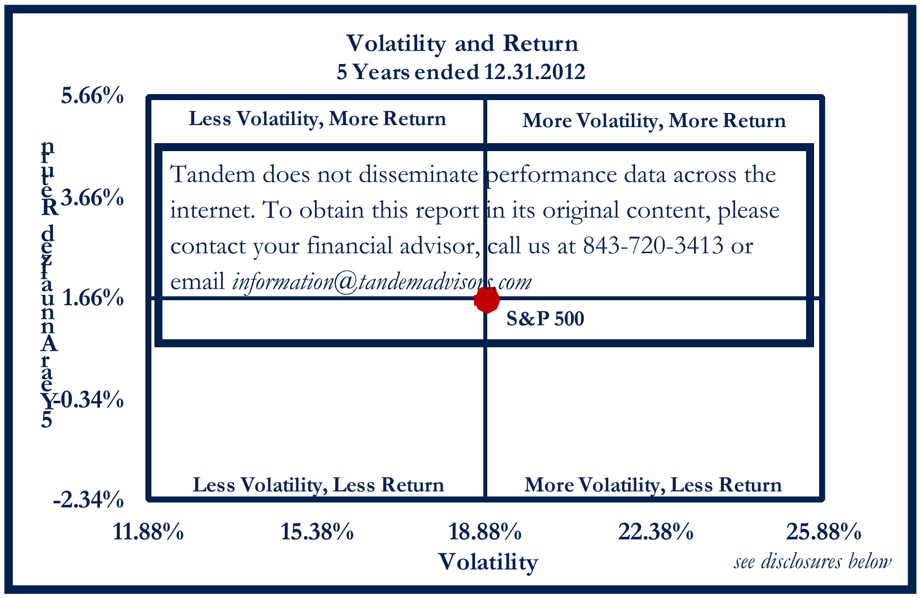

grow due to their own efforts, their stock prices ultimately reflect improving fundamentals. Dividend growth produces income growth, something bonds cannot offer.

The chart above illustrates that over the past five years, Tandem's clients experienced a much shallower decline in 2008 and a quicker recovery in the aftermath than did the S&P 500. Further, the swings highlighted in the S&P on the previous page were less volatile in Tandem's accounts. While it is true that the past is not guaranteed to repeat itself, our clients' experiences led them to stay in the market and recover from the decline of 2008. Other investors, experiencing greater volatility, may not have been as fortunate. As the chart immediately above illustrates, less volatility in choppy markets can lead to better gains and a more pleasant experience.

The past four years have been good ones. The market will likely continue its climb, but no doubt with major bumps along the way. In our view, limiting volatility is the best strategy for staying in the market while staying sane.

*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. The Firm was founded in October 1990, and manages domestic large-cap equity, mid-cap equity, fixed income, and balanced strategies. Tandem's Large Cap Core Composite (known as Tandem Equity Income prior to 12/31/2009) has an inception date of March 31, 1991. The Large Cap Core Composite includes all appropriate actual fee-paying, discretionary accounts with a minimum client contribution of $100,000. Tandem's Equity Composite (formerly called Tax-Deferred Equity Composite) has an inception date of May 31, 2007. The Equity Composite includes all appropriate actual fee-paying, discretionary accounts with a minimum client contribution of $100,000. The gross of fee returns include the deduction of trading expenses. The net of fee composite returns include the deduction of actual custodian and investment management fees. Accounts eligible for this composite are included after one complete calendar quarter under management. Performance results are calculated in U.S. dollars 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. 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 1.0% 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 8.0% per year, and the ending dollar value of the account would be reduced from $2,593.74 to $2,367.26. A complete description of the investment advisory fees can be found in Form ADV Part 2 on file with the SEC at www.adviserinfo.sec.gov 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. *** Revised 7/2012, accounts with net cash flows greater than 5% of the account market value at the start of that quarter removes the account from the composite at the end of the last full month prior to the net cash flow. The account may re-enter the composite after one full calendar quarter as long as the net cash flows are less than 5% of the account market value at the start of the quarter. The S&P 500 is a capitalization-weighted index, calculated on a total return basis with dividends reinvested. It is not possible to invest directly in an index. 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. These Composite returns may differ from the actual experience of clients and fees may differ in certain types of accounts than the fees represented here. Tandem Investment Advisors, Inc. claims compliance with Global Investment Performance Standards (GIPS®). To receive a list of composite descriptions of Tandem Investment Advisors, Inc and/or a presentation that complies with GIPS standards, contact John Carew at (843) 720-3413, or write Tandem Investment Advisors, Inc., 145 King Street, Suite 145, Charleston, SC 29401, or jcarew@tandemadvisors.com.*

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can be rationalized by thinking that it won't be too late to get in the market later. Perhaps on the next big downswing. History suggests this is not a likely outcome.

The behavior of individual investors is unfortunately used by some professionals as a contrary indicator. A look at the two charts below makes clear why. It appears that individual investors make investment decisions by looking backward.

Mutual funds are a preferred vehicle of individual investors. The top chart below illustrates the amount of money investors put into, or take out of, stock mutual funds in every calendar year from 1986 through 2011. The second chart shows the same illustration for bond funds. At the exact time money should have been coming out of funds, it was pouring in in record amounts. Similarly, at every market bottom, when forward thinkers might have been inclined to put money in, the individual investor was actually withdrawing money. The timing of market cycles historically has been nearly perfectly wrong!

Logic tells us to buy low and sell high. Experience tells us we don't do this in practice. Why? Perhaps because when we find ourselves in the midst of fear or greed, the immediate wins over our brains. It is easy for us to form a reasoned opinion when we look at the historical charts below. But when we find ourselves in the moment, we don't have the benefit of looking at a chart of the future. And thus the individual investor incorrectly times his or her investment decisions with predictable regularity. It appears logical at this time, based on the information displayed below, that investors should be taking money out of bonds and putting it into stocks. But they are not. The fear of the past repeating itself is more gripping than the logic of what will likely happen next.

Lest it seem we pick only on the individual investor, profes-

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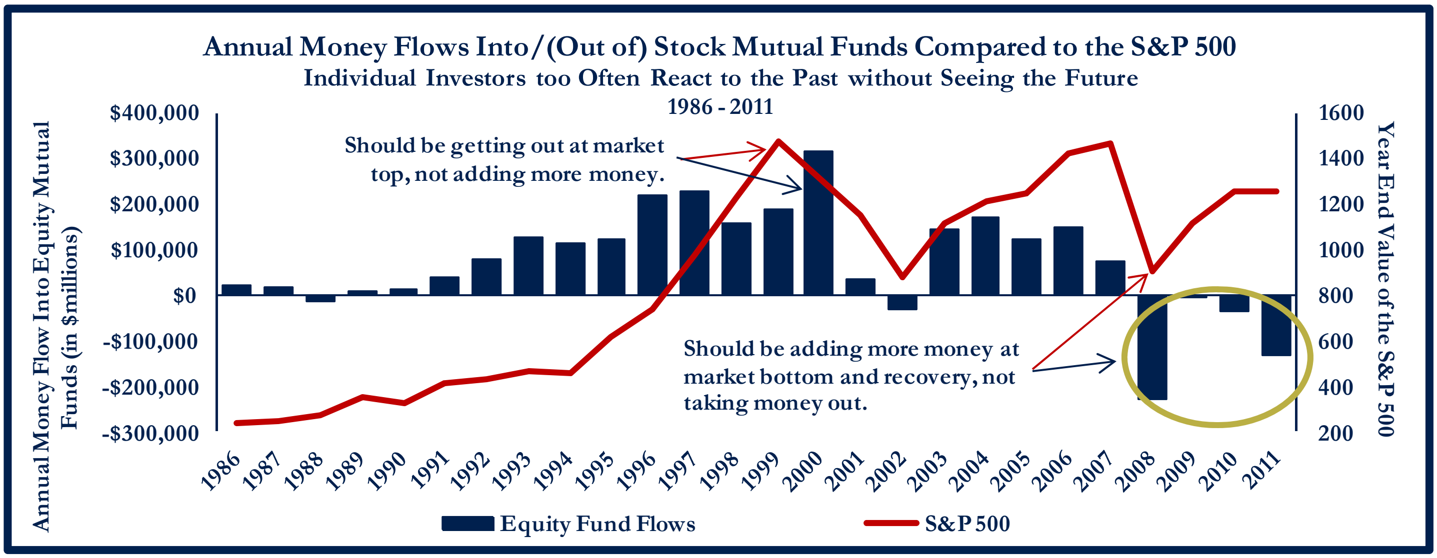

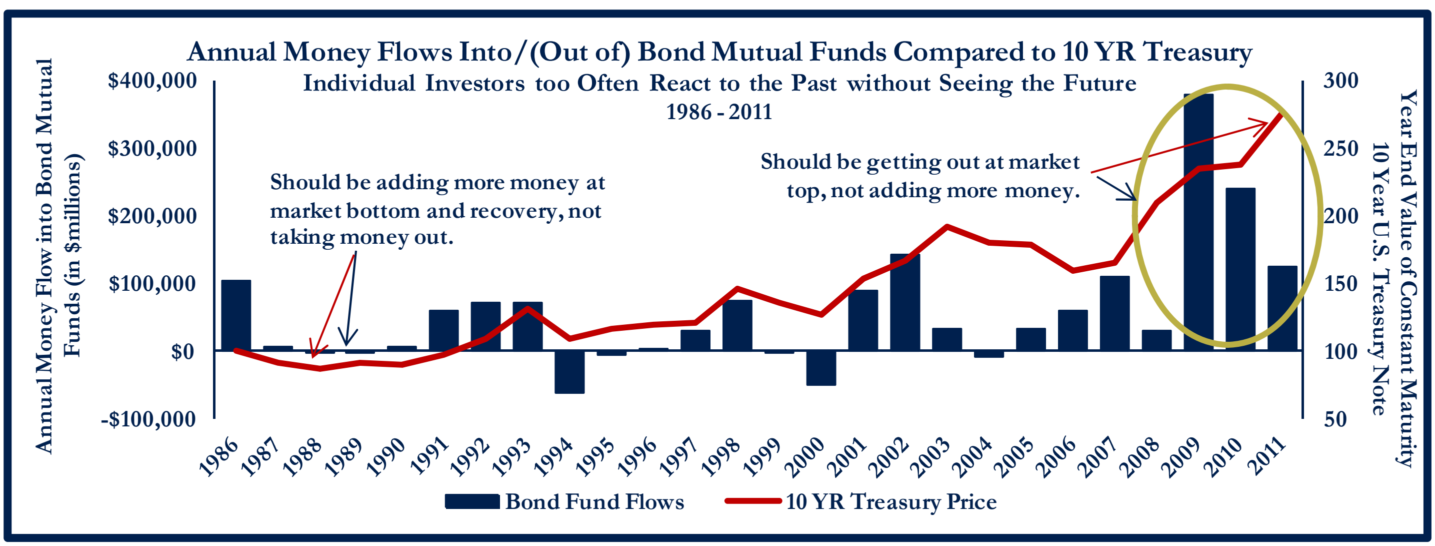

The data used to compile the charts above comes from publically available sources believed to be reliable. Past performance is no guarantee of future results.

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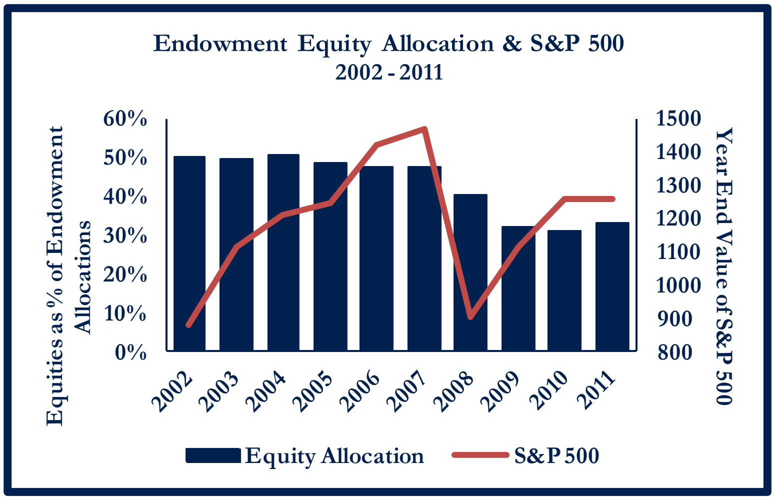
sionals are far from immune to this phenomenon. The so-called "smart money" often fails to see past the immediate, or is at least slow to react. The Endowment chart below is compiled from data collected by the National Association of College and University Business Officers (NACUBO) through their annual survey of college and university endowments. It is plain to see that endowments, viewed by many as "smart money", have steadily reduced their exposure to stocks over the last ten years with little regard to market timing. Endowments have missed the opportunity to add to stocks the past three years as the market has rebounded. This trend will eventually reverse itself, or at least endowments will stop moving away from stocks. And when that happens, all that money that has been flowing out of stocks will stop. This will prove a positive for stocks.



The one thing professionals have demonstrated that individuals have not is discipline. The professional embarks on a plan and follows through. Reduce exposure to stocks consistently over time. Yet they too seem to have succumbed to the immediate at the expense of the future. They were correct to reduce equity exposure prior to 2008, but they were too slow and then accelerated their migration after the market had already declined. Backward looking? Perhaps.

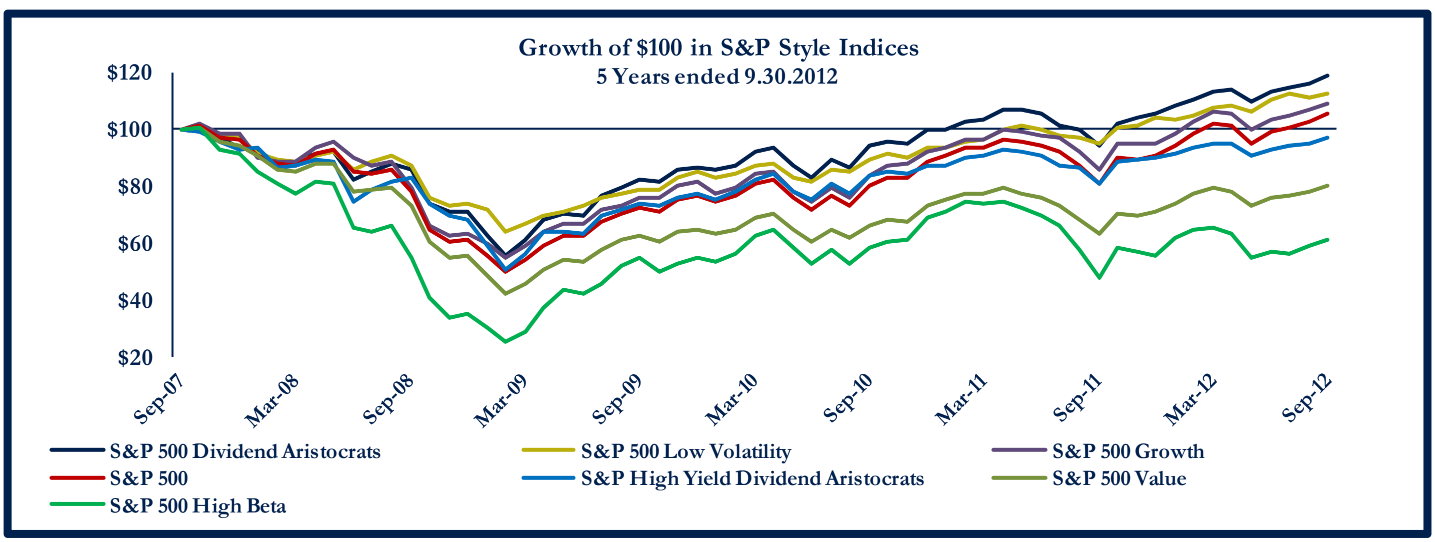
The point is that investing is challenging enough without emotion being part of the equation. We are likely faced with a challenging investment landscape for the foreseeable future. If interest rates finally rise, bond values will decline, perhaps dramatically. If Washington fails to avert the next cliff, the stock market will suffer. What is an investor to do when faced with so much uncertainty?

Clearly stocks appear to offer value at present, but there is no guarantee that this value will be realized any time soon. The road will be a bumpy one no doubt. The prudent approach, the $20 gift card, is not always the easy choice.

We have elected to bring back the chart at the bottom of the page because it teaches a valuable lesson. If you look closely, you see that without exception the indices that lost the least have performed the best. We believe the first rule to making money is to stop losing it, and clearly this approach works in the present environment.

Tandem believes that volatility is the enemy of the individual investor. Volatility makes us opt for the immediate, the emotional, rather than the greater reward for patience. Invest in stocks, but choose the ones that deliver on their promise in spite of Washington, the economy or any other external influence. Limiting volatility reduces the influence of emotion. If extreme outcomes are less likely, perhaps we can reduce the brain's preference for the immediate.

What kind of investor are you? Can you resist the urge to take the $15 gift card? Stick with your plan. Choose the $20 gift card. It is ultimately more rewarding.



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Market Report Card

Yield table			
	Current	3 months ago	1 year ago
3-month Treasury Bill	0.04%	0.11%	0.01%
5-year Treasury Note	0.72%	0.67%	0.88%
10-year Treasury Bond	1.76%	1.72%	1.95%
30-year Treasury Bond	2.95%	2.88%	2.98%
Prime Rate	3.25%	3.25%	3.25%
Federal Funds Rate	0.03%	0.14%	0.07%
Discount Rate	0.75%	0.75%	0.75%
3-Month LIBOR	0.31%	0.36%	0.58%

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				
	12/31/12 Close	% Change 1 Year	% Change 3 Years	% Change 5 Years
S&P 500	1,426.19	13.41%	27.90%	-2.87%
Dow Jones Industrial	13,104.14	7.26%	25.66%	-1.21%
NASDAQ	3,019.51	15.91%	33.07%	13.85%
Russell 2000	849.35	14.63%	35.81%	10.88%
German Xetra DAX	7,612.39	29.06%	27.78%	-5.64%
London FTSE 100	5,897.81	5.84%	8.96%	-8.66%
Shanghai Composite	2,269.13	3.17%	-30.76%	-56.87%
Crude Oil	$91.82	-7.09%	15.70%	-4.35%
Gold	1,662.00	5.86%	51.09%	99.35%
CRB Index	295.01	-3.37%	4.10%	-17.76%
U.S. Dollar Index	79.8	-0.47%	2.49%	4.07%
Euro/Dollar*	131.97	1.87%	-7.86%	-9.58%

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

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