

Notes from the Trading Desk

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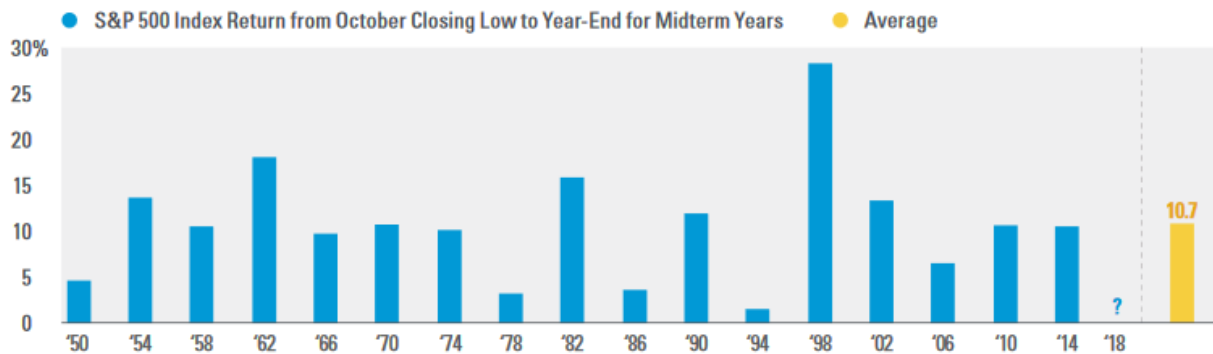
U.S. equities finished higher across the board last week. The Dow led the way up, moving higher 2.84%. The S&P 500 moved up 2.13%, while the Nasdaq and the Russell 2000 moved up a modest 0.68% and 0.10%, respectively. The beginning of the week started off with a bang as we gapped higher following Election Day. However, some of the air was let out of the balloon on Friday. The strong move last week was largely a defensive one. Healthcare was the leading sector, moving up more than 4%. However, REITs, Utilities, and Staples were not very far behind — up 3.66%, 3.10%, and 2.88%. In fact, riskier plays seemed to still bear the brunt of any weakness. EEM (an emerging market ETF) was down 2.50% for the week, while Tech spearheaded the move lower on Friday. Energy has been getting walloped of late as well. The sector as a whole is now down nearly 12% since October 9th — thanks in large part to the weakness in Crude, as WTI fell for the 5th straight week. As the elections have hoarded air time of late, the further flattening of the yield curve has gone seemingly unnoticed. 10s minus 2s is once again showing a spread of a measly 25 bps, down from the 36 bps spread that it popped to in October.

The continued flattening of the yield curve, as well as the possible slowdown in the U.S. economy has caused recessionary whispers to once again emerge in earnest for seemingly the first time since 2015/2016. On Friday, famed bank analyst Dick Bove proclaimed that there was a 60% chance of a U.S. recession by the end of 2019. A JP Morgan model said as recently as October that there was a 60% chance of recession in the next two years as well. The world outside of the U.S. seems to be quite a bit more dreary. While our own major indices are all up roughly 4% to 7% YTD, the same cannot be said abroad. Europe is a sea of red this year. The Euro STOXX 50 is down nearly 8%. The CAC is down 3.87%, while the DAX and the Italian FTSE are down 10.75% and 11.88%, respectively. Asia has fared even worse. The China Shanghai Composite is down 21.42%, while the Hang Seng is down 14.43%. The Korean KOSPI is down 15.46%, while the Nikkei is the "bright" spot in Asia, down only 2.26%.

What is perhaps even more alarming though is that a global slowdown is becoming increasingly apparent. Ned Davis Research's Global Recession Probability Model currently has the probability of a global recession at 80%. While credit spreads in the U.S. remain relatively tight, spreads have begun to widen elsewhere. The BofAML Euro High Yield Index Option-Adjusted Spread has widened from 2.79% at the start of the year to 4.14% as recently as October. While most of the world is still growing, according to global GDP numbers, most are doing so at decelerating rates. China was growing at 6.9% as of Q3 2017, but that number has slowed each quarter to 6.5% as of Q3 2018 (still an impressive number, but a slow down nonetheless). Germany has gone from 2.8% growth last year to 1.9% as of this past summer. France is even worse, sliding from 2.8% to 1.5%. Canada's growth rate has gotten cut in half, from 3.8% to 1.9% in a year's time. We seem to be one of the few developed markets actually accelerating. Though, as Billy pointed out last week in his monthly *Observations*, much of our recent growth can be attributed to a build in inventories — which is not necessarily sustainable.

A global slowdown would certainly be bad news for U.S. equities. More than 1/3 of the S&P 500's revenue is derived outside of the United States. The Nasdaq is even more globally entwined, as more than 43% of its constituents' revenue comes through international channels. In the May 14th edition of *Notes*, we discussed how synchronized global growth, as we saw towards the end of 2017 and the start of 2018, seems to limit future returns. Unfortunately, the limited returns seem to have played out the last few months as returns have been muted while volatility continues to rear its ugly head. On the bright side, we are entering an historically strong part of the year. Since 1928, December has, on average, experienced the second highest monthly return. What's more, according to Ryan Detrick and LPL Financial, midterm years are historically strong years for stocks following their October lows. The S&P 500 has closed the year off of its October low 18 out of 18 times in midterm years, with an average year end rally of 10.7%.

2 A BIG YEAR-END BOUNCE IS POSSIBLE FOR STOCKS



Source: LPL Research, FactSet 10/31/18

The Standard & Poor's 500 Index is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. The modern design of the S&P 500 stock index was first launched in 1957. Performance back to 1950 incorporates the performance of predecessor index, the S&P 90.

All indexes are unmanaged and cannot be invested into directly. Unmanaged index returns do not reflect fees, expenses, or sales charges. Index performance is not indicative of the performance of any investment. All performance referenced is historical and is no guarantee of future results. Estimates may not develop as predicted.

Upgrades/Downgrades & Dividends

HRL — Downgraded to sell from hold at Vertical Group, citing valuation (11/6).

SBNY — Upgraded to buy from neutral at UBS, their price target was increased from \$122 to \$138 (11/5).

Portfolio News

It was a slow week on the news front, though BDX, CVS, EXPD, and HSIC all reported numbers on Tuesday. Becton Dickinson reported numbers largely in line with analyst estimates. However, their forward sales guidance was a little light compared to the street's. CVS beat on both the top and bottom line and reaffirmed their CY18 guidance. Henry Schein missed on the topline, though their earnings were slightly better than analyst estimates. Finally, EXPD had a large earnings beat and also reported strong topline numbers. Costco also reported their October sales numbers. Comp sales for Costco beat estimates handily as they were up 8.6% vs. estimates of 7.7%.

Earnings season is largely in the rearview for both Tandem and the S&P 500. 81% of Tandem's core holdings have reported their Q3 numbers and the results have been great. Earnings have grown at a healthy clip of 23.0%, which is exceptional versus their June 30 estimated growth of 13.80%. Sales growth has been robust as well, as Tandem's core holdings have grown their topline 8.2%, which beats the estimated growth of 7.6%. 90% of the S&P 500 has reported their quarterly numbers as well. They reported earnings growth of 25.5% and sales growth of 9.3%.

	WTD	MTD	QTD	YTD
Dow Jones	2.8%	3.5%	-1.8%	5.1%
S&P 500	2.1%	2.6%	-4.6%	4.0%
Nasdaq	0.7%	1.4%	-7.9%	7.3%
Russell 2000	0.1%	2.5%	-8.7%	0.9%
Comm. Svcs	-0.2%	-0.9%	-6.8%	-9.9%
Con Disc	2.0%	4.7%	-7.2%	10.9%
Con Staples	2.9%	3.1%	5.3%	-0.5%
Energy	0.9%	1.7%	-9.8%	-5.2%
Financials	2.6%	3.1%	-1.9%	-3.2%
Health Care	4.0%	4.7%	-2.4%	12.4%
Industrials	2.1%	3.5%	-7.7%	-4.6%
Info Tech	1.4%	0.7%	-7.4%	10.6%
Materials	1.9%	4.6%	-5.3%	-9.3%
Utilities	3.1%	2.0%	4.0%	3.9%
REITs	3.7%	3.1%	1.5%	0.4%

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