Last week was a very strong week for U.S. equities. The S&P 500 rose 1.97% — the index’s highest weekly gain since late August, after it had then racked up four consecutive weekly losses. The Dow rose 1.82% and the Nasdaq gained 2.29% — also good for the Tech-heavy index’s best gain in the last five months. However, the real shining stars were found in the Mid and Small Cap spaces. The Russell Mid Cap, like the S&P 500 and Nasdaq posted its best return since late August. The Russell 2000, a small-cap index, shot 2.53% higher! Anything and everything equity related seemingly got in on last week’s action. However, despite the strong gains across the board, the market actually did so with a rather defensive tone. Utilities, the best performing sector, gained 3.76%. REITs were not too far behind gaining 2.49% for the week. Outside of Tech, cyclicals largely underperformed the broader market — though every sector with the exception of Energy closed the week in the green.

The S&P 500 has risen 13 out of the last 15 weeks. This has only occurred 3 times since the 1980s. It seems that volatility has completely deserted the marketplace. The VIX (often viewed as the market’s fear gauge) is trading at the bottom end of its range over the last two years. The market hasn’t seen a ±1% move in nearly 70 trading sessions. While it may be anecdotal evidence at best, the last two times this occurred were not particularly great moments for the market. Volatility, measured in terms of ±1% moves, was last this muted in October of 2018, just before the bottom fell out in Q4 of that year. The instance before that was January 25th, 2018 — as the market topped out before succumbing to the volatility that burst on the scene the following February. It is rare air the market is currently finding itself in. We saw a similar exodus of volatility in 2017. However, prior to that, one has to go back to the mid-90s to find a similar time period in terms of volatility. While the dearth of volatility is sure to end one day, it is worth pointing out that day does not have to be today or tomorrow. In fact, the longest string of trading sessions without a ±1% was 184 days set back in 1963!

We have previously used a lot of ink in this column when discussing the Federal Reserve and Quantitative Easing, or more commonly known as QE. However, within the scope of discussing volatility, it is worth using just a little more ink! A quick refresher on QE may be in order. QE aims to flush investors out of government bonds and pushes investors further out on the risk curve. The Federal Reserve buys assets in order to inject liquidity directly into the marketplace, and ultimately the economy. Just this past week, Dallas Fed President Robert Kaplan acknowledged that the Fed’s injection of liquidity into the marketplace does in fact boost risk taking. However, what is more pertinent to our conversation here is the artificial tamping down of volatility that is caused by the Fed. Not to be misunderstood, the Fed is not directly intervening in equities. Currently, the Federal Reserve is interfering only in short-term interest rates, though they continue to insist that they are not engaging in QE at all. But, if it walks like a duck, and quacks like a duck, it’s probably a duck.
The stamping out of volatility in short-term interest rates by the Federal Reserve seems to trickle into the rest of the market. In fact, as seen in the chart below, as the Fed increases the size of their balance sheet and injects liquidity into the marketplace (as the blue line increases), volatility in the S&P 500 decreases (the grey line falls). The recent ascent in the Fed’s Balance Sheet, as they have begun injecting liquidity into the Repo market, has coincided with a sharp drop in volatility. On the other hand, in periods where the balance sheet (blue line) either stops growing as fast or begins to shrink — as we saw in 2018 — market volatility (grey line) spikes. While correlation does not mean causation, the relationship between volatility and Federal Reserve intervention seems a bit more than coincidental. Per Bloomberg, Deutsche Bank recently observed that since the Fed started buying T-bills in early October the S&P 500 has gone up almost 1% for each 1% increase in the Fed’s balance sheet. Furthermore, Bloomberg reported that through the most recent cycle, the S&P 500’s annualized gain during periods of Federal Reserve balance sheet expansion was 5.4% higher than periods where there was no intervention.

There’s an old adage on Wall Street that is ringing true today, “Don’t Fight the Fed”. We are certainly seeing this play out in terms of market positioning. On Friday, it was reported that famed hedge fund investors David Tepper and Stanley Druckenmiller were increasingly bullish because of the Fed. Druckenmiller specifically said, “I revealed a very bullish posture intermediate term since October when Powell guaranteed he would not rescind the insurance cuts.” In other words, Druckenmiller is bullish purely because of the Federal Reserve and their decision to keep priming the pump. Tepper, in the same vein, according to sources on CNBC, reportedly became more bullish in December as the Federal Reserve was putting more money into the system.

It seems and feels a bit like a game of musical chairs with just two players left — the market/market forces and the Federal Reserve. It will be interesting to see who will ultimately rule the day. QE is more or less a new phenomenon in the United States. And, we have only ever implemented QE on a large scale this market cycle. So, we have never seen its ability to succeed this late in the market cycle. The liquidity being artificially pumped into the marketplace and the investor response reminds me a bit of Chuck Prince’s infamous quote. The ex-Citi CEO, in response to the enormous amounts of global liquidity in 2007, told the Financial Times “As long as the music is playing, you’ve got to get up and dance.” That didn’t work out to well for Prince in 2007. But, time will tell how it will work out for investors investing purely for the sake of the Fed’s liquidity today.

Transition Update**

In the December 30th edition of Notes, we said that “opportunities have, more or less, been drying up as a lot of names traded higher.” Despite the calendar turning the page, the new year feels much like the old. As such, not much has changed in terms of a transition update. Earnings season will really get going this week and next, which might create a few opportunities for us to take advantage of. Not to give the wrong impression, we are certainly not just sitting on our hands doing nothing. There have been a few opportunities, just not as many as we see in more volatile markets.

Over the past few weeks, we have continued to take advantage of our model signaling both Walgreen’s and Smucker’s cheap valuation. We have bought both names a number of times already year-to-date, and that likely won’t change anytime soon — barring any significant changes. Dollar Tree and eBay, similar to WBA and SJM, have been bought quite a few times as well. Both stocks remain well off their recent highs — though they each seem to have recently found support in their price action. This past week, we were able to add to Expeditors International on their Friday pullback. The logistics firm preannounced relatively disappointing numbers during the pre-market on Friday. As a result, EXPD, which was trading down as much as 10.1% in the premarket, ultimately fell 5.5%. AbbVie, another name that our quantitative model has signaled as undervalued, briefly fell to the lower end of their 3-month trading range. That gave us the opportunity to add to the name, something we hadn’t been able to do for some weeks.

**The transition update describes activity taken by Tandem on the transition level, not the composite or firm-wide level. The transition update is applicable to new accounts and new money. New accounts and new money are not automatically invested on the first day. Rather, they are transitioned into our strategy over a longer time period that is dependent upon market conditions. This update describes that transition.
Expeditors International, which we touched on in the Transition Update, likely had the biggest news splash of all Tandem names last week. Prior to the market opening on Friday, EXPD announced their earnings results for Q4, which were negative by-and-large. In the release, management said, “We do not believe this to be a business model/performance issue and instead believe it ties more closely to the business environment in which we are operating.” In other words, the trade war and the slowing of the global economies are finally leaving a mark — especially in transports. It would be surprising to not see this sentiment matched by other Transportation companies over the coming weeks. However, despite the negative remarks, EXPD actually only closed the week down roughly 50 bps.

**Portfolio News & Notes**

**Upgrades/Downgrades & Dividends**

- **CHKP** — Downgraded to underweight from equal weight at Morgan Stanley, price target cut to $106 from $115 (1/13).
- **CHKP** — Downgraded to neutral from outperform at First Analysis, target cut to $133 to $119 (1/14).
- **CHRW** — Upgraded to overweight from equal weight at Barclays, target cut from $95 to $100 (1/15).
- **CHRW** — Upgraded to positive from neutral at Susquehanna, target increased from $95 to $122 (1/17).
- **NEE** — Downgraded to sector weight from overweight at KeyBanc (1/17).
- **NEE** — Downgraded to neutral from buy at Goldman Sachs, target of $256 (1/17).
- **NEE** — Downgraded to neutral from outperform at Credit Suisse, target remains $250 (1/17).
- **RSX** — Initiated hold with a price target of $96 at Deutsche Bank (1/17).
- **TYL** — Downgraded to neutral from outperform at RW Baird, target remains $310 (1/13).
- **WCN** — Initiated buy with a price target of $106 at Deutsche Bank (1/17).
- **YUM** — Upgraded to overweight from equal weight at Morgan Stanley, target increased to $118 from $113 (1/17).

**Dividends**

- **CHKP** — Dividend of $0.26 per share on 1/28.
- **CHRW** — Dividend of $0.21 per share on 2/14.
- **EBAY** — Dividend of $0.17 per share on 2/9.
- **NEE** — Dividend of $0.56 per share on 2/27.
- **REITs** — Dividend of $0.10 per share on 1/30.

**Earnings Calendar**

<table>
<thead>
<tr>
<th>Date</th>
<th>Time</th>
<th>Ticker</th>
</tr>
</thead>
<tbody>
<tr>
<td>1/21</td>
<td>Pre-Market</td>
<td>SBNY</td>
</tr>
<tr>
<td>1/22</td>
<td>Pre-Market</td>
<td>JNJ</td>
</tr>
<tr>
<td>1/22</td>
<td>Pre-Market</td>
<td>ABT</td>
</tr>
<tr>
<td>1/23</td>
<td>Pre-Market</td>
<td>CMCSA</td>
</tr>
<tr>
<td>1/24</td>
<td>Pre-Market</td>
<td>NEE</td>
</tr>
</tbody>
</table>

**Dow Jones**

- WTD: 1.82%
- MTD: 2.84%
- QTD: 2.84%
- YTD: 2.84%

**S&P 500**

- WTD: 1.97%
- MTD: 3.06%
- QTD: 3.06%
- YTD: 3.06%

**Nasdaq**

- WTD: 2.29%
- MTD: 4.64%
- QTD: 4.64%
- YTD: 4.64%

**Russell Mid Cap**

- WTD: 2.28%
- MTD: 2.73%
- QTD: 2.73%
- YTD: 2.73%

**Russell 2000**

- WTD: 2.53%
- MTD: 1.87%
- QTD: 1.87%
- YTD: 1.87%

**Com. Svcs**

- WTD: 2.39%
- MTD: 5.21%
- QTD: 5.21%
- YTD: 5.21%

**Con Disc**

- WTD: 1.13%
- MTD: 1.97%
- QTD: 1.97%
- YTD: 1.97%

**Con Staples**

- WTD: 1.93%
- MTD: 1.48%
- QTD: 1.48%
- YTD: 1.48%

**Energy**

- WTD: -1.12%
- MTD: -1.68%
- QTD: -1.68%
- YTD: -1.68%

**Financials**

- WTD: 1.14%
- MTD: 0.76%
- QTD: 0.76%
- YTD: 0.76%

**Health Care**

- WTD: 1.63%
- MTD: 2.48%
- QTD: 2.48%
- YTD: 2.48%

**Industrials**

- WTD: 1.99%
- MTD: 3.52%
- QTD: 3.52%
- YTD: 3.52%

**Info Tech**

- WTD: 2.95%
- MTD: 5.87%
- QTD: 5.87%
- YTD: 5.87%

**Materials**

- WTD: 2.70%
- MTD: -0.49%
- QTD: -0.49%
- YTD: -0.49%

**Utilities**

- WTD: 3.76%
- MTD: 3.27%
- QTD: 3.27%
- YTD: 3.27%

**REITs**

- WTD: 2.49%
- MTD: 2.31%
- QTD: 2.31%
- YTD: 2.31%

**DISCLAIMER**: This writing is for informational purposes only. The information contained in this writing should not be construed as financial or investment advice on any subject matter. Tandem Investment Advisors, Inc. does not represent that the securities, products, or services discussed on, or accessible through, this site are suitable for any particular investor. You acknowledge that your requests for information are unsolicited, and the provision of any information through this site shall not constitute or be considered investment advice, or an offer to sell, or a solicitation of an offer to buy any product, service, or security. 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 Tandem investment product. For complete performance information and disclosures, please contact John Carew at jcarew@tandemadvisors.com. From time to time Tandem may discuss select purchases and/or sales within this report. All past portfolio purchases and sales are available upon request. Any portfolio transaction discussed here does not constitute advice or a recommendation. Please consult your financial advisor before making any investment decisions. For information regarding past purchases and sales, please contact John Carew at jcarew@tandemadvisors.com.