The TANDEM Report

Volume XXII, Issue 1, January 2021

"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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All performance figures, charts and graphs contained in this report are derived from publicly available sources believed to be reliable. Tandem makes no representation as to the accuracy of these numbers, nor should they be construed as any representation of past or future performance.

Market Commentary

A Year of Many Records; Some Noteworthy, Some Dubious

The year of endless Zoom meetings has mercifully come to an end, but not before making stock investors a happy lot. The year ended so robustly it is as if the market never crashed in March. Did we just imagine that?

The perils of the real world inexplicably manifested themselves as good fortune for the investment world. I say inexplicably not because it is unexplainable now, which is not the case, but rather because in the moment of panic, the manner in which the stock market ultimately responded was unfathomable, even to the most optimistic among us.

The S&P 500 appreciated 16.26% for the year. Not bad coming on the heels of 2019, which saw the S&P up more than 30%. Yet 16.26% doesn't begin to tell the story.

From an all-time high on February 19, the S&P collapsed at the fastest rate on record. The market fell 33.93% in only 24 trading days. That market bot-

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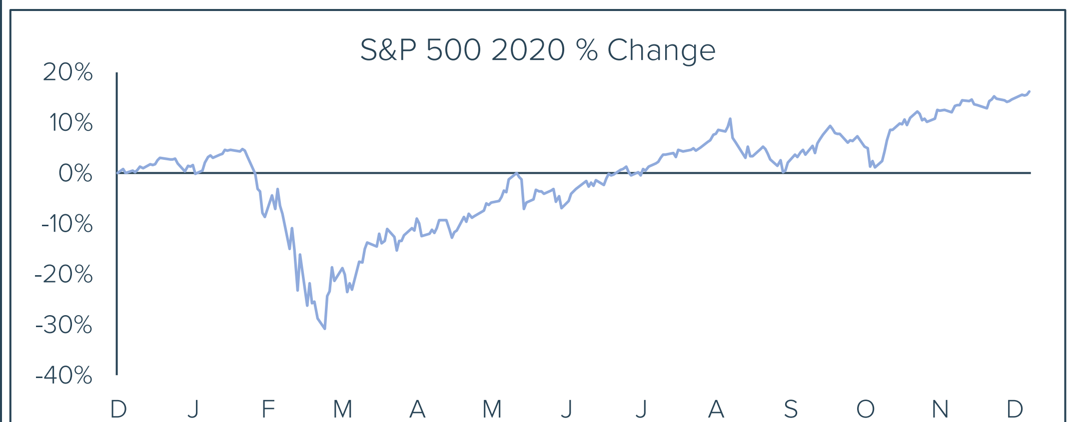

Commentary

Stocks are Expensive. Does That Mean the Market Is?

Predicting the next move in the stock market is a fool's game, in my opinion. Of course, that could be my opinion because I have never demonstrated any particular skill as a prognosticator. But let us leave that aside for now and focus our attention on what I perceive to be Tandem's skillset.

Tandem does not invest in "the stock market". We seek to invest in the stocks of companies that demonstrate the ability to grow consistently over time. And we believe that price, or valuation, matters a great deal.

By most traditional measures, stocks are expensive. Notice I say stocks, not the stock market. I cannot say with any certainty that the stock market is expensive. But I can comfortably say that stocks are expensive. Some are ex-

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tremely expensive, and a few bring the bubble of the late 1990s to mind. There is certainly evidence of widespread speculation.

A year ago we felt that valuations were extended, and the cash levels in our portfolios reflected our inability to find enough places to commit your capital. Then came the COVID sell-off and we found plenty of places to deploy the cash we had accumulated. But that proved short-lived. With all the stimulus from both Congress and the Federal Reserve, asset prices reflated in record time. And today company valuations exceed even the lofty levels of one year ago. Again we find it less than compelling to commit your capital to securities we consider overvalued.

Valuations in some cases are reaching the absurd. Tesla is valued at more that $1.4 million per vehicle sold in 2020. GM is valued around $8,000 per vehicle sold. Tesla sold a little over 500,000 cars last year. GM sold more than 7 Million. We do not own Tesla (or GM).

Several new IPOs this year have skyrocketed in price on the day they first traded, some more than doubling. Bitcoin moves in huge swings, mostly to the upside, and is now trading at more than 5 times its price a year ago. The use of options as a speculative tool has increased dramatically. Options cost less than the underlying stocks, so less capital is required to own them. And typically options are owned with some measure of borrowed money. The amount of money borrowed to buy stocks is also approaching stratospheric levels.

The moves higher in Facebook, Alphabet, Amazon, Netflix and Google (the fabled FAANG stocks) seem pedestrian when compared to these speculative wonders. A new generation of investors is spreading its wings. They haven't yet been scarred by the sorts of things that keep us old-timers on the defensive in times such as these.

These examples are of stocks, not markets. It would be hard to argue that all stocks are overvalued, which makes it hard to argue that the stock market itself is overvalued. We clearly find plenty of stocks that we still like. After all, even if our portfolios are not 100% invested in stocks, they are certainly mostly invested in stocks. And if you read *Commentary* in the October issue of *The TANDEM Report*, you know that we believe being in or out of the market is a false choice. We should always be in the market. Just not always all in!

All this leads me to the following prediction: like all previous periods of speculative excess, this too will end badly. Take that for what it is worth, as I openly acknowledged in paragraph 1 that I have no particular skill as a prognosticator!

What I will not predict is *when* this will end badly. We are in the midst of some of the most dramatic asset price inflation in my lifetime. If you are fortunate enough to own assets (and if you are reading this you likely fall into the category), you have been given a great gift.

There is so much money (I would argue too much money) in the financial system that the value of financial assets is being radically overstated. In the 1970s we experienced a very different type of inflation. The costs of goods and services rose appreciably, not the value of financial assets.

Inflation, by definition, occurs as the result of too much money chasing too few goods. In the 70s, wage gains pushed higher the cost of goods and services. Fed Reserve Chairman Paul Volcker finally broke the back of inflation by raising interest rates to unheard of levels. I once had a money market account that yielded 21%. But high rates did the trick. The economy recessed and excesses were reigned in.

Today, there are no inflationary wage gains to speak of, nor is there anyone like Paul Volcker at the Fed. Sure, Volcker's actions were painful in the moment. But they were for the economy's long-term benefit. Ben Bernanke, Janet Yellen, and perhaps Jerome Powell, have pursued policies quite the opposite of Mr. Volcker's. The result has been a massive expansion of the wealth gap.

These Fed Chairs have pursued a zero interest rate policy, which has been discussed many times in these pages. Zero interest rates devalue savings and hope to increase borrowing, thereby creating a stimulus for the economy by putting more money to work. The Fed forced interest rates to zero by creating trillions of dollars and using them to buy government debt (which has become quite plentiful). Increased demand for fixed interest instruments like government bonds causes prices to rise, which in turn send interest rates lower.

Sadly, the policy has not worked as promised. Household borrowing is way down and savings has increased. Household borrowing is supposed to spur the economy, as we can buy more TVs, iPads and cars on credit. Theory has not become reality.

On the other hand, government borrowing has risen sharply, even if consumer borrowing didn't. Unfortunately, government borrowing is less stimulative to the economy, and it has a crowding out effect on investors. With the Fed buying nearly all of our government's new debt, investors are unable to buy as much of these bonds as they might like, and are forced into other instruments, like riskier bonds, stocks, real estate, bitcoin, gold…you name it.

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Whether intended or not, this is how the Fed has managed to create asset inflation. And this is how they have widened the wealth gap - by inflating the value of assets the wealthy own without any equal advantage for the non-asset owners among us.

If you own stocks, bonds, a home, or anything that has lasting value, you win! If you don't, this Fed can't, or won't, help you.

I say with certainty that this will end badly, and I believe I can even tell you how. I just can't tell you when.

We caught a glimpse of how in 2018. Jerome Powell, newly appointed Fed Chair, continued his predecessor's policy of raising rates, which the stock market seemed to take in stride. But then he decided to really take away the punch bowl, which was the Fed's post-financial crisis policy called quantitative easing. This was the mechanism used to buy up bonds and force rates lower while driving investors to other asset classes. Powell embarked on the reverse of this policy, dubbed quantitative tightening.

The almost immediate result of quantitative tightening was a collapse in global asset prices, including a decline of 20% in the U.S. stock market by December of 2018. I believe it is important to understand what this quantitative tightening was. Until this policy announcement, the Fed had been in the habit of buying every month billions of dollars in bonds, with a balance sheet of nearly $5 trillion dollars. Powell proposed to reduce (not eliminate, simply reduce) the size of the Fed's balance sheet to $2.5 trillion to $3 trillion over a period of 4 years.

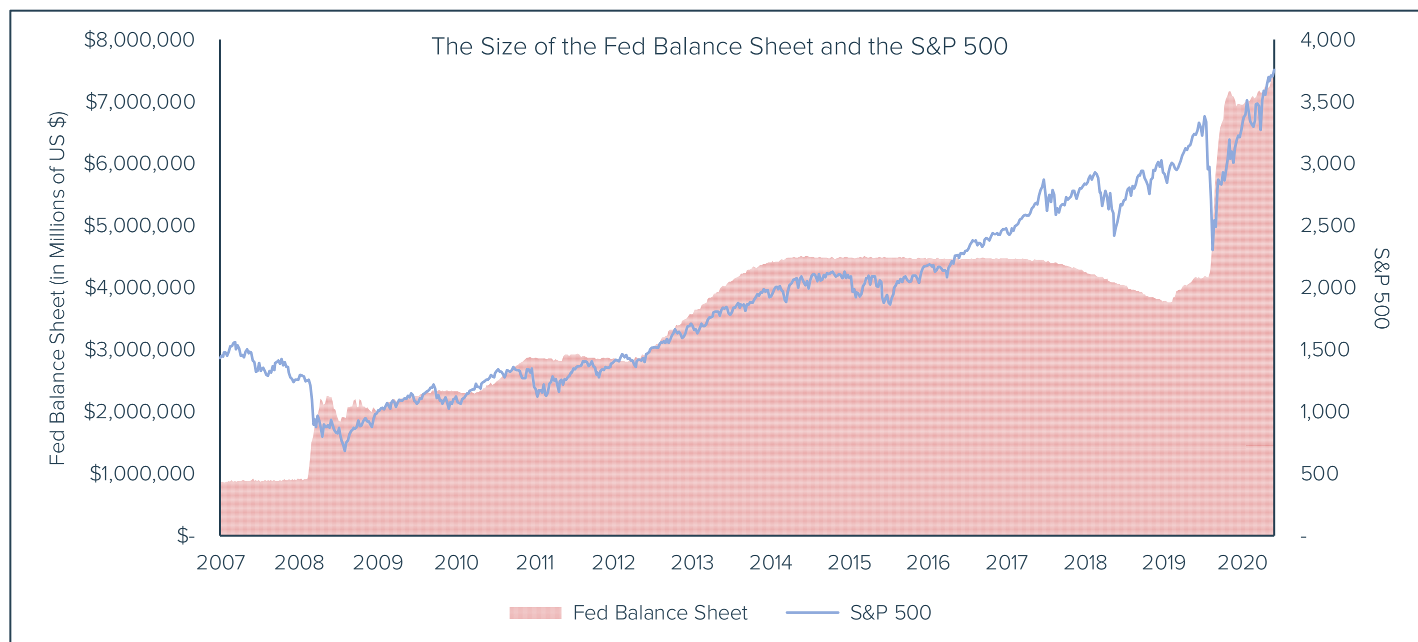
Prior to the Financial Crisis, the Fed's balance sheet was nearly $900 billion. Powell inherited a balance sheet roughly 5 times that size. But markets made it clear that his plan would not be taken lightly. And so he relented.

We now live in a world where fiscal (government) and monetary (central bank) policy focus on maintaining asset prices. So it is good to be an asset owner. One day, there will be another Paul Volcker, or perhaps a politician with courage, that will move to break the back of inflation. When that happens, asset prices will deflate. And it won't be pretty.

In the meantime, stocks can remain expensive for a very long time without the market caring. When stocks are the best alternative, their valuations matter little. Demand will be plentiful enough to send prices even higher. There just aren't enough shares of FAANG or enough bitcoins to satisfy demand.

We will remain cautious with how we commit your capital. Our *Commentary* in these pages in January 2020 spoke to the importance of staying invested. Indeed, staying invested is the key to ultimate investment success. But staying invested can be challenging when markets move lower. By seeking to limit our exposure to the companies most vulnerable when the downside comes, we hopefully help you stay invested for the long run. Trying to time entries and exits is as foolhardy as trying to prognosticate.

As we have pointed out countless times, it is important that we take stock of the amount of risk we take on to realize the gains in the market, and to determine if that risk is appropriate. We don't get out of the market. We get out of the stocks that don't justify the risk, in our view. Stocks are expensive. That doesn't mean the market is. Yet.



MARKET COMMENTARY (CONTINUED)

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tom on March 23rd would never be tested again. The S&P was up more than 9% the very next day and it was off to the races. Record highs were reached again by August, less than seven months after a bear market ended, and the S&P closed the year at another all-time high.

When the dust settled, the S&P had rallied 67.88% from the bottom of March 23rd. Simply unbelievable. Earnings, however, did not keep pace. In March 2019, the S&P 500 companies were projected to earn $186.36 in 2020. By March 2020, that projection had fallen to $151.52. By December, expectations were lowered to $120.25, up from $109.06 in June, but still well shy of previous expectations.

While the economy and earnings struggled, stock prices soared. Earnings for 2021 are now expected to jump about 36% to $165. This number is down considerably from the expectation of $183 in March of last year. Still, a 36% increase in earnings understandably gets the attention of investors.

It is hard to know if the 36% jump will materialize, or if expectations will be lowered again. We suspect expectations are rosier than warranted, but what that means for the market is anyone's guess. Last quarter we joked that the Price/Earnings (or PE) ratio has been rendered irrelevant and that Price/Stimulus is the new measure of fair value. Turns out our jest was accurate. As long as Congress and the Fed keep the money flowing, stocks stand to prosper.

2020 was less generous to the Dow Jones Industrials. That index only managed a gain of 7.25%. The real action was to be found in the more speculative NASDAQ index, which advanced a whopping 43.64% for the full year.

Many other records were set as well. Some were noteworthy, others more dubious. In addition to record highs for nearly every U.S. stock index, 2020 saw a record number of new equity and debt offerings, record levels for the Fed's balance sheet, record amounts of stimulus, records for both job losses and job gains, record GDP declines and advances, record debt, record debt as a percentage of GDP, and of course record deficits.

It seems we probably pulled a great deal of gains forward in 2020. Let's enjoy them while they are here and see what happens next.

Risk (revisited)

The following is condensed from Commentary *in the October 2019 issue*

What is risk? It's subjective, really, isn't it? An "in the eye of the beholder" sort of thing. To most, risk is only vaguely quantifiable. It is either present in some degree, or it isn't. Others think of risk in terms of a probability or likelihood - I know I shouldn't move this heavy piece of glass by myself, but I can probably manage.

Whether we perceive it or not, investment risk in some measure is always present. And even when we do perceive risk's presence, we are not all-together clear about how our behavior should be tempered for the risk we perceive.

From our perspective, risk provides opportunity, but not in the manner most might think. High and rising prices are good for those that already hold stocks, but less good for those wanting to buy them. Yet data suggests that more money flows into the market when prices are high than when prices are lower. How can this be if the aim is to buy low?

The answer is simply that when we are uncertain, we take comfort in numbers. High prices often beget higher prices. Higher prices must then equal less risk because everything is working, or so it may seem. Similarly, when prices are falling, we get nervous. We see prices going down and others selling, so we sell too. After all, with prices falling, risk is rising, isn't it?

Not really. It certainly may feel that way emotionally, but in point of fact, risk and price generally move together. As prices rise, so too does risk. And as prices fall, risk declines.

To us, risks are elevated as prices rise, and there is opportunity in this elevated risk. If the objective is to buy low and sell high, rising prices can represent an opportunity to sell high, thereby reducing our risk.

Holding cash doesn't reduce risk. Reducing risky assets in our portfolio reduces risk. Buy low, sell high, and have the discipline and patience in between. Investing just to be invested isn't a strategy. It is a hope. Investing when the price is right is a strategy. It is not about timing the market. It is about appropriately recognizing the presence and amount of risk.

Read the full article at https://tandemadvisors.com/wp-content/uploads/2019/10/The-TANDEM-Report-October-2019.pdf

Tandem News

In this edition of Tandem News we would like to take a moment to welcome the many new readers of *The TANDEM Report* joining us. Regular readership of the fabulous commentary has risen a good deal over the past year, and now numbers at least in the mid– to high-tens! Quite a success story.

We would like to remind readers, both new and old, that every issue of *TTR* is archived on our website under the Commentary tab. As this is the 82nd printing of this esteemed publication, there are too many for a human to consume, so we thought it might be helpful to highlight a few of our more topical articles. All are taken from the *Commentary* section. Enjoy!

- *I Think the Whole World's Gone Mad* - Oct 2020
- *The Fox and the Hedgehog* - Jul 2020
- *Risk* - Oct 2019 (*Excerpt on Page 4)*
- *This is How Cash is Supposed to Work* - Jan 2019
- *Emotions and Perspective* - Jan 2016

5 Year Annualized Dividend Growth for Tandem's Holdings by Strategy from Q4 2015 to Q4 2020

Tandem's average dividend-paying holding has increased it's dividend by 9.53% 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	11.60%
AbbVie, Inc.	17.93%
Accenture Plc	9.86%
Automatic Data Processing	11.90%
Becton, Dickinson	4.69%
BlackRock	10.74%
Brown & Brown	8.59%
Brown-Forman Cl B	5.71%
CBOE Global Markets	11.14%
Comcast	12.97%
Costco	11.84%
Dollar General	10.35%
Ecolab Inc.	6.52%
Essential Utilities	7.09%
Expeditors International	7.63%
FactSet Research	11.84%
Hormel Foods	11.06%
Intercontinental Exchange	14.87%
Johnson & Johnson	6.13%
Microsoft	9.24%
National Retail Properties	3.63%
NextEra Energy	12.70%
T. Rowe Price	11.60%
Raytheon Technologies	NA
Republic Services	7.21%
ResMed	5.39%
J.M. Smucker	6.08%
Stryker	10.64%
Walgreens Boots Alliance	5.36%
Waste Connections	16.14%
Average	**9.67%**

Companies not paying a dividend on 12.31.2015, or that have restructured since then, are NA. All companies in Large Cap Core currently pay a dividend.

Equity 5 Yr. Annualized Dividend Growth

Company	Dividend Growth
Abbott Laboratories	11.60%
AbbVie, Inc.	17.93%
Accenture Plc	9.86%
Automatic Data Processing	11.90%
Becton, Dickinson	4.69%
BlackRock	10.74%
Brown & Brown	8.59%
Brown-Forman Cl B	5.71%
CBOE Global Markets	11.14%
Check Point Software Tech	NA
Comcast	12.97%
Costco	11.84%
Dollar General	10.35%
Ecolab Inc.	6.52%
Essential Utilities	7.09%
Euronet Worldwide	NA
Expeditors International	7.63%
FactSet Research	11.84%
Fiserv	NA
Hormel Foods	11.06%
Intercontinental Exchange	14.87%
Johnson & Johnson	6.13%
Laboratory Corp of America	NA
Microsoft	9.24%
NextEra Energy	12.70%
O'Reilly Automotive	NA
PayPal Holdings	NA
T. Rowe Price	11.60%
Raytheon Technologies	NA
Republic Services	7.21%
ResMed	5.39%
Henry Schein	NA
J.M. Smucker	6.08%
Stryker	10.64%
Tyler Technologies	NA
Verisk Analytics	NA
Walgreens Boots Alliance	5.36%
Waste Connections	16.14%
Average	**9.89%**

Mid Cap Core 5 Yr. Annualized Dividend Growth

Company	Dividend Growth
Becton, Dickinson	4.69%
Brown & Brown	8.59%
Brown-Forman Cl B	5.71%
CBOE Global Markets	11.14%
Check Point Software Tech	NA
Ecolab Inc.	6.52%
Essential Utilities	7.09%
Euronet Worldwide	NA
ExlService Holdings	NA
Expeditors International	7.63%
FactSet Research	11.84%
Fiserv	NA
Hormel Foods	11.06%
Laboratory Corp of America	NA
National Retail Properties	3.63%
NV5 Global Inc.	NA
O'Reilly Automotive	NA
T. Rowe Price	11.60%
Republic Services	7.21%
ResMed	5.39%
Henry Schein	NA
J.M. Smucker	6.08%
Stryker	10.64%
Tyler Technologies	NA
UMB Financial Corp	5.49%
Verisk Analytics	NA
Waste Connections	16.14%
Yum! Brands, Inc.	NA
Average	**7.83%**

The list of holdings above for Tandem's 3 strategies are as of 12.31.2020. 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.

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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	0.09%	0.11%	1.54%
2-year Treasury Note	0.14%	0.13%	1.61%
5-year Treasury Note	0.39%	0.27%	1.68%
10-year Treasury Bond	0.93%	0.68%	1.86%
30-year Treasury Bond	1.67%	1.42%	2.30%
Prime Rate	3.25%	3.25%	4.75%
Federal Funds Rate	0.09%	0.09%	1.55%
Discount Rate	0.25%	0.25%	2.25%

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

	12/31/2020 Close	% Change 1 Year	% Change 3 Years	% Change 5 Years
S&P 500	3,756.07	16.26%	40.49%	83.77%
Dow Jones Industrial	30,606.48	7.25%	23.82%	75.65%
NASDAQ	12,888.28	43.64%	86.69%	157.38%
Russell 2000	1,974.86	18.36%	28.61%	73.86%
German Xetra DAX	13,718.78	3.55%	6.20%	27.70%
London FTSE 100	6,460.52	-14.34%	-15.96%	3.50%
Shanghai Composite	3,473.07	13.87%	5.02%	-1.87%
Crude Oil	$48.52	-20.54%	-19.70%	30.99%
Gold	$1,895.10	21.86%	36.15%	69.05%
CRB Index	167.80	-9.68%	-13.44%	-4.73%
U.S. Dollar Index	89.89	-6.42%	-2.10%	-8.96%
Euro/Dollar*	1.22	8.93%	1.79%	12.46%

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

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