THE TANDEM REPORT

Volume XIX, Issue 2, April 2018

"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

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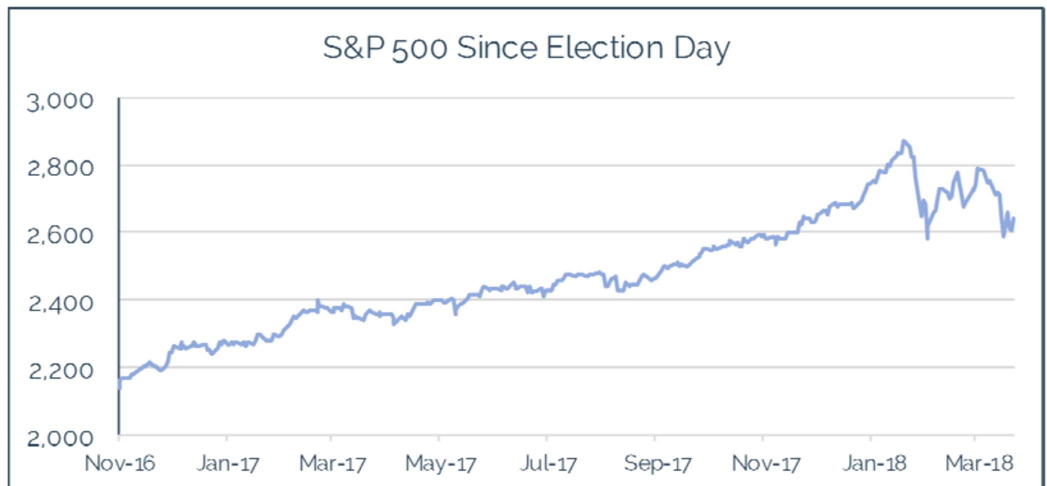
MARKET COMMENTARY:
The Winning Streak is Over. What Happens Next?

After 15 months of consecutive gains, the S&P 500 is now on a two month losing streak. February brought the first 10% correction to the U.S. stock market since 2015-2016. While headlines of the day may be blamed for this recent reversal of fortune, we think there is more to this flirtation with correction territory than mere headline risk.



From Election Day through January of this year, the market had gone up without interruption. The anticipation of deregulation and tax cuts increased optimism for meaningful growth in corporate earnings. And in fact that anticipated growth has materialized. And share prices rose to reflect the anticipation, the materialization, and even more anticipation. Prices were due for a pause, and headlines may have provided just the excuse the market sought.

Markets dislike uncertainty to be sure. And for the first time in awhile, there are things for investors to be uncertain about. President Trump's proposed tariffs are sparking fears of trade wars with China and Europe. Russia continues to be problematic. New Fed Chair Powell

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COMMENTARY:
Paying Homage to the Bull

The bull market turned 9 years old last month. That is quite an accomplishment. The only bull on record that lasted longer was from October 1990 to March 2000 (9 years, 5 months). This old bull has created a lot of wealth during its run, and it shows no sign of slowing any time soon. In fact, it may even be picking up a new head of steam with its sights set on surpassing the record for longevity.

Corporate earnings are accelerating and 2018 looks to be a very profitable year for American business. Profits are the fuel bulls run on. Long-running bull markets not only need profits, but they

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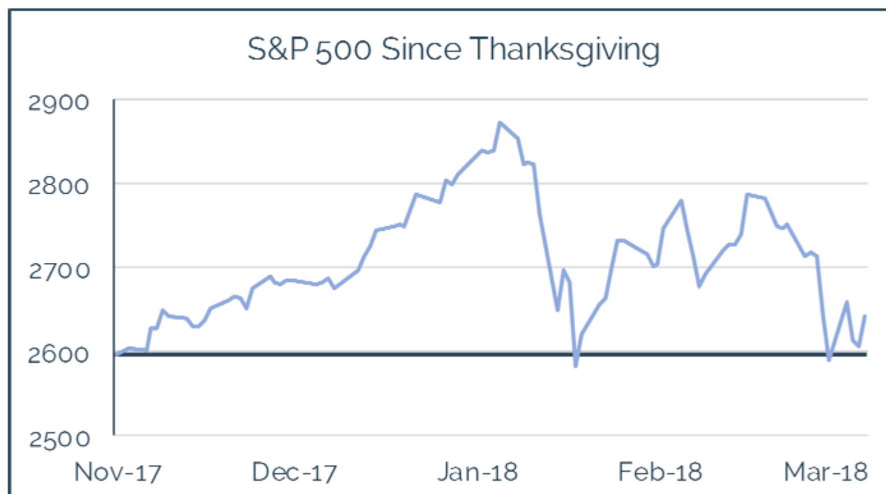
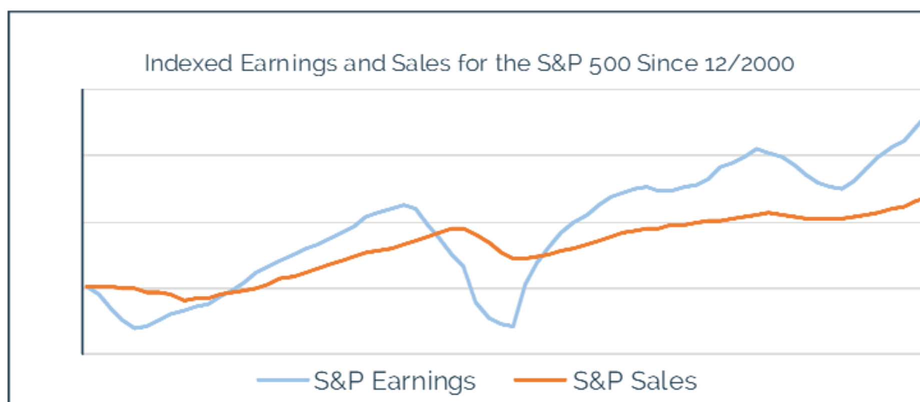
introduces an unknown regarding the extent and probability of future interest rate hikes. The Fed continues to unwind its balance sheet and rates are rising quickly. Any combination of these items making headlines can unsettle investors - at least temporarily.

The S&P 500 reached an all-time high on January 26th of this year and from there corrected 10.16% in only 9 trading days. After regaining a little more than 2/3 of its losses, the market was unable to sustain this level (twice) and sold off again back to its recent lows. We appear to be potentially range-bound for awhile as the market chops around looking for direction.



And boy is it chopping! For the entirety of 2017, there were only 8 days when the S&P closed higher or lower by at least 1% from the previous day. And there were only 10 days when the S%P moved at least 1% from high to low intraday. Through the end of March of this year there have already been 23 and 35 such days respectively. What is more, the S&P never moved 2% in 2017. It has already had 6 closes more than 2% different from the previous day and 10 intraday swings of at least 2%. Volatility is back in a big way.



Last year was not normal. There was little volatility and the market closed up all 12 months of the year. That is rare. This year is perhaps more volatile than normal, but it is much closer to normal than 2017 was. And investors need to remember that. Volatility is normal.

Volatility is also the enemy of the average investor because it makes us do the wrong thing at the wrong time for the wrong reason. When markets soar higher, investors erroneously feel confident and chase those prices. The end result is often that they pay too much, or buy high. Similarly, dramatic price declines scare investors and they panic and get out, selling low.

For some reason, risk is perceived by many to be greater after price declines and diminished after price increases. The reverse is more likely to be true, and thus volatility is rarely the friend of the average investor. For February and March, volatility was evident.

But is it really just headline risk causing this new behavior in the market? Or is there more to this? In our view, stock valuations had become unsustainable, and we said so last quarter in these very pages. Bull markets rarely end simply because stocks become overvalued. Overvalued stocks are certainly more susceptible to a fall, but they generally need a trigger. More often than not the trigger is unknown until the autopsy is performed. Rarely is it just news. It has to be something that impacts the economy or corporate earnings in a fundamental way. So what could impact the economy or earnings in a fundamental way?

The economy actually appears to be pretty strong at the moment. Corporate earnings and share prices have risen dramatically. Earnings for the S&P 500 are expected to grow over 25% this year and another 10% in 2019. This is the strongest period of earnings growth since 2011.

We have argued repeatedly in these pages that prices do not need to fall in order for stocks to become more attractively valued. In fact, if forecasted growth becomes reality, and prices just stay steady for a year or so, valuations will look a lot more attractive by most measures.

However, the earnings recovery since the financial crisis has not been accompanied by a similar recovery in

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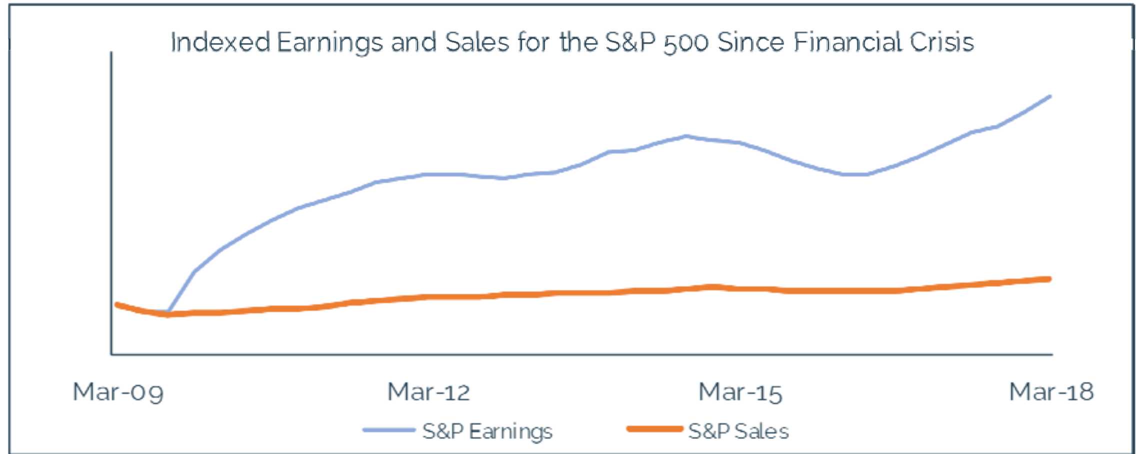
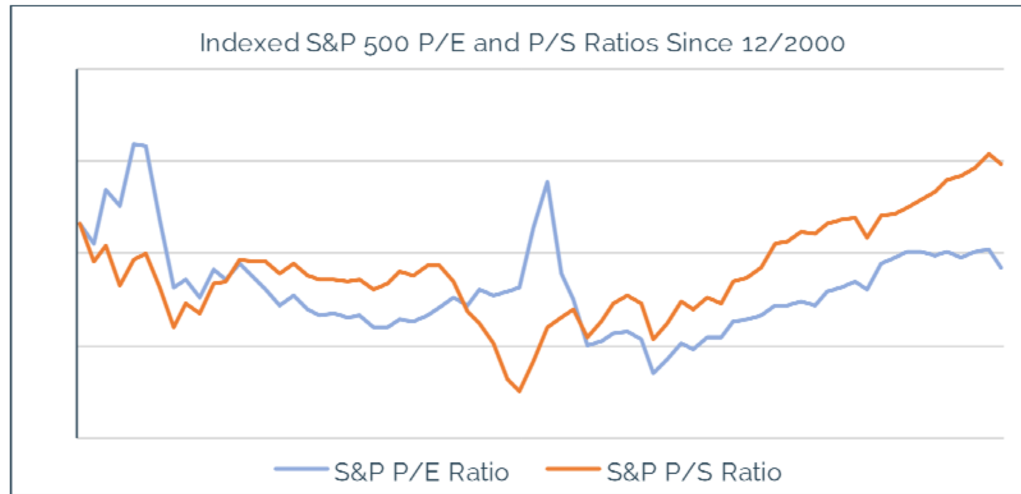
sales! And this is a very odd circumstance. Typically earnings are more volatile than sales, but the two generally track together. Not so since 2009.

Since the depths of the financial crisis in March 2009, S&P earnings have increased 200%, while S&P sales have only increased 25%. That is quite a disparity. How do earnings grow if sales don't?



One reason earnings have grown so dramatically without similar sales growth is the prolonged zero interest rate policy by the Fed. With rates so low for so long, corporations are spending less to service their debt, thereby propping up profit without increasing sales. There are other, more complex methods of financial engineering that produce similar results.



Cost reduction has been the largest driver of earnings growth during this recovery. Whether cost savings come from lower interest rates, fewer employees, greater productivity, a weaker currency or lower tax rates, earnings have grown without a corresponding gain in sales.

Without increased sales at some point, earnings growth will prove difficult to sustain. And herein lies a valuation conundrum. Market observers correctly point out that the S&P's Price/Earnings Ratio (P/E) is nowhere near the record highs in 2009 and 2002. From a P/E standpoint, stocks are not cheap, but they don't appear to be expensive either. The lower chart above clearly indicates P/E ratios have been much higher than the present level. But this assertion can be misleading. The highest P/Es of the past 18 years occurred in the depths of recession, after stock prices had already collapsed. PEs in 2002 (recession) and 2009 (recession) were some of the highest recorded. Why? Because P/E is price divided by earnings. And in a recession, earnings take a bigger hit than price. So P/E is highest at the bottom, which is counterintuitive but true. From that perspective, today's P/E does seem elevated.

More obvious is that the Price/Sales ratio (P/S) is at an unprecedented valuation. This is it. This is the highest P/S ratio on record going back to the end of 2000. Although P/S ratios are not widely used as a valuation metric, they are certainly relevant. By this measure, stocks are extremely expensive.

Expensive stocks are often more susceptible to headline risk. It is not necessarily because the owners of these stocks are more nervous when prices are high. It is more likely because there are fewer interested buyers when prices are elevated. A lack of buyers can make prices swing with greater volatility. And this describes the market we find ourselves in today.

So after a lengthy run of calm prosperity, 2018 has delivered a little chaos. The market is no longer one-directional. At least for now. And we welcome this development. We do not suggest it is permanent, or that the bull market is over. Rather, volatility creates opportunity. We have been able to add to our holdings at attractive prices. This is a welcome change indeed. It is a heck of a party, but we are sticking close to the door.

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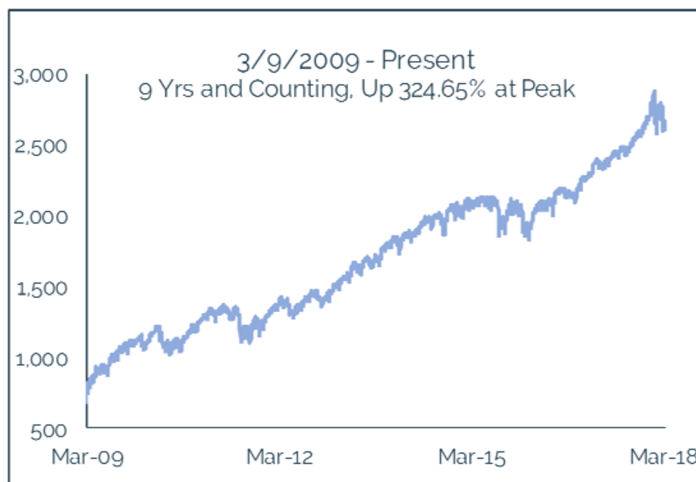
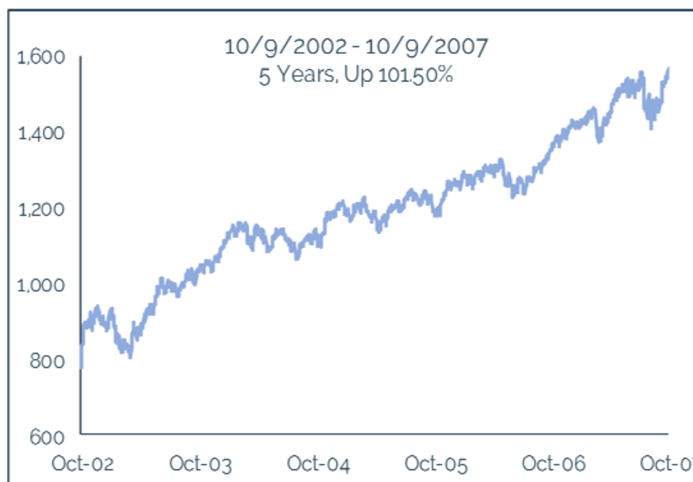
also need to begin at a very low valuation. The current bull actually began at a price lower than the previous bull market starting price.

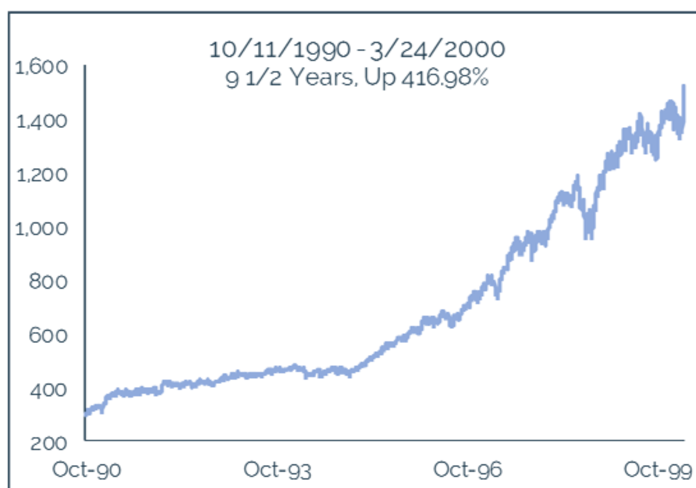
This bull is not only remarkable for its duration, but also for its price increase. Second only to the 1990's bull, this one returned 324.65% at its peak on January 26, 2018. From a closing low of 676.53 on March 9, 2009, the S&P reached 2,872.87 at its high. That translates to an annualized rate of return of about 17.75% from the 2009 bottom. Think about that. If you bought the S&P on March 9, 2009, you would have experienced an annualized return of more than 17%. This really does illustrate that price matters. Buying when prices are cheap significantly increases returns. Had you waited just one year to buy the S&P on March 9, 2010, your annualized rate of return through the recent high would have dropped to less than 12.5%. As we pointed out in the last edition, valuation really does matter.

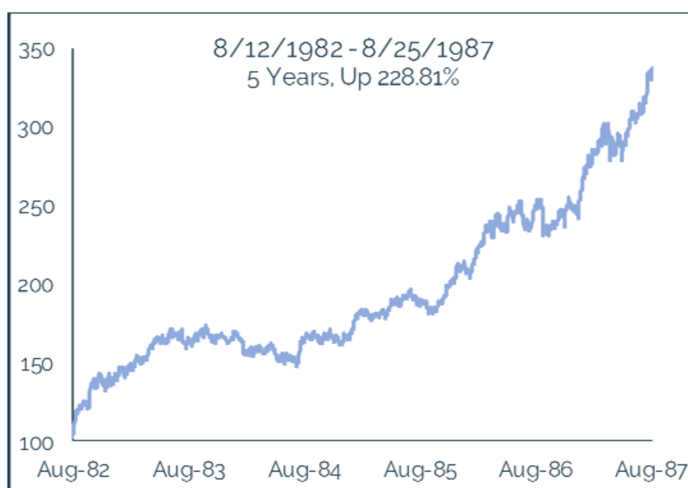
Just for fun we have put up charts of the last 4 bulls to see how this one stacks up. We have noted that it is the second longest in duration and that it has produced the second greatest total return from bottom to peak. But the bull market of the 80's produced an annualized rate of return exceeding 26% from bottom to top. That is massive. Of course that bull market lasted only 5 years and ended painfully in October 1987.

The last 4 Major Bull Markets in the S&P 500 all at least doubled in price and lasted at least 5 years.









The granddaddy of all bull markets was the one we experienced in the 90's. Lasting almost a full decade, it produced an annualized rate of return of about 19%. Of course, that one ended badly too when the Tech Bubble finally burst.

The first bull market of this century was the shortest lived, provided the most modest return (~15% annualized) and ended the worst. Seems like we should have gotten more out of that one given how much was lost when it ended!

We have said repeatedly that we believe caution is warranted when dealing with this bull. Valuations are definitely high and the easy money has already been made. But that doesn't mean that this bull will end any-

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time soon. This one doesn't yet look like the other 3 did as they approached the end of their runs.

As noted, earnings growth is accelerating, not contracting. That is not a sign of an aging bull. Interest rates are rising, as was the case with the other tired bulls, but rates are not actually high. Rates could become problematic at some point, but that will most likely be when they are high enough to entice investors out of stocks and into bonds. We aren't there yet.

Also missing from this bull are hyper-inflated asset values. In the 2000's we saw real estate and commodity prices rise to excessive levels along with stocks. In the 80's and 90's we witnessed wild, euphoric, herd mentality buying of stocks. The hysteria hasn't taken hold yet in this one.

It is reasonable to conclude that this bull has lasted this long, and could potentially last a good deal longer, for a couple of reasons unique to its lifespan. First, it began at extremely depressed levels after the financial crisis. It had a long way to go just to return to normal. And second, it has benefitted from central bank intervention. This is certainly a unique bull and will no doubt take its rightful place in history when it decides to rest.

5 Year Annualized Dividend Growth for Tandem's Holdings by Strategy
from Q1 2013 to Q1 2018

Tandem's average dividend-paying holding has increased it's dividend by 12.61% 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	14.87%
AbbVie, Inc.	19.14%
Accenture Plc	10.43%
Becton, Dickinson	8.67%
Brown & Brown	10.76%
Brown-Forman Cl B	9.15%
Cognizant Tech Solutions	NA
Costco	12.70%
CVS Health	17.32%
Dollar General	NA
Dominion Resources	8.22%
Ecolab Inc.	12.26%
Expeditors International	8.45%
FactSet Research	12.56%
Hormel Foods	17.14%
Intercontinental Exchange	NA
Microsoft	12.80%
National Retail Properties	3.76%
NextEra Energy	10.96%
NIKE	13.75%
T. Rowe Price	13.00%
Republic Services	7.98%
ResMed	15.54%
J. M. Smucker	8.45%
Stryker	12.14%
TJX Companies Inc	21.88%
Tractor Supply	21.98%
United Technologies	5.52%
Walgreens Boots Alliance	7.78%
Waste Connections	15.88%
Average	**12.34%**

Companies not paying a dividend on 3.31.2013 are NA. All companies in Large Cap Core currently pay a dividend.

Equity 5 Yr. Annualized Dividend Growth

Company	Dividend Growth
Abbott Laboratories	14.87%
AbbVie, Inc.	19.14%
Accenture Plc	10.43%
Becton, Dickinson	8.67%
Brown & Brown	10.76%
Brown-Forman Cl B	9.15%
Cognizant Tech Solutions	NA
Costco	12.70%
CVS Health	17.32%
Dollar General	NA
eBay	NA
Ecolab Inc.	12.26%
Expeditors International	8.45%
FactSet Research	12.56%
Hormel Foods	17.14%
Intercontinental Exchange,	NA
MEDNAX	NA
Microsoft	12.80%
NextEra Energy	10.96%
NIKE	13.75%
O'Reilly Automotive	NA
PayPal Holdings	NA
T. Rowe Price	13.00%
Republic Services	7.98%
ResMed	15.54%
Signature Bank NY	NA
Stryker	12.14%
TJX Companies Inc	21.88%
Tractor Supply	21.98%
United Technologies	5.52%
Verisk Analytics	NA
Walgreens Boots Alliance	7.78%
Waste Connections	15.88%
Average	**13.13%**

Mid Cap Core 5 Yr. Annualized Dividend Growth

Company	Dividend Growth
Becton, Dickinson	8.67%
Brown & Brown	10.76%
Brown-Forman Class B	9.15%
Cognizant Tech Solutions	NA
Dollar Tree, Inc.	NA
Ecolab Inc.	12.26%
Expeditors International	8.45%
FactSet Research	12.56%
Fiserv	NA
Hormel Foods	17.14%
MEDNAX	NA
National Retail Properties	3.76%
O'Reilly Automotive	NA
T. Rowe Price	13.00%
Republic Services	7.98%
ResMed	15.54%
Ross Stores	21.49%
Scripps Networks	NA
Signature Bank NY	NA
J. M. Smucker	8.45%
Stryker	12.14%
Tractor Supply	21.98%
Verisk Analytics	NA
Waste Connections	15.88%
Yum! Brands, Inc.	NA
Yum China Holdings, Inc.	NA
Average	**12.45%**

The list of holdings above for Tandem's 3 strategies are as of 3.31.2018. 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	1.73%	1.34%	0.75%
2-year Treasury Note	2.28%	1.84%	1.31%
5-year Treasury Note	2.63%	2.18%	2.01%
10-year Treasury Bond	2.84%	2.40%	2.48%
30-year Treasury Bond	3.09%	2.77%	3.08%
Prime Rate	4.58%	4.40%	3.88%
Federal Funds Rate	1.51%	1.30%	0.79%
Discount Rate	2.08%	1.90%	1.38%

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

	3/31/18 Close	% Change 1 Year	% Change 3 Years	% Change 5 Years
S&P 500	2,640.87	11.77%	27.71%	68.30%
Dow Jones Industrial	24,103.11	16.65%	35.59%	65.33%
NASDAQ	7,063.45	19.48%	44.13%	116.17%
Russell 2000	1,529.43	10.35%	22.08%	60.73%
German Xetra DAX	12,096.73	-1.76%	1.09%	55.18%
London FTSE 100	7,056.60	-3.64%	4.19%	10.06%
Shanghai Composite	3,168.90	-1.66%	-15.45%	41.68%
Crude Oil	$ 64.91	28.53%	4.31%	60.11%
Gold	$ 1,329.60	4.64%	13.21%	27.47%
U.S. Dollar Index	89.66	-9.34%	-5.33%	9.60%
Euro/Dollar*	1.23	15.12%	14.57%	-3.93%

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

TANDEM
INVESTMENT ADVISORS