

Notes from the Trading Desk

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Market Movers & Shakers

Thanks to the Friday rally, all of the major indices closed higher for the week. The Dow and the Russell were both up a little more than 1/3 of a percent. The S&P closed 55 bps higher and the Nasdaq was up 1.35%. The Nasdaq has now jumped nearly 11% since its February 9th bottom. The S&P has traded around 8.5% higher since it kissed its 200 day back on the 9th as well. The previous week's price action was monstrous! All indices ripped higher for the biggest weekly move since 2013. The two week rally looked as if it was going to fade into the weekend till Friday afternoon. Up till Friday, each trading session followed the same general pattern. Monday-Thursday saw rallies into the early afternoon that ultimately faded into the close. There's an old saying on Wall Street that bear markets open on strength and close on weakness. It would certainly be incorrect to put forth that we are in the midst of a bear market — after all we are up nearly 10% on the S&P in just as many sessions. However, it was a rather interesting pattern to watch in the marketplace. If it is to continue, it would be concerning.

Outside of the equity world, Gold traded lower for much of the week. It ultimately closed down around 1.7%. Gold has now topped out 8 times in the mid 1300s during the last two years. Seems to be running into quite a bit of resistance, though it has been making a huge rounding bottom over the last 5 years. Crude moved another 3% higher over the past week. The Texas Tea is up nearly 50% since late June. Last, but certainly not least in today's market, treasuries were largely mixed. The 10-Year was flat on the week, closing below 2.90. The 2-Year moved higher nearly 8 bps as it begins knocking on 2.30. The 10-Year actually set a 4 year high on Wednesday as it got to 2.95.

Surely 3% is right around the corner? Bloomberg even published a "Market Guide to Trading when 10-Year Treasuries Hit 3%". While we very might well hit 3%, the long-term view that rates are moving higher is becoming harder to buy. For one, higher rates has become a very popular narrative in the media and on Wall Street. According to Jones Trading and BOAML's February Fund Manager Survey, "60% [of managers] say inflation and bonds are the most likely catalyst for a cross-asset crash". Allocations to bonds supposedly fell to their lowest level since 1998. In the short run, that side of the boat seems a little crowded.

Even over a longer time horizon, it seems hard to believe that rates will head that much higher. The global market's demand for yield is currently too strong and will remain a major headwind for a continued rise in treasury yields. Grant's Interest Rate Observer put out an interesting piece highlighting the absurd demand for yield on Friday. I recommend giving it a read! However, I will try to summarize to the best of my abilities. The Republic of Kenya sold a 10-year note yielding 7.25% and a 30-year bond yielding 8.25% this past Thursday. The issues were oversubscribed by 7 times. This oversubscription was on the back of a Moody's downgrade on the 13th to B2. The appetite for yield is insatiable. Let us not forget Argentina's 100 year issuance last year was 3.5x oversubscribed. The country that defaulted twice this century had oversubscribed demand for 100-Year debt. The craziness hardly stops there though. Tajikistan, which is B-3 rated, sold a 10-year unsecured note with a yield of 7.125%. The \$500 million issue was snapped right up — all of this for a country with a per capita GDP of \$804. For comparison, the US's per capita GDP is over \$57,000. Lastly, Austria issued century bonds last year with a coupon of 2.1%. Austrian CPI is currently 1.8%! This appetite for yield makes a strong case for why there is a ceiling on our rates. If an Austrian 100-Year bond yielding 2.1% is oversubscribed by more than 3x, imagine what happens to our 10 year at 3.5%, or even 4%, if it ever gets that high. It will get snapped right up.

At the end of 2017, the Federal Surplus/Deficit as a percentage of GDP was -3.43%. That number is worse than when we were coming out of our recession following 9/11. In fact, we've never been this low unless we were coming out of a recession! The economy is humming along right now. By all accounts, the economy is in a goldilocks era, unemployment is low, inflation is muted, GDP is superb. All is well. To be sure, the deficit is not a problem if we can continue to grow. Growth takes care of everything. We already have a massive deficit though, and we just increased it even more. There certainly is demand for debt in the marketplace, we just got done discussing that. However, we continue to increase the supply of our debt as one of the biggest buyers (the Fed) has left the marketplace. So what happens if the economy does stumble? It's the million dollar question, Luckily, the Fed's Rosengren and Dudley gave us the answer last week. Both said that Fed bond purchases will be "quite likely" and a "viable tool" for monetary policy in the future. Who's ready for QE4?

Upgrades & Downgrades

CTSH — Upgraded to buy from hold at Argus Research; price target of \$100 (2/22)

ICE — Upgraded to overweight from neutral at J.P. Morgan; price target increased to \$83 from \$76 (2/20).

VRSK — Upgraded to overweight from neutral at J.P. Morgan; price target of \$118 (2/22).

Portfolio News

It was a seemingly quiet week here at Tandem. However, we were able to take advantage of two names as we continued to exit Cerner and Wabtec. Both names have been discussed before, but I will quickly rehash the two companies and the reasons to sell. Both companies violated our fundamental requirements. Cerner, despite having a very deep management bench, choose to hire their new CEO from Phillips Electronics. Wabtec proved unable to grow their business for a couple of years, and as such, they must be liquidated.

As far as individual headlines go, it was a muted week for us. We had EXPD, HRL, and HSIC all report their Q4 numbers this past week. Expeditors had a big beat, though the number is not necessarily comparable to analyst estimates because they reported a large tax benefit as a result of the new tax laws. VRSK traded higher after reporting solid numbers with some good organic growth. The WSJ wrote an article discussing the rollback of regulation for meatpackers. The release of this article coincided with HRL's earnings report. Hormel ultimately closed higher after their numbers were reported.

United Technologies also made headlines this past week. Bloomberg reported that UTX is considering splitting up their conglomeration of businesses. They would be split into three different companies, one of which focuses on aerospace, one for elevators, and one for climate control. Bloomberg reported that a decision should be reached by the end of the year.

	WTD	MTD	QTD	YTD
Dow Jones	0.4%	-3.2%	2.4%	2.4%
S&P 500	0.6%	-2.7%	2.8%	2.8%
Nasdaq	1.4%	-1.0%	6.3%	6.3%
Russell 2000	0.4%	-1.6%	0.9%	0.9%
C.D.	1.0%	-1.8%	7.2%	7.2%
C.S.	-2.2%	-6.2%	-4.9%	-4.9%
Energy	1.0%	-8.6%	-5.2%	-5.2%
Fins	0.4%	-2.2%	4.0%	4.0%
H.C.	-0.1%	-3.2%	3.1%	3.1%
Ind.	0.3%	-2.9%	2.2%	2.2%
I.T.	1.9%	0.0%	7.5%	7.5%
Mats	1.2%	-2.8%	1.2%	1.2%
Utes	0.5%	-1.8%	-4.8%	-4.8%
REITs	0.0%	-5.4%	-7.3%	-7.3%

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Earnings Calendar

Date	Time	Ticker
2/26	SNI	PM
2/28	TJX	AM