THE TANDEM REPORT

Volume XVII, Issue 3 July 2016

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 useful.

Respectfully,

John B. Carew
President,
Chief Investment Officer

In This Issue

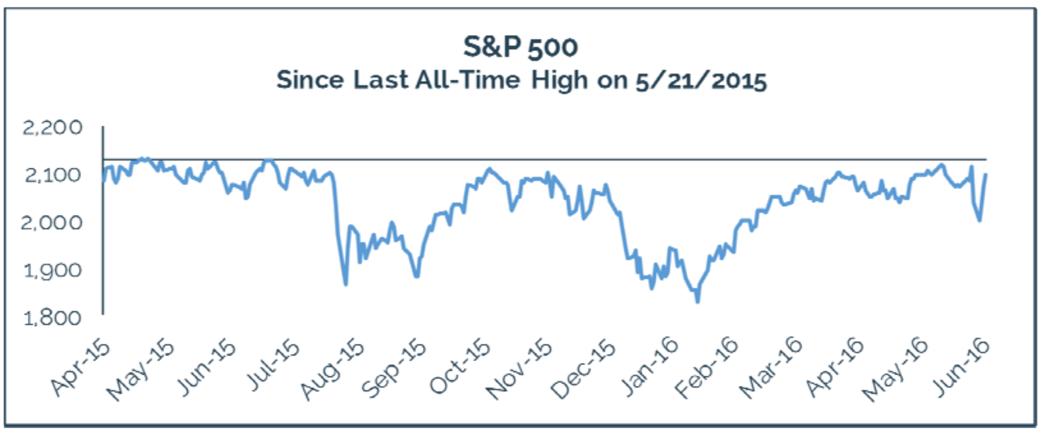
MARKET COMMENTARY:
An Amazing Market with Little Margin for Error

What an amazing stock market this is! Since making an all-time high on May 21, 2015, the market has had two major sell-offs and a quick panic about the U.K. exiting the E.U. Each time the market rallied back to test its highs. After the 2nd quarter ended, it finally succeeded in breaking through.

This market's climb is certainly not based on fundamentals, as we remain in a corporate earnings recession. Brexit was thought to be just the external influence that could derail it. In reality, Brexit was about as relevant to the stock market as Y2K was, which is to say not at all.

What is becoming clear with prices at these lofty levels is that the margin for error is very thin and that most companies are *not* fully participating in the rally. For the 12 months ended June 30, the S&P returned 3.99% with dividends. The average Tandem holding returned 7.8% over the same time period, but the range of returns across all of Tandem's holdings is huge. The best performer, SCANA, returned 53.8%. The worst performer, FMC Technologies, gave back 35.7%. That is quite a disparity. And that is what makes investing in this market

(Continued on page 5)



COMMENTARY:
Beware of the Risks You Don't See

Central Banks around the globe have pushed interest rates to unprecedented lows. In many parts of the world, rates are actually negative. Think about that for just a moment. You are willing to lend your money, and the borrower gets to *charge* you for that privilege. If you lend money to the governments of Japan or Germany by buying their bonds, you pay *them* interest! That's completely backwards and just plain crazy. But that's the world we now confront.

At least in this country you can still get a positive interest rate (for now). But not much of one. You can loan our government money for 10 years and they will pay you about 1.6%. Not very attractive, but still a positive return.

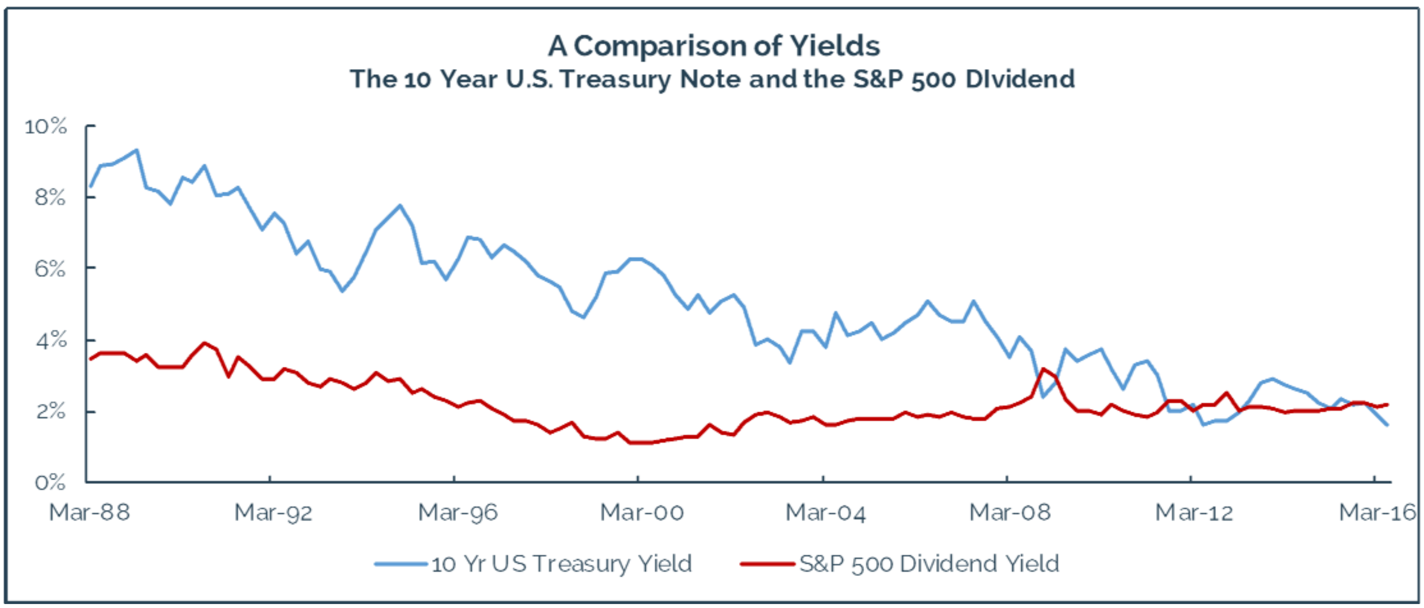
While low interest rates are designed to spur economic growth by making bor-

(Continued on page 2)

(Continued from page 1)

rowing more enticing, the plan doesn't seem to be working so well. Global economic growth is tepid at best.

Instead of fueling economic growth, low rates are posing a real hardship to retirees and others who had expected their savings and investments to produce a meaningful amount of their income. With rates so low, savers and investors are being forced to consider alternative income-producing vehicles, and many are doing so without fully understanding the risks they take. It is a very dangerous circumstance many Americans face completely unaware of the risks they don't see.



Let's start with a bit of history. Historically, bonds have been attractive income producing vehicles with little risk to principal. You buy a bond, collect interest payments, hold it until maturity and get all your money back. The biggest risks typically are the erosion of your principal that inflation may cause and the ability of the bond issuer to pay you back at maturity.

With rates so low, retirees and investors can no longer make enough money owning bonds and must look elsewhere. Many are looking to stocks. The chart above tracks the history of 10 Year Treasury yields and S&P 500 dividend yields since 1988. Prior to 2008, Treasuries yielded more than stocks. Now they don't. Many now ask themselves '*Why accept so little for a Treasury when Company X has a 4% dividend yield?*'. And a new stock investor is born!

In many ways this is reminiscent of the real estate bubble leading up to the Financial Crisis. The real estate market had primarily been made up of people that actually *used* the houses they bought. But then whole new classes of buyers emerged. First came the investor, followed by the flipper. Introducing new buyers to a market increases demand, sending prices higher. Higher prices bring about a cycle that just repeats itself. Higher prices attract more buyers, until there are no more buyers left to attract. They have all bought. And that is how bubbles burst. When there are no more buyers, there is no one left to sell to, and prices collapse.

Today's stock market keeps going higher too. At least part of what drives stock prices higher is the introduction of a new class of buyer - the bond buyer that needs more income. These bond buyers don't *want* to be stock investors, but they now have to be. Forced to expand their search for income-producing investments, they turn to what are commonly viewed as conservative, blue chip dividend stocks. Names like AT&T, Verizon, Altria, Philip Morris International, Duke Energy, Ford and BP have become very popular with investors. Many energy names pay a nice dividend as well-pipeline companies and the like. But those got crushed when the price of oil collapsed, exposing many investors to a loss of principal they hadn't contemplated.

What many fail to realize is that they are taking just as big of a risk in their 'blue chip' companies as they took in the energy companies if they are just buying them for the dividend. The risk they don't see is what happens to the price of their stocks if interest rates rise.

Before we illustrate this risk in a table with math, let's think about it logically. There are many owners of high-dividend stocks that would rather not be stock investors at all. They haven't selected the companies they

(Continued on page 3)

Tandem News

Thank You & Farewell, Welcome, Congratulations and an Updated Policy

Thank you and farewell to Libby Barger, our dedicated teammate and Director of Client Services for the past 4 years. Libby has a great opportunity in Atlanta and we want to thank her for her service and wish her all the best in her new job and city,

Welcome to Allison Snyder, our new Director of Client Services. Allison has spent the past 8 1/2 years in the financial services industry, most recently with SunTrust. We are fortunate that we could persuade her to join our team and are thrilled to have her on board.

Congratulations to Ben Carew on his promotion to Associate Portfolio Manager. Ben has been making his presence felt at Tandem in various capacities since 2013 and has worked under Billy Little's tutelage since 2015. He also served as US Economist for the 3rd College of Charleston Investment Program. Good job Ben.

Lastly, for those of you that come to us through your Financial Advisor, we will no longer be producing quarterly statements for you. If you feel you need to continue to receive our statement in addition to the one from your Advisor, please contact Allison Snyder at 843-720-3413 or asnyder@tandemadvisors.com and she will put you back on the list. Thank you for your understanding.

Commentary (Continued)

(Continued from page 2)

buy based on any fundamental metric like earnings or dividend growth. They have simply bought these companies because of the dividend income they produce. So what would we expect these investors to do with their stock if they found a more satisfactory interest rate in a bond or CD? Most would probably sell their stocks and happily move back to the type of investments they prefer. And what would happen to the prices of those stocks if this investor class became sellers? They would likely fall.

It can be reasonably argued that it will be a very long time before interest rates return to a more useful level. Central Banks do not seem likely to undo the environment they have created any time soon. *But the unseen risk still exists.* And now we will use math and a table.

Let us consider a hypothetical investment in 3 stocks favored among high-dividend investors - AT&T, Duke Energy and Ford. All pay a dividend that yields around 4%, which is significantly higher than any fixed rate investment of any quality. The table we have constructed to the right shows 3 scenarios: current price, yield and income as of June 30; change in price and yield if interest rates were to increase by a mere 1/4%; change in price and yield if interest rates were to rise by 1/2%. For the purpose of this table, we must make a few assumptions that may or may not happen in the real world. Generally we assume that nothing else changes other than interest rates. Earnings for each company remain unchanged, expectations for each are unchanged...nothing other than interest rates changes.

Hypothetical $100 Investments	AT&T	Duke Energy	Ford
As of June 30, 2016			
Value	$100.00	$100.00	$100.00
Income	$4.44	$3.99	$4.77
Yield	4.44%	3.99%	4.77%
If Interest Rates rise 0.25%			
New Value	$94.67	$94.10	$94.96
Income	$4.44	$3.99	$4.77
New Yield	4.69%	4.24%	5.02%
Implied Price Change	**-5.33%**	**-5.90%**	**-5.04%**
If Interest Rates rise 0.50%			
New Value	$89.89	$88.86	$90.46
Income	$4.44	$3.99	$4.77
New Yield	4.94%	4.49%	5.27%
Implied Price Change	**-10.11%**	**-11.14%**	**-9.54%**

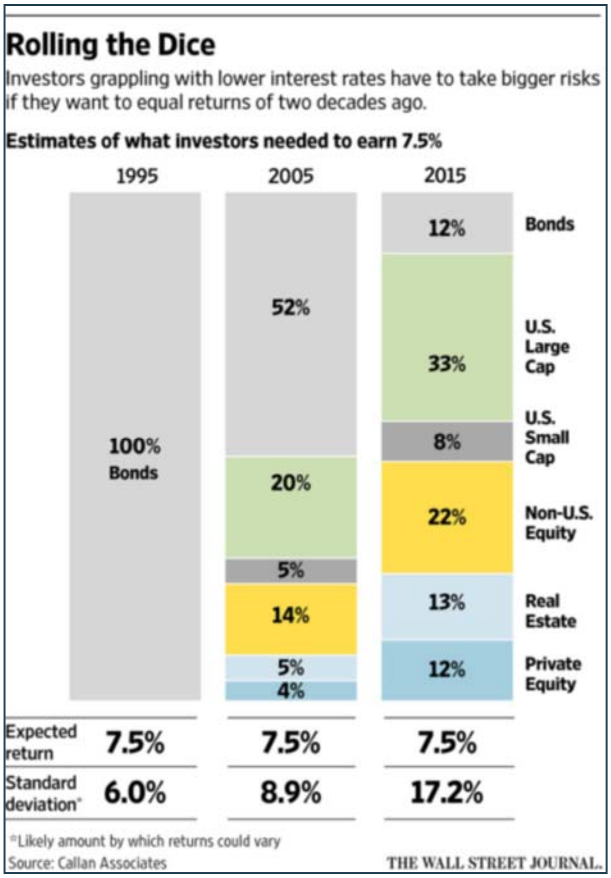
What starts out as a $100 investment loses more in value than it produces in income if interest rates just rise by 1/4%! That is extraordinary, and most income investors fail to perceive this risk before they take the plunge into stocks. Fortunately for many, rates have not risen. But it's certainly not a stretch to think they could go higher by 1/4%. And that would result in a hit to principal in these hypothetical investments of more than

(Continued on page 4)

(Continued from page 3)

5%, and around 10% if rates go up by 1/2%. And perhaps even more sadly, rates rising by these modest amounts don't help out the would-be bond buyers. Rates would still be historically low.

There is no obvious solution to overcome these low rates. As long as stock prices keep rising, frustration over low rates will be muted. However, we cannot help but wonder if investors fully comprehend the risk they are adding to their portfolios in search of income.



Our friend Andy Barnett in Raleigh shared the table above with us and we found it quite telling. In 1995, investors could expect a 7.5% rate of return in a portfolio constructed of 100% bonds. In 2015, the percentage of bonds in the portfolio dropped to 12% to realize the same expected rate of return. This clearly illustrates the dilemma investors face.

The table above also highlights the risk many investors don't see. The 1995 portfolio had a standard deviation of 6%. The 2015 portfolio's standard deviation skyrocketed to 17.2%. You may not be familiar with the term standard deviation, but think of it this way. It is a measure of portfolio risk. A portfolio that produces very consistent rates of return from month-to-month and year-to-year has a very low standard deviation because the volatility of returns is minimal. This would be considered a less-risky portfolio. However, a portfolio that produces widely-varying rates of return would have a higher standard deviation, The greater the volatility of returns, the greater the standard deviation. Higher standard deviations do not predict better or worse rates of return. They simply promise more volatile rates of return.

To many investors, higher standard deviations imply too great a risk - not that they will necessarily lose money, but that if they are relying on the principal, volatility can be problematic.

As you likely know by now, Tandem believes that volatility is the enemy of the average investor and that the best way to combat volatility is through constructing a portfolio of companies that grow their earnings through any economic environment and therefore can reliably grow their dividends. As long as earnings and dividends consistently grow, returns are typically less volatile. Tandem does not seek high dividend-paying stocks. We seek high dividend-growing stocks. The tables on page 5 to the right clearly illustrate this. And for reference and comparison to the table to the left, Tandem's Large Cap Core strategy has annualized about 8%* *(see below)* over the last 10 years with a standard deviation of 10.46%. These results imply far less risk (volatility) than the 2015 portfolio in the table with a higher expected rate of return. There are, of course, many ways to skin a cat. We like our way.

As long as investors are forced into stocks to produce income, stock prices will continue to rise. As stock investors ourselves, we love rising stock prices! But we must always be mindful of the fact that the higher prices go, the less the margin for error becomes. Enjoy the party, but stay close to the exit.

When the time does come for investors to sell their income-producing stocks, it could get ugly. It is easy to think that you can just keep collecting the dividend and not worry about any drop in price. But eventually price will matter, and we worry that not enough investors understand the risks to their principal they have been forced to take by these extraordinary Central Bank measures. Tandem is very mindful of the risk and strives to manage accordingly. When the price of a stock gets to high to justify, we must take the profit we have been given, even if we have no place to deploy the proceeds. After all, the best way to manage the unseen risk is to buy low and sell high.

** Tandem Large Cap Core net of fees return for 10 years thru 6.30.2016 was 8.04%. Fees include Tandem's management fee and commissions incurred. Fees vary by account type. For a complete discussion of the impact of fees on performance please inquire about our Composite Performance Presentation by emailing jcarew@tandemadvisors.com or calling 843-720-3413. Past performance is no guarantee of future results.*

(Continued from page 1)

so challenging. Companies exceeding expectations are rewarded, particularly if they pay a nice dividend or exhibit a high rate of growth. But companies with more modest rates of growth are not participating.

As for Tandem's 48 unique holdings comprising all 3 strategies, 19 stocks had negative returns for the last 12 months with an average return of –12.2%. The 29 stocks with positive returns had an average return of 21.0%. Again, that is an amazing disparity.

This is an amazing market that keeps heading higher even when fundamentals don't support the move. With interest rates this low, where else is there for investors to go? We love the rally, but we don't mind less exposure than normal. We will stick to our fundamentals, wherever they lead us. Right now, they have us invested, but less so than we might be in a different market.

5 Year Annualized Dividend Growth for Tandem's Holdings by Strategy
from Q2 2011 to Q2 2016

Large Cap Core 5Yr. Annualized Dividend Growth	
Company	**Dividend Growth**
Abbott Laboratories	NA
AbbVie	NA
Accenture Plc	19.57%
Aptargroup	10.76%
Bank of the Ozarks	28.06%
Becton, Dickinson	9.99%
Brown & Brown,	8.90%
Brown-Forman Corp Cl B	9.77%
Coca-Cola	8.29%
Costco	13.40%
CSX	35.10%
Dominion Resources,	7.28%
Ecolab	14.87%
Expeditors International	9.86%
W.W. Grainger	13.07%
Intercontinental Exchange	NA
ITT	NA
Microsoft	17.61%
National Retail Properties	2.74%
NextEra Energy	9.61%
Nike	15.60%
T. Rowe Price	11.74%
QUALCOMM	19.78%
Republic Services	8.45%
Resmed	NA
SCANA	3.46%
Scripps Networks Cl A	19.14%
J. M. Smucker	8.77%
Stryker	16.12%
TJX Companies	22.31%
Tractor Supply	31.95%
United Technologies	6.58%
Wabtec	74.11%
Walgreens Boots Alliance	15.52%
Waste Connections	14.09%
Average	**16.22%**

The list of holdings above for Tandem's 3 strategies are as of 6.30.2016. These lists do not constitute investment advice, nor do they represent performance of any Tandem investment product. FactSet is the data source for the above calculations.

Equity 5 Yr. Annualized Dividend Growth	
Company	**Dividend Growth**
Abbott Laboratories	NA
AbbVie	NA
Accenture Plc	19.57%
AMETEK	17.61%
Aptargroup	10.76%
Bank of the Ozarks	28.06%
Becton, Dickinson	9.99%
Brown & Brown,	8.90%
Brown-Forman Corp Cl B	9.77%
Cerner	NA
Coca-Cola	8.29%
Cognizant Technology	NA
Costco	13.40%
CSX	35.10%
eBay	NA
Ecolab	14.87%
Expeditors International	9.86%
FMC Technologies,	NA
W.W. Grainger	13.07%
Intercontinental Exchange	NA
ITT	NA
MEDNAX	NA
Microsoft	17.61%
NextEra Energy	9.61%
Nike	15.60%
O'Reilly Automotive	NA
PayPal Holdings	NA
T. Rowe Price	11.74%
QUALCOMM	19.78%
Republic Services	8.45%
ResMed	NA
Scripps Networks Cl A	19.14%
Signature Bank New York	NA
Stryker	16.12%
Thermo Fisher Scientific	NA%
TJX Companies	22.31%
Tractor Supply	31.95%
United Technologies	6.58%
Wabtec	74.11%
Walgreens Boots Alliance	15.52%
Waste Connections,	14.09%
Average	**17.85%**

Mid Cap Core 5 Yr. Annualized Dividend Growth	
Company	**Dividend Growth**
AMETEK	17.61%
Aptargroup	10.76%
Bank of the Ozarks	28.06%
Becton, Dickinson	9.99%
Brown-Forman Cl B	8.90%
Brown & Brown	9.77%
Cerner	NA
Cognizant Technology	NA
DollarTree	NA
Ecolab	14.87%
Expeditors International	9.86%
Fiserv	NA
FMC Technologies	NA
W.W. Grainger	13.07%
ITT	NA
MEDNAX	NA
National Retail Properties	2.74%
O'Reilly Automotive	NA
Republic Services	8.45%
ResMed	NA
Ross Stores	19.67%
Signature Bank New York	NA
SCANA	3.46%
J. M. Smucker	8.77%
Scripps Networks Cl A	19.14%
Stryker	16.12%
Thermo Fisher Scientific	NA
T. Rowe Price	11.74%
Tractor Supply	31.95%
Wabtec	74.11%
Waste Connections	14.09%
Yum! Brands	12.97%
Average	**16.48%**

Wabtec is the leading dividend grower in all 3 Tandem strategies, posting a 5-yr. annualized increase of 74.11%. Tractor Supply, another company found in all 3 strategies, is the 2nd leading dividend grower with an annualized increase of 31.95%.

Contact Information:

Tandem Investment Advisors, Inc.

145 King Street
Suite 227
Charleston, SC 29401

(800) 303-8316
(843) 720-3413

www.tandemadvisors.com

Yield table			
	Current	3 months ago	1 year ago
3-month Treasury Bill	0.26%	0.29%	0.01%
2-year Treasury Note	0.58%	0.88%	0.65%
5-year Treasury Note	1.01%	1.38%	1.65%
10-year Treasury Bond	1.49%	1.89%	2.35%
30-year Treasury Bond	2.30%	2.68%	3.12%
Prime Rate	3.50%	3.50%	3.25%
Federal Funds Rate	0.30%	0.36%	0.04%
Discount Rate	1.00%	1.00%	0.75%
30 yr Fixed Mortgage	3.48%	3.69%	3.66%

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				
	6/30/16 Close	% Change 1 Year	% Change 3 Years	% Change 5 Years
S&P 500	2,098.86	1.73%	30.67%	58.93%
Dow Jones Industrial	17,929.99	1.76%	20.26%	44.43%
NASDAQ	4,842.67	-2.89%	42.30%	74.60%
Russell 2000	1,151.92	-8.14%	17.85%	39.22%
German Xetra DAX	9,680.09	-11.56%	21.62%	31.06%
London FTSE 100	6,504.30	-0.26%	4.65%	9.40%
Shanghai Composite	2,929.61	-31.51%	48.02%	6.07%
Crude Oil	$ 48.33	-18.73%	-49.93%	-49.35%
Gold	$ 1,320.60	12.70%	7.92%	-12.12%
CRB Index	192.57	-15.23%	-30.13%	-43.04%
U.S. Dollar Index	95.96	0.45%	15.42%	28.77%
Euro/Dollar*	1.11	0.00%	-14.62%	-23.45%

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