THE TANDEM REPORT

Volume XX, Issue 2, April 2019

"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 consistent and superior investment performance over time. 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

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MARKET COMMENTARY:
Q1 Rebound Stretches Valuations...Again

Last quarter in this column we stated that not every bear market is a crisis and that they certainly create opportunities. We did not expect the opportunity of the 20% December decline to be so widely recognized so quickly. Now we find ourselves back at the lofty valuations we experienced in September, with one considerable difference.

In September, as the S&P 500 reached its last all-time high on the 20th, the economy was humming, corporate earnings were strong and the Federal Reserve was hawkish (inclined to raise interest rates). The market began it's sell-off, culminating in a sizable move down on Christmas Eve. Suddenly the market was concerned about a slowing economy and no growth in corporate profits. Then the Fed blinked.

And that is what is different today from the last time we were here. The Fed is now perceived to be dovish (inclined at least to no longer raise rates, if not lower them). It would seem obvious that the backdrop was far more ap-

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COMMENTARY:
The Dividend

According to the Cambridge Dictionary, a dividend is a payment by a company of a part of its profit to the people who own shares in the company. A part of the profit indeed! But how big a part? Some companies with plenty of profit don't even pay a dividend. Others, with little or no profit, pay a dividend that exceeds the company's profit. Why the disparity?

Tandem has always believed that dividend policy tells investors a great deal about the way a company treats its shareholders. Each company must decide what, if any, dividend it will pay to shareholders, and how much profit is appropriate to share.

Some companies prefer to retain all of their earnings to reinvest them in the business. These companies tend to have greater opportunities for growth

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than most, or they exist in a hyper-competitive and ever-changing industry. There is merit to this decision, but for this conversation, we will focus on those companies that do share a portion of their profit.

Dividends can be quite impactful on total return. In fact, since the end of World War II, roughly 40% of the S&P's total return can be attributed to dividends. They are clearly an important component of total return. Some investors value dividends chiefly for the income they produce. Dividend ***yield*** is what they seek and growth would just be icing on the cake. Others believe that dividend ***growth*** is the Holy Grail and the surest way to produce consistent and superior returns. Tandem falls in the growth camp, not the income camp.

Tandem pays little attention to dividend yield. In fact, we find that many (though certainly not all) high dividend stocks pay such a high dividend for one of two unfortunate reasons: either they choose not to reinvest enough earnings to provide for future growth, or the dividend is potentially in danger of being reduced.

The dividend growth investors we know of value dividend growth so much so that they make it their primary objective in screening stocks. There is even an index called Dividend Aristocrats that includes all S&P 500 companies that have paid and grown their dividend annually for at least 10 years. There are 57 companies that meet this criteria and are included in the index.

Tandem takes a considerably different view of dividend growth. While we require dividend growth for any company we own that pays a dividend, we do not seek dividend growth. We seek companies that consistently grow earnings, revenues and cash flow through any economic environment. For these companies, dividend growth is a by-product of good corporate management. Unlike most dividend growth investors, we do not seek dividend growth, we require it. More importantly, we seek companies that grow and reinvest in future growth. This makes dividend growth sustainable. As a result, Tandem's average dividend paying holding has experienced an 11.26% annual rate of growth the last 5 years (see tables on page 5). The Dividend Aristocrats constituents have only averaged an annualized 8.55% rate of increase.

It is our belief that companies producing the results that we demand will produce a more consistent, repeatable investment experience for our clients. It is our opinion that if a company can increase the cash flow it pays to investors in the form of dividends, the value of that company is likely to grow. And if that company can repeat this growth in dividends year after year, it is even more likely that the value of the company will increase. Will it increase at a rate faster than the broader market for any given period of time? Who knows? That is not our objective. Our objective is to provide a smoother, less volatile, more repeatable experience that will likely outperform the market over a complete cycle.

Sometimes examples work better than words. So let us study 3 hypothetical companies that we will call Company A, Company B and Company C. All are profitable and pay a dividend. In our example, we will purchase 1 share of each of these for $20.

Company A pays out as much of its earnings as it can, reinvesting little for future growth. It pays a $1/share dividend that never grows. The initial hypothetical dividend yield is 5%.

Company B represents the average holding in the Dividend Aristocrats Index. It pays a dividend of $0.42/share for a yield of 2.12% at the time of hypothetical purchase, and has a dividend growth rate of 8.55%.

Company C pays a $0.35 dividend for a yield of 1.75% at the time of hypothetical purchase, and has a dividend growth rate of 11.26%.

We will compare these companies as if we were conducting an experiment in the lab (which of course is not possible in the real world, unfortunately). In the first example we hold all things constant including dividend yields. In other words, over the 10 years of this hypothetical study, the dividend yield for all 3 companies never changes. The result of the first experiment is simply that the company with the greatest dividend growth will produce the greatest total return.

Dividend yield = dividend amount/price per share

If dividend yield and amount never change, price won't either. So Company A pays a nice dividend, but that is all. Companies B and C pay more modest dividends that become larger each year. If yield stays the same and dividend amount grows, price must grow as well. So B and C produce a greater total return than A, with C producing the best result when dividend yields remain constant.

In the second example we assume dividend yields increase by 0.10% each year. When yields rise, prices fall. A stock that pays a dividend of $1/share yields 5% when the price is $20. If the dividend yield increases to 5.1% but the dividend is still $1/share, the price has to fall to $19.61 to reflect the rising yield. Without dividend growth to offset the uptick in rates, Company A consistently declines in value. It had the highest yield of the 3 at time of hypothetical purchase (5%), and

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ends with the highest yield as well (5.9%). It also experiences a price decline in this example, while B and C grow their dividends and share prices, although by less than in the first example. Once again, C produces the best total return.

Lastly, we explore the impact on the total return of these companies when dividend yields decline by 0.1% each year. All 3 companies produce their best total returns in the third example, as we should expect. If prices fall when rates rise, they logically rise when rates fall. But dividend growth wins the day, and Company C's superior dividend growth makes it 3-for-3 on a total return basis.

Of course, there are other elements to consider when investing. Earnings growth typically impacts share price even more dramatically than dividend growth. We will not conduct a similar experiment for earnings growth, but consider this: if earnings don't grow, dividend growth isn't sustainable.

There are ways to grow dividends that do not require the consistent growth in earnings, revenues and cash flow we require. A company can buy back shares and have the effect of increasing dividends on a per share basis. A company can borrow money to increase its

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Example 1: Constant Dividend Yield

	Dividend Growth			Share Price Change			Total Cumulative Return		
	A	B	C	A	B	C	A	B	C
Yr 1	1.00	0.42	0.35	20.00	20.00	20.00	5.00%	2.12%	1.75%
Yr 2	1.00	0.46	0.39	20.00	21.71	22.25	10.00%	12.97%	14.96%
Yr 3	1.00	0.50	0.43	20.00	23.57	24.76	15.00%	24.75%	29.65%
Yr 4	1.00	0.54	0.48	20.00	25.58	27.55	20.00%	37.54%	46.00%
Yr 5	1.00	0.59	0.54	20.00	27.77	30.65	25.00%	51.42%	64.19%
Yr 6	1.00	0.64	0.60	20.00	30.14	34.10	30.00%	66.48%	84.43%
Yr 7	1.00	0.69	0.66	20.00	32.72	37.94	35.00%	82.84%	106.94%
Yr 8	1.00	0.75	0.74	20.00	35.52	42.21	40.00%	100.59%	132.00%
Yr 9	1.00	0.82	0.82	20.00	38.55	46.96	45.00%	119.86%	159.87%
Yr 10	**1.00**	**0.89**	**0.91**	**20.00**	**41.85**	**52.25**	**50.00%**	**140.78%**	**190.88%**

Example 2: Rising Dividend Yield

	Dividend Growth			Share Price Change			Total Cumulative Return		
	A	B	C	A	B	C	A	B	C
Yr 1	1.00	0.42	0.35	20.00	20.00	20.00	5.00%	2.12%	1.75%
Yr 2	1.00	0.46	0.39	19.61	20.73	21.05	58.04%	39.61%	38.58%
Yr 3	1.00	0.50	0.43	19.23	21.53	22.22	61.15%	46.12%	46.59%
Yr 4	1.00	0.54	0.48	18.87	22.41	23.51	64.34%	53.21%	55.48%
Yr 5	1.00	0.59	0.54	18.52	23.36	24.95	67.59%	60.90%	65.31%
Yr 6	1.00	0.64	0.60	18.18	24.39	26.52	70.91%	69.25%	76.17%
Yr 7	1.00	0.69	0.66	17.86	25.50	28.25	74.29%	78.27%	88.15%
Yr 8	1.00	0.75	0.74	17.54	26.70	30.15	77.72%	88.03%	101.33%
Yr 9	1.00	0.82	0.82	17.24	27.99	32.23	81.21%	98.57%	115.84%
Yr 10	**1.00**	**0.89**	**0.91**	**16.95**	**29.38**	**34.50**	**84.75%**	**109.94%**	**131.79%**

Example 3: Declining Dividend Yield

	Dividend Growth			Share Price Change			Total Cumulative Return		
	A	B	C	A	B	C	A	B	C
Yr 1	1.00	0.42	0.35	20.00	20.00	20.00	5.00%	2.12%	1.75%
Yr 2	1.00	0.46	0.39	20.41	22.78	23.60	112.04%	81.40%	80.96%
Yr 3	1.00	0.50	0.43	20.83	26.02	27.95	119.17%	100.08%	104.89%
Yr 4	1.00	0.54	0.48	21.28	29.80	33.24	126.38%	121.67%	133.76%
Yr 5	1.00	0.59	0.54	21.74	34.23	39.73	133.70%	146.76%	168.86%
Yr 6	1.00	0.64	0.60	22.22	39.45	47.74	141.11%	176.05%	211.89%
Yr 7	1.00	0.69	0.66	22.73	45.64	57.73	148.64%	210.47%	265.18%
Yr 8	1.00	0.75	0.74	23.26	53.03	70.35	156.28%	251.18%	331.96%
Yr 9	1.00	0.82	0.82	23.81	61.92	86.51	164.05%	299.74%	416.87%
Yr 10	**1.00**	**0.89**	**0.91**	**24.39**	**72.72**	**107.57**	**171.95%**	**358.19%**	**526.76%**

The 3 tables above are a comparison of 3 hypothetical companies. Company A does not grow it's dividend and begins with a yield of 5.0%. Company B grows its dividend at the same rate as the Dividend Aristocrats Index (8.55% annually) and begins with a yield of 2.12%. Company C grows its dividend at 11.26% annually and begins with a dividend yield of 1.75%.

Market Commentary (Continued)

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pealing in September than it is now. Corporate profit growth could actually be negative this year, and some would argue the yield curve (considered an accurate predictor) has foretold recession. Why have stocks recaptured nearly all of their losses in so short a time?

Like much of this 10-year bull market, fundamentals matter less than Fed policy. If the Fed appears accommodative, the market takes that as an all-clear. And quite frankly, the market is wise to have such a reaction. Every time the market has stumbled, the Fed has made clear its intention to be supportive of conditions conducive to strong stock performance. Fundamentals be damned for now. Reckoning can come later.

As we have discussed many times, fundamentals always matter ultimately. Overpaying today limits the potential long-term return. That is just a fact. Sometimes the long-term takes longer than we anticipate. And as Keynes once noted, in the long-run we are all dead. So there is that.

In the meantime, the market is likely to follow the Fed's cue and go higher. Eventually the economy will regain its footing, corporate profits will resume a healthy rate of growth and all will be right in the world. And when that time comes, the Fed may be forced to interrupt (or worse) the party again!

Fundamentals cannot adequately support current stock valuations. Only Fed policy can. And if the economy picks up momentum, the Fed may start to reverse course again and become more hawkish. These circumstances set up an expectation of increased volatility as the Fed, the economy and profits all ping pong back and forth. We like volatility, as it too creates opportunity.

Please remember that we do not invest your money in "the stock market". You are invested in individual companies that meet our very strict criteria and that have fared well through all sorts of turbulence. And we are poised to take advantage of any volatility. We have ample cash to deploy with another correction or sell-off. We believe that your portfolio is well-prepared for whatever lies ahead.

A New Mutual Fund and a Big Thank you

We are extremely excited to tell you that our Large Cap Core strategy is now available as a mutual fund, thanks to the good folks at Castle Investment Management. This is Castle's venture, not ours. We have simply been hired as a sub-advisor to manage the Castle Tandem Fund as we would any other Large Cap Core account.

To learn more about the Fund, please visit Castle's website at www.castleim.com/tandx/ or call them at (703) 260-1921. The Castle Tandem Fund is distributed by Rafferty Capital Markets, LLC.

A Big Thank You

Milestones and recognitions are always appreciated. In his April edition of ***Observations*** (on our website), Billy said it well and it bears repeating:

"To all the financial professionals who've hired us, their clients and our direct clients – thank you for believing in and supporting our investment strategy. And above all else, thank you for entrusting us with your hard-earned money.

The Informa Investment Solutions' PSN manager database is North America's longest running database of investment managers and they recently named us as one of the top managers within the following universes:*

- *Managed Account Large Cap Equity*
- *Managed Account U.S. Core*
- *Managed Account U.S. Equity*
- *Managed Account Mid Cap Equity*
- *Large Cap*
- *Large Core Equity*
- *U.S. Core Equity*

We take great pride in our investment strategy and discipline. And without your support and money to manage, we wouldn't be able to do what we do. So, thank you!

The past 15 months have been and continue to be one of the more confusing times for an individual investor…(As a result) individual investors throw up their hands and let their emotions take over. Without a strict investment discipline, you are simply a rudderless boat getting tossed around by the waves. It's not any fun and you're unlikely to make it to your destination.

It is our job to help you navigate the storms and sort through the confusion to make sure you stay on track. We often talk about the "market", but the reality is it makes no difference to us if the "market" is up, down or sideways. Our goal is to pay attractive prices for businesses with growing revenues, earnings and cash flows. And, then we look to sell when those prices overvalue those fundamentals. We have our proprietary way of identifying these companies and our discipline guides us. It's really that simple and done the same way every day of the week."

** For more information on the Informa Investment Solutions PSN rankings, please visit our website.*

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dividend. A company could even sell an asset. But the only sustainable way to grow a dividend over time is to grow a business over time as well.

And this is the beauty of Tandem's approach to dividend growth. We don't seek it. We don't try to identify it. We simply demand it of any company that grows earnings, revenues and cash flow over any economic cycle. Without all these qualities, a company cannot be in our portfolio. We believe it produces a more consistent, repeatable and less volatile experience, no matter what the market may be doing.

There are many ways to invest successfully. Dividend growth strategies have proven over time to be one such way. We believe that Tandem's unique approach to dividend growth - identifying growing companies rather than growing dividends, and then demanding dividend growth - produces a consistent, repeatable and less volatile experience for our clients. Less volatility means clients are more likely to stay invested, even in the most volatile times. Some may enjoy the excitement of being the hare, but we all know that the tortoise wins the race.

5 Year Annualized Dividend Growth for Tandem's Holdings by Strategy from Q1 2014 to Q1 2019

Tandem's average dividend-paying holding has increased it's dividend by 11.26% on an annualized basis for the last 5 years. This growth is the result of strong and growing earnings, cash flow and revenue.

Large Cap Core 5Yr. Annualized Dividend Growth	
Company	**Dividend Growth**
Abbott Laboratories	7.78%
AbbVie, Inc.	20.57%
Accenture Plc	9.44%
Becton, Dickinson	7.16%
Brown & Brown	9.86%
Brown-Forman Cl B	7.43%
Comcast	13.30%
Costco	12.95%
CVS Health	12.70%
Dollar General	NA
Dominion Energy	8.87%
Ecolab Inc.	10.84%
Expeditors International	8.45%
FactSet Research	12.83%
Hormel Foods	16.00%
Intercontinental Exchange	16.17%
Microsoft	10.44%
National Retail Properties	4.30%
NextEra Energy	11.51%
NIKE	12.89%
T. Rowe Price	11.55%
Republic Services	7.60%
ResMed	8.16%
Signature Bank NY	NA
J. M. Smucker	7.94%
Stryker	11.26%
TJX Companies Inc	21.88%
Tractor Supply	18.98%
United Technologies	4.49%
Walgreens Boots Alliance	6.91%
Waste Connections	15.75%
Average	**11.31%**

Companies not paying a dividend on 3.31.2014 are NA. All companies in Large Cap Core currently pay a dividend.

Equity 5 Yr. Annualized Dividend Growth	
Company	**Dividend Growth**
Abbott Laboratories	7.78%
AbbVie, Inc.	20.57%
Accenture Plc	9.44%
Becton, Dickinson	7.16%
Brown & Brown	9.86%
Brown-Forman Cl B	7.43%
Celgene	NA
Comcast	13.30%
Costco	12.95%
CVS Health	12.70%
Dollar General	NA
Dollar Tree	NA
Dominion Energy	8.87%
eBay	NA
Ecolab Inc.	10.84%
Euronet Worldwide	NA
Expeditors International	8.45%
FactSet Research	12.83%
Hormel Foods	16.00%
Intercontinental Exchange	16.17%
Microsoft	10.44%
NextEra Energy	11.51%
NIKE	12.89%
O'Reilly Automotive	NA
PayPal Holdings	NA
T. Rowe Price	11.55%
Republic Services	7.60%
ResMed	8.16%
Signature Bank NY	NA
J.M. Smucker	7.94%
Stryker	11.26%
TJX Companies Inc	21.88%
Tractor Supply	18.98%
Tyler Technologies	NA
United Technologies	4.49%
Verisk Analytics	NA
Walgreens Boots Alliance	6.91%
Waste Connections	15.75%
Average	**11.56%**

Mid Cap Core 5 Yr. Annualized Dividend Growth	
Company	**Dividend Growth**
Becton, Dickinson	7.16%
Brown & Brown	9.86%
Brown-Forman Cl B	7.43%
Covetrus	NA
Dollar Tree	NA
Ecolab Inc.	10.84%
Euronet Worldwide	NA
ExlService Holdings	NA
Expeditors International	8.45%
FactSet Research	12.83%
Fiserv	NA
Hormel Foods	16.00%
National Retail Properties	4.30%
O'Reilly Automotive	NA
T. Rowe Price	11.55%
Republic Services	7.60%
ResMed	8.16%
Ross Stores	20.59%
Henry Schein	NA
Signature Bank NY	NA
J. M. Smucker	7.94%
Stryker	11.26%
Tractor Supply	18.98%
Tyler Technologies	NA
Verisk Analytics	NA
Waste Connections	15.75%
Yum! Brands, Inc.	2.57%
Yum China Holdings, Inc.	NA
Average	**10.66%**

The list of holdings above for Tandem's 3 strategies are as of 3.31.2019. 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.

Contact Information:

Tandem Investment Advisors, Inc.

145 King Street
Suite 400
Charleston, SC 29401

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

www.tandemadvisors.com

Past performance is no guarantee of future results. Indices are unmanaged and not available for direct investment. They are shown or referred to for illustrative purposes only and do not represent the performance of any specific investment.

Yield table			
	Current	3 months ago	1 year ago
3-month Treasury Bill	2.40%	2.37%	1.70%
2-year Treasury Note	2.41%	2.68%	2.28%
5-year Treasury Note	2.37%	2.68%	2.63%
10-year Treasury Bond	2.57%	2.83%	2.84%
30-year Treasury Bond	2.98%	3.10%	3.09%
Prime Rate	5.50%	5.35%	4.58%
Federal Funds Rate	2.41%	2.27%	1.51%
Discount Rate	3.00%	2.85%	2.08%

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				
	3/31/19 Close	% Change 1 Year	% Change 3 Years	% Change 5 Years
S&P 500	2,834.40	7.33%	37.61%	51.38%
Dow Jones Industrial	25,928.68	7.57%	46.61%	57.55%
NASDAQ	7,378.77	12.12%	64.57%	105.21%
Russell 2000	1,539.74	0.67%	38.21%	31.15%
German Xetra DAX	11,526.04	-4.72%	15.66%	20.62%
London FTSE 100	7,279.19	3.15%	17.88%	10.32%
Shanghai Composite	3,090.76	-2.47%	2.89%	52.01%
Crude Oil	$ 60.14	-7.39%	56.86%	-40.80%
Gold	$1,293.00	-2.25%	4.76%	0.75%
CRB Index	183.75	-5.94%	7.76%	-39.69%
U.S. Dollar Index	97.28	8.12%	2.84%	21.45%
Euro/Dollar*	1.12	-8.97%	-1.42%	-18.54%

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

TANDEM
INVESTMENT ADVISORS