Notes from the Trading Desk

Ben Carew, CFA
Tandem Investment Advisors

February 3, 2020

Market Mover & Shakers

U.S. stocks fell again last week. According to FactSet, the S&P 500, which fell 2.12%, just had back-to-back weekly declines for the first time since late August. The Dow Jones tumbled 2.53% lower, while the Nasdaq fell 1.76%. The Russell 2000 posted the worst performance of the major indices, as the small cap index fell 2.90%. The Russell Mid Cap also had a rough go as it dropped 2.45%. Utilities continued their strong run as the defensive sector climbed another 0.82%. Utilities are now up 6.61% for the year, handily beating all other sectors as the best performer. Yields fell rather sharply throughout the week. The 2-year Treasury, which started the year at 1.57% is now knocking on the door of 1.30% as it closed at 1.32% on Friday. Friday's close marked the lowest yield on the 2-year since late 2017. Some parts of the curve have inverted once more as the 3-month Treasury is now yielding 1.56%. The action in the 10-year could get interesting in the next few trading sessions if it is to test its August low of 1.43%. A break of those levels would seem to all but guarantee a retest of the 1.36% yield printed in the summer of 2016 — a cycle low.

We would be remiss to discuss last week's trading action without touching on the coronavirus. Through Friday, Bloomberg reported that the number of confirmed cases was approximately 10,000. These numbers soared past the numbers from the SARS epidemic that occurred in 2002-03. On the bright side, the coronavirus seems to have a much lower reported fatality rate. However, as no one here at Tandem is a doctor, I will not spend too much time rehashing the details surrounding the virus. Rather, we will spend the time focusing on signals from the market.

It is debatable as to whether or not the market's belief in a global slowdown is a result of the virus, or something else all together. However, there is no doubt that over the last few weeks the market has begun pricing in an apparent slowdown. Domestic yields have fallen dramatically, as we touched on above. However, the sharp slide in yields was hardly contained to the United States. The 10-year Bund fell further into negative territory. The German bond was yielding as much as –0.17% just a few weeks ago, but has since fallen to –0.44%. Similarly, yields have slid over the last couple of weeks in Japan, the United Kingdom, Italy, Spain, and Canada to name just a few. And, it is hardly just yields pointing towards a slowdown. Nearly all commodities have gotten rocked recently as well. Crude, which climbed into the mid-60s in early January closed below $52 a barrel on Friday. Similarly, copper has slid nearly 13% since January 14th. Traders seem to be in agreement that the global economy is heading for a slowdown.

The recent trend in commodities and yields are more market-based indications of a slowdown. However, data is beginning to point towards a potential slowdown as well. On Friday, the Chicago PMI report sent markets lower as the reading came in at 42.9 — well below the consensus 48.9. PMI, or Purchasing Manager's Index, is an index that tracks manufacturing. Per FactSet, the Chicago Business Barometer provides an overall gauge of business activity as published in the NAPM - Chicago monthly Business Report. An index reading above 50 indicates that economic activity is generally expanding; below 50, that it is generally declining. 42.9 is the lowest level since 2015. It is worth reiterating that PMI measures manufacturing — a portion of the economy that is now less relevant than it once was as the U.S. Economy has switched from a manufacturing economy to a more service-based economy. However, the backdrop domestically seems to have been deteriorating for some time now. The Philadelphia Fed recently indicated that 9 states are heading for a contraction in the first half of 2020. This is the highest number of states the Fed expects to contract since the end of the Financial Crisis in 2009.

There is an old saying on Wall Street, "So goes January, so goes the year." According to Fidelity, the S&P 500 has averaged a 7.4% gain from February through December since 1946. If January closes higher, then the S&P 500 has on average gained 11.1% for the remaining 11 months. However, a January that closed lower had an average return of just 1.3% for the remaining months. Now, one should not base a strategy off an old adage, nor is history guaranteed to repeat itself, but history can be worth noting.

*Transition Update***

I have felt a bit like a broken record of late in the Transition Update, as opportunities were quite limited at the end of 2019 and the start of 2020. However, a lot of this changed last week. Volatility stemming from the coronavirus gave us a lot of opportunity to put new money to work in our transition accounts. We have continued to buy Walgreens, Dollar Tree, Expeditors, eBay, JM Smucker, and C.H. Robinson. By and large, we have been transitioning into these select names rather quickly over the last few months. The sell-off did present some new opportunities in names that we had not previously had the chance to buy. As such, we were able to begin transitioning into names like O'Reilly, Fiserv, PayPal, Brown Forman and many others. If this burst of volatility is to continue, then it would not be surprising to see us continue to transition accounts much more quickly than we were towards the end of last year.

***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.*

Upgrades/Downgrades & Dividends

CHRW — Downgraded to neutral from positive at Susquehanna, price target cut to $82 from $95 (1/29).

ORLY — Downgraded to neutral from overweight at JPMorgan, price target cut to $415 from $490 (1/31).

PYPL — Upgraded to buy from neutral at Guggenheim Securities with a price target of $133 (1/31).

RMD — Downgraded to neutral from buy at UBS, though the price target was increased to $174 from $150 (1/31).

ROST — Initiated accumulate with a target of $132 at Gordon Haskett (1/29).

SBNY — Downgraded to market perform from outperform at Hovde Group, however the price target increased to $161 from $150 (1/29).

TJX — Initiated hold with a price target of $66 at Gordon Haskett (1/29).

UTX — Initiated buy with a price target of $186 at Benchmark Company LLC (1/31).

Earnings Calendar

Date	Time	Ticker
2/3	Pre-Market	CHKP
2/4	Post-Market	FISV
2/5	Post-Market	ORLY
2/6	Pre-Market	YUM
2/6	Pre-Market	ICE
2/6	Post-Market	BDX
2/7	Pre-Market	ABBV

Portfolio News & Notes

Everything was not so dreary here at Tandem despite the market's gloom and doom last week. While we had a few names underperform around earnings — looking at you C.H. Robinson — we had a few more names that helped performance nicely. We had 10 names (BRO, UTX, SYK, CHRW, EBAY, UMBF, TROW, MSFT, PYPL, and RMD) report their earnings last week. All but CH Robinson beat their EPS estimates and all beat their sales estimates. With another 15 names reporting over the next 14 days, things are bound to be busy. As it currently stands, 19 of Tandem's 45 names have reported earnings. Earnings growth for the average Tandem holding is expected to be 14.99% for the quarter and sales are expected to grow 5.80%. For comparative purposes, 45% of the S&P 500 has reported their results with earnings expected to decline –0.35% and sales expected to grow 3.01%, according to FactSet.

	WTD	MTD	QTD	YTD
Dow Jones	-2.53%	-0.99%	-0.99%	-0.99%
S&P 500	-2.12%	-0.16%	-0.16%	-0.16%
Nasdaq	-1.76%	1.99%	1.99%	1.99%
Russell Mid Cap	-2.45%	-0.87%	-0.87%	-0.87%
Russell 2000	-2.90%	-3.26%	-3.26%	-3.26%
Comm. Svcs	-2.99%	0.66%	0.66%	0.66%
Con Disc	0.13%	0.58%	0.58%	0.58%
Con Staples	-0.79%	0.20%	0.20%	0.20%
Energy	-5.65%	-11.17%	-11.17%	-11.17%
Financials	-1.37%	-2.80%	-2.80%	-2.80%
Health Care	-3.29%	-2.88%	-2.88%	-2.88%
Industrials	-2.90%	-0.51%	-0.51%	-0.51%
Info Tech	-2.17%	3.89%	3.89%	3.89%
Materials	-3.54%	-6.18%	-6.18%	-6.18%
Utilities	0.82%	6.61%	6.61%	6.61%
REITs	-1.89%	1.42%	1.42%	1.42%