The TANDEM Report

Volume XVIII, Issue 2 April 2017

"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 superior investment performance. 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

In This Issue

Market Commentary:

"In the short run, the market is a voting machine but in the long run, it is a weighing machine" ~ Benjamin Graham

Much like the month of March is said to behave, the stock market came into the 1st quarter like a lion and went out like a lamb. The post-election enthusiasm we experienced last quarter continued through much of this quarter, carrying all 4 major U.S. stock indices to record highs. And then just as suddenly, the rally subsided.

The post-election bounce had been fueled by a remarkable, almost unprecedented, rebound in investor sentiment. Suddenly the glass became half-full instead of half-empty. And the reasons for the improved sentiment resided in the new administration's promises of tax reform, the repeal and replacement of Obamacare, infrastructure spending and less regulation in general. With a Republican controlled House and Senate, surely it was just a matter of time before all these changes would be realized. Anticipation lifted the hopes and expectations of investors.

Then reality set in. Governing, at least for Republicans, is hard! The party couldn't settle differences among themselves on tax reform or on how to repeal Obamacare or what to replace it with. The stock market took notice.
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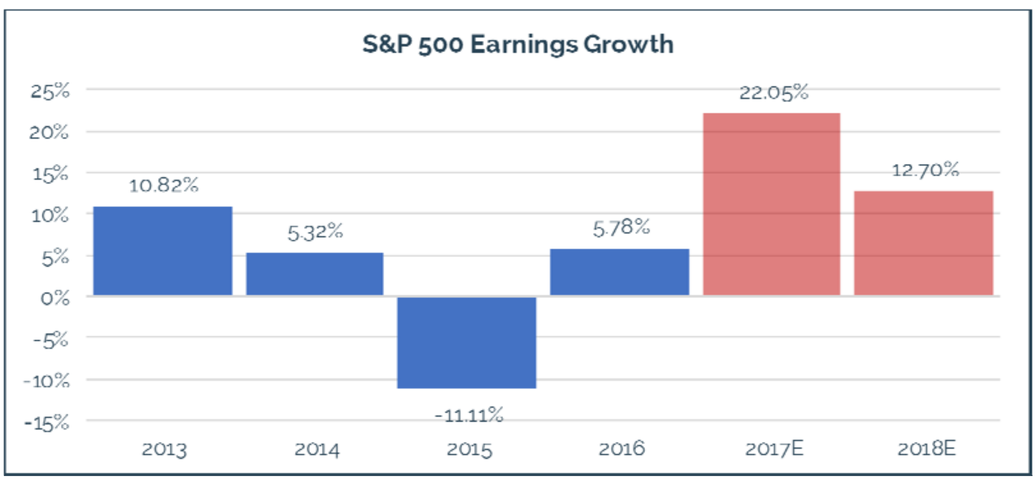

Commentary:

More Buyers than Sellers

Stock prices rose from 2009 - 2013 because the recession was over, corporate profits were improving and the Federal Reserve was exceedingly accommodating. Stock prices were cheap. Stock prices rose from 2014 - 2016 in spite of a corporate earnings recession because corporations bought their own stock back in record amounts while the Fed was accommodating. Stocks were not cheap. Stock prices have risen in 2017 because the Trump Administration promises a pro-growth agenda as the Federal Reserve begins to take away the punch bowl after nine years. Stock prices are only cheap if President Trump and the Re-
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publican Congress deliver on their promises for the economy. Otherwise, stock prices are rising simply because there are more buyers than sellers.

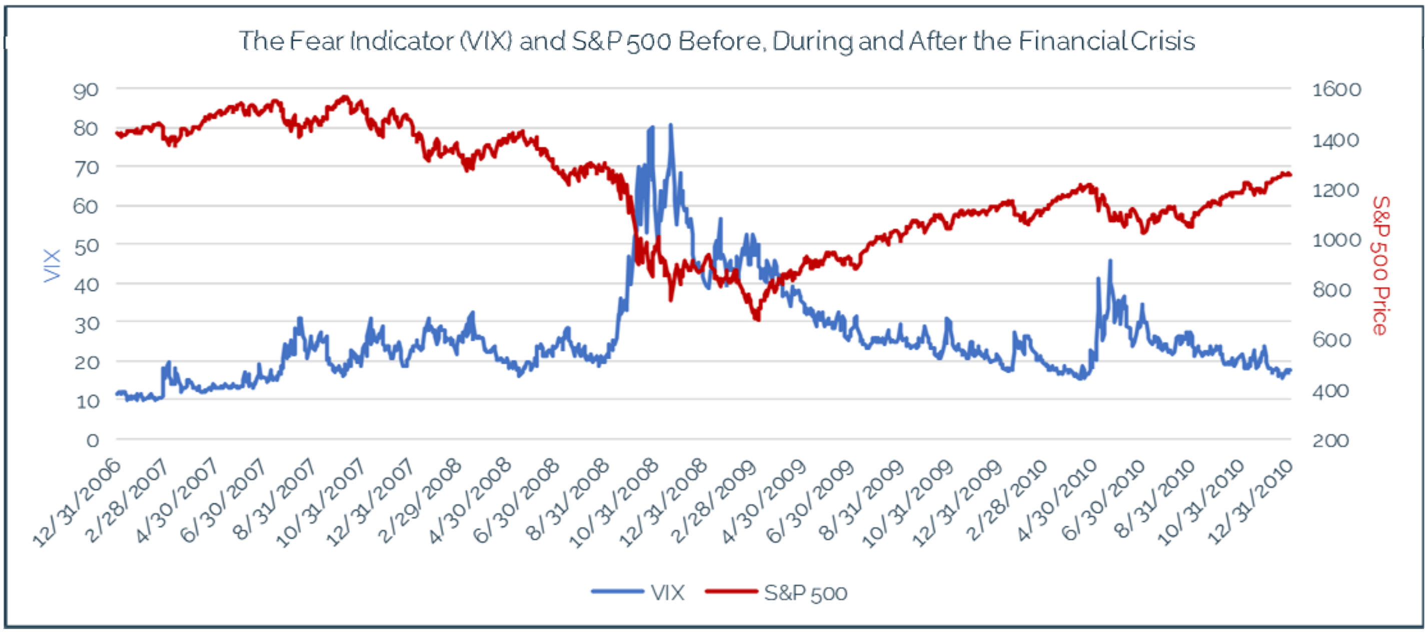
Rising markets such as this one, long on promises but void of any concrete fundamental underpinnings, pose a challenge. When asked why a stock or the market rose one day for no apparent reason, we often reply, *"more buyers than sellers".* Although sarcastic, the answer is still true. For whatever reason, more people decided to buy than decided to sell. To a large degree, this is the market we find ourselves in now.

Investor sentiment changed in a remarkable way with the election, and investor sentiment is a powerful thing. When investors believe the future holds great promise, they pile into stocks in anticipation of that greater future. Most times that future promise is realized. Most times, but not all times. And therein lies the challenge.

Playing defense in a bull market can be frustrating at times. Last quarter was one of those times. It is so much more fun to play offense and talk about our brilliance when the market goes up. The truth is, just about anyone can make money in a bull market. There is little skill in that if you are simply willing to accept the risk that comes with the fun. What is harder is to defend against the risk while still playing the game!

We are still playing the game, but our defense is on the field. It is always on the field. Sometimes its presence is just more obvious. It is our job to buy low and sell high. A good defense is necessary to protect the gains that the offense has realized. Defense requires the confidence to sell when markets are soaring. Similarly, a successful offense requires the conviction to buy when stock prices have plummeted. Both things can seem scary in the moment. Too many settle for an offense that is all-in and a defense that is all-out. That approach is a recipe for failure. Knowing when to attack and when to defend is less important than simply having an investment discipline that does both at all times. Investors must remove emotion from the equation and stick to the process.

Emotion makes investors do the wrong thing at the wrong time for the wrong reason. Market volatility can cause lots of emotion. We tend to not think about volatility being a bad thing when it results in higher stock prices. But upward volatility is what makes too many investors buy high instead of low. As prices rise, it is natural to want to participate. We call that FOMO - Fear Of Missing Out. So investors buy when prices are high.



Then when prices capitulate, too many investors sell low because they have lost money and cannot stomach the downward volatility. Would they have more ability to stomach a downturn had they sold high? Or bought low? Most likely.

The first rule of investing ought to be *stop losing money*. But that rule seems hard to live by when everyone is doing so well in the market. Studies document that the average mutual fund investor rarely experiences a mutual fund's true performance. When prices rise, they buy. And when prices fall, they sell. In other words, they buy high and sell low - the exact opposite of what they really should be doing.

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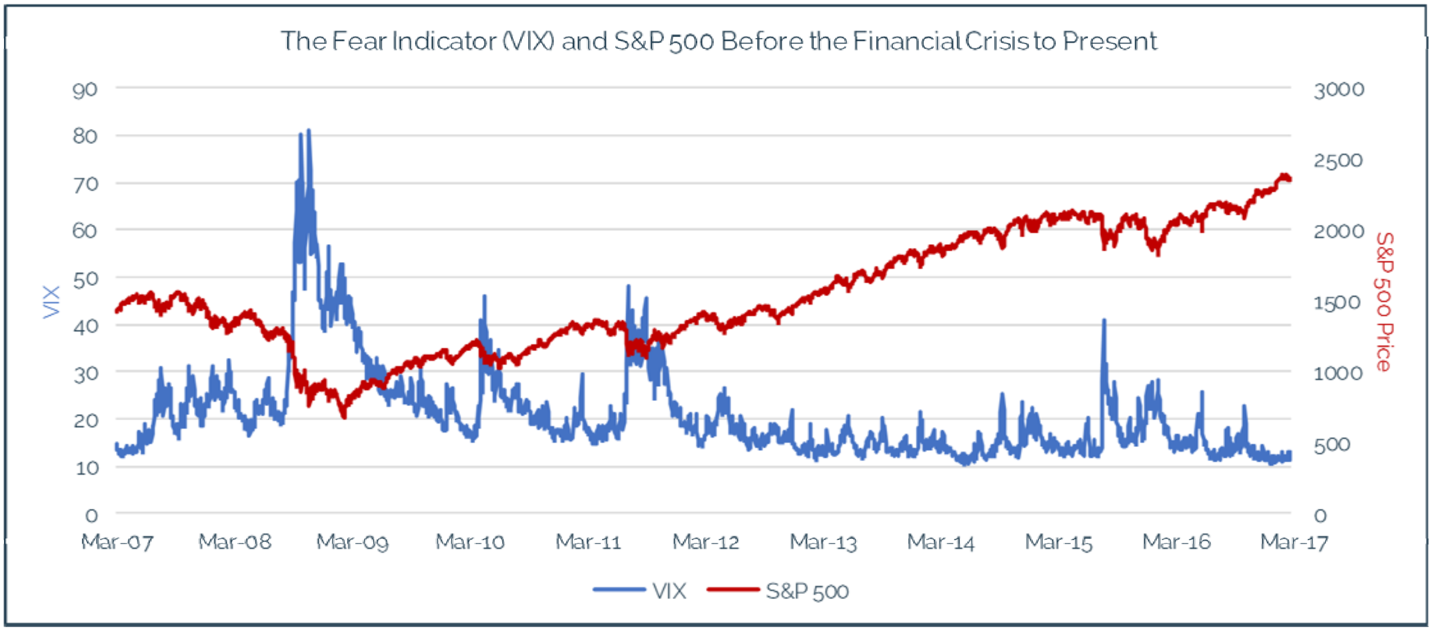
Why do investors behave this way time and again? Emotion. Emotion fueled by volatility. And the worst kind of volatility is a lack of it! A lack of volatility indicates complacency. When people are afraid, they tend to pay attention, even if they don't always make the best decisions. But when people are complacent, they are just like jellyfish floating with the tide.



There is an indicator of fear called the VIX. When the VIX is low, people are unafraid. When the VIX rises, fear is increasing. The chart on the preceding page shows the VIX and the price of the S&P 500 through the financial crisis. According to the VIX, people had relatively little fear at the market's peak in 2007 but record levels of fear near the bottom of the S&P's dramatic descent.

This is perfectly normal in a sense. Why fear what is working, and why be complacent in the midst of chaos? Yet studies indicate that fear, or a lack thereof, drives investment decisions. People reacted to their emotions and bought too late when prices were already high, and then sold too late when prices were already low. The average mutual fund investor missed the market's turnaround and the beginning of what is now a 9 year bull market. Some still aren't fully in the market. But the recent rally has certainly lured more in!

The chart on this page shows the same relationship between the VIX and the S&P, but extends into the present. As the market continues its 9 year run and sets new all-time highs, the VIX drifts to it's lowest recorded levels over the past 10 years. Complacency has returned.

The best defense for fear and complacency is adherence to a process that removes emotion. Our process is just math. We believe that valuations over time will always revert back to the mean, or norm. Sometimes valuations get out of line, and that creates opportunity. We like to take risks when the odds favor us. Without the odds in our favor, what's the point in taking the risk?

In our process, if stocks are undervalued, we buy. When valuations get excessive we take profit. When growth goes away, we liquidate. And so far, valuations have *always* reverted to the mean. It's just math. Not emotion. We always prefer to take advantage of mispriced securities than to simply float in the tide of a rising market like a jellyfish.

Sometimes the jellyfish wins the day. And to be sure, not everyone is behaving like a jellyfish simply because they are riding the wave. Some have a good process in place, and a good process usually wins out in the end. If President Trump and the Republicans fail to deliver, this becomes a tired, expensive bull market in much need of rest and repricing. If they succeed in achieving their stated goals, this market can be supported by improving fundamentals. Guessing how it will all turn out is sport or gaming, not investing. Investing requires that you play both offense and defense simultaneously and follow your discipline.

Whenever markets set new highs more money is attracted. And it is ok to try to make that last dollar of a bull market. Just know that if you get too greedy, that last dollar you make will be the first one you lose.

MARKET COMMENTARY (CONTINUED)

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With the exception of the tech-heavy NASDAQ, stocks peaked on March 3rd and have largely been adrift since.

Stocks have certainly not corrected, but without some meaningful progress on President Trump's agenda, it has become difficult to see how they go much higher from here. Without these reforms, will corporate profits reach the lofty levels investors have been expecting? The chart on page 1 illustrates the magnitude of earnings growth the market is anticipating. For the first time since 2013 earnings are expected to grow by double digits. Expectations are that the S&P 500 will show earnings growth of 22.05% this year and another 12.70% next year. Stock prices have already risen to reflect these projections. What happens if they are not met?

The Trump rally has been led largely by Technology, Financial and Industrial stocks. Technology stocks have risen partly on the anticipation of tax reform that would allow companies to repatriate their overseas earnings. Financials have been fueled by the prospect of a repeal of many of the regulations enacted under Dodd-Frank. And Industrials have expected to profit from infrastructure spending. Will these things actually happen this year? Or next?

The stock market is priced for perfection. If all the promises are delivered, stock prices will be off to the races for sure. So far the market has been patient. Although the rally peaked in most indices *(see charts below)* on March 3rd, the recent setbacks for the Trump agenda have not caused any sort of correction. At its peak, the S&P 500 was up 11.98% post election. At the end of March it was still up 10.43%. How long this patience will persist is anyone's guess. At some point, there no doubt will come a reckoning if expectations are not going to be met.

As the 2nd quarter gets underway, stock prices seem to exhibit a little more nervousness. Some of that has to do with the risk of global unrest. Syria, North Korea, Iran and Russia pose challenges for the new Administration. Yet geopolitical fallout would likely pose less of a threat to stock prices if health care or tax reform can gain some traction in Congress.

As fascinating as all the political squabble can be, interest rates could be telling us a story of their own. The Federal Reserve appears poised to continue to in-

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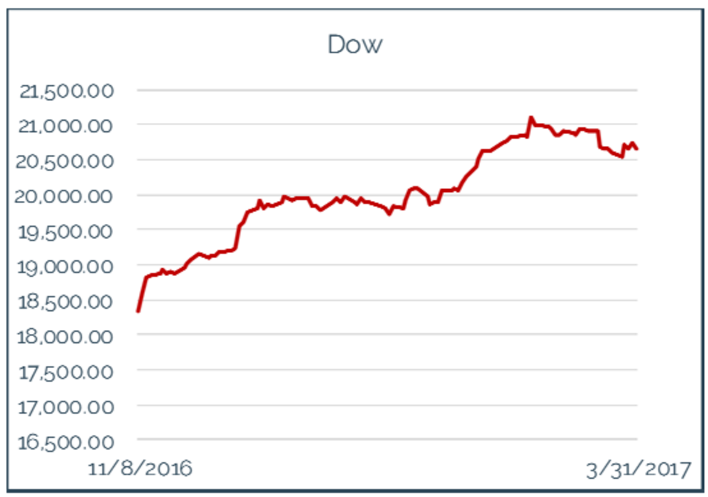

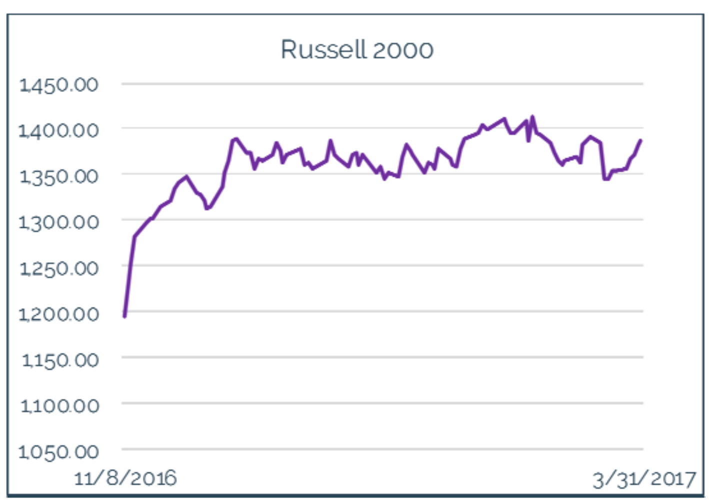

Market Commentary (Continued)

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crease short term interest rates this year. At the same time, the bond market is lowering longer term rates. This is called yield curve flattening as short rates and long rates move closer together. Should this trend hold for any period of time, profits for many companies (particularly financials) will be squeezed, making the robust earnings growth that is expected less likely. If the trend in rate compression intensifies and causes long rates to go below short rates (yield curve inversion), the Fed's actions could easily result in recession.

The great value investor Benjamin Graham once said "in the short run, the market is a voting machine but in the long run, it is a weighing machine". We know the market votes in favor of the pro-growth agenda put forth by Candidate Trump. It is giving the new President some latitude for the time being. Let's hope that Congress and the Fed don't end up weighing too much!

5 Year Annualized Dividend Growth for Tandem's Holdings by Strategy
from Q1 2012 to Q1 2017

Large Cap Core 5Yr. Annualized Dividend Growth	
Company	**Dividend Growth**
Average Tandem Stock	**13.77%**
S&P 500	**11.16%**
Abbott Laboratories	NA
AbbVie	NA
Accenture Plc	12.38%
Aptargroup	7.78%
Bank of the Ozarks	25.32%
Becton, Dickinson	10.16%
Brown & Brown,	9.69%
Brown-Forman Cl B	9.36%
Coca-Cola Company	7.73%
Costco Wholesale	13.40%
Dominion Resources	7.43%
Ecolab	13.09%
Expeditors International	9.86%
W.W. Grainger	13.07%
Hormel Foods	17.78%
Intercontinental Exchange	NA
ITT	7.06%
Microsoft	14.29%
National Retail Properties	3.40%
NextEra Energy	10.37%
NIKE Cl B	14.87%
T. Rowe Price Group	10.89%
QUALCOMM	19.78%
Republic Services	7.78%
ResMed	NA
SCANA	4.35%
Scripps Networks Cl A	20.11%
J. M. Smucker	9.34%
Stryker	14.87%
TJX Companies	22.31%
Tractor Supply	31.95%
United Technologies	6.58%
Westinghouse Air Brake	46.14%
Walgreens Boots Alliance	10.76%
Waste Connections	14.87%

Companies not paying a dividend on 3.31.2012 are listed as NA. Abbott Labs, ITT, YUM and YUM China restructured and are listed as NA because they do not have 5-year data that reflects restructuring.

Equity 5 Yr. Annualized Dividend Growth	
Company	**Dividend Growth**
Average Tandem Stock	**14.47%**
S&P 500	**11.16%**
Abbott Laboratories	NA
AbbVie	NA
Accenture Plc	12.38%
Aptargroup,	7.78%
Bank of the Ozarks	25.32%
Becton, Dickinson	10.16%
Brown & Brown	9.69%
Brown-Forman Cl B	9.36%
Cerner	NA
Coca-Cola	7.73%
Cognizant Tech Cl A	NA
Costco	13.40%
eBay	NA
Ecolab	13.09%
Expeditors International	9.86%
W.W. Grainger	13.07%
Hormel Foods	17.78%
Intercontinental Exchange	NA
ITT	7.06%
MEDNAX	NA
Microsoft	14.29%
NextEra Energy	10.37%
NIKE Cl B	14.87%
O'Reilly Automotive	NA
PayPal Holdings	NA
T. Rowe Price Group	10.89%
QUALCOMM	19.78%
Republic Services	7.78%
ResMed	NA
Scripps Networks Cl A	20.11%
Signature Bank New York	NA
Stryker	14.87%
Thermo Fisher Scientific	2.90%
TJX Companies	22.31%
Tractor Supply	31.95%
United Technologies	6.58%
Westinghouse Air Brake	46.14%
Walgreens Boots Alliance	10.76%
Waste Connections	14.87%

Mid Cap Core 5 Yr. Annualized Dividend Growth	
Company	**Dividend Growth**
Average Tandem Stock	**13.99%**
S&P 400	**10.79%**
Aptargroup	7.78%
Bank of the Ozarks	25.32%
Becton, Dickinson	10.16%
Brown & Brown	9.69%
Brown-Forman Cl B	9.36%
Cerner	NA
Cognizant Tech Cl A	NA
Dollar Tree	NA
Ecolab	13.09%
Expeditors International	9.86%
Fiserv	NA
W.W. Grainger	13.07%
Hormel Foods	17.78%
ITT	7.06%
MEDNAX	NA
National Retail Properties	3.40%
O'Reilly Automotive	NA
T. Rowe Price Group	10.89%
Republic Services	7.78%
ResMed	NA
Ross Stores	17.98%
SCANA	4.35%
Scripps Networks Cl A	20.11%
Signature Bank New York	NA
J. M. Smucker	9.34%
Stryker	14.87%
Thermo Fisher Scientific	2.90%
Tractor Supply	31.95%
Westinghouse Air Brake	46.14%
Waste Connections	14.87%
Yum! Brands	NA
Yum China	NA

The list of holdings above for Tandem's 3 strategies are as of 3.31.2017. 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. All percentages are annualized for a 5-year period.

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Yield table			
	Current	3 months ago	1 year ago
3-month Treasury Bill	0.74%	0.51%	0.29%
2-year Treasury Note	1.31%	1.20%	0.88%
5-year Treasury Note	2.01%	1.96%	1.38%
10-year Treasury Bond	2.48%	2.49%	1.89%
30-year Treasury Bond	3.08%	3.11%	2.68%
Prime Rate	3.75%	3.64%	3.50%
Federal Funds Rate	0.79%	0.54%	0.36%
Discount Rate	1.25%	1.14%	1.00%

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				
	3/31/17 Close	% Change 1 Year	% Change 3 Years	% Change 5 Years
S&P 500	2,362.72	14.71%	26.19%	67.75%
Dow Jones Industrial	20,663.22	16.84%	25.55%	56.40%
NASDAQ	5,911.74	21.39%	40.79%	91.22%
Russell 2000	1,385.92	24.41%	18.15%	66.92%
German Xetra DAX	12,312.87	23.55%	28.85%	77.24%
London FTSE 100	7,322.92	18.59%	10.98%	26.95%
Shanghai Composite	3,222.51	7.28%	58.49%	42.41%
Crude Oil	$ 50.60	14.12%	-38.33%	-45.04%
Gold	$ 1,251.20	0.61%	-5.60%	-30.93%
CRB Index	185.88	9.01%	-38.99%	-39.74%
U.S. Dollar Index	100.56	6.27%	25.53%	27.37%
Euro/Dollar*	1.07	-6.10%	-22.40%	-19.91%

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