The TANDEM Report

Volume XVIII, Issue 3, July 2017

TANDEM Investment Advisors

"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:
The Bull Charges Onward

This market is fearless. Nine years in and the Bull Market shows no sign of slowing down. In the past, bad news was good news for stocks, as a lack of economic growth meant more Federal Reserve intervention. Now, even though economic growth remains tepid, corporate earnings growth has taken control and is running at an impressive clip. Bears are throwing in the towel and falling in line. Record highs in virtually every stock market index at home and abroad are seemingly being set daily.

For the 2nd quarter ended June 30, major U.S. stock market indices stood at or near all-time highs. Returns year-to-date exceed 8% while index returns since the election are in the teens. Even interest rate hikes by the Federal Reserve can't derail this train.

	S&P 500	Dow Industrials	NASDAQ
2nd Qtr	2.57%	3.32%	3.87%
YTD	8.24%	8.03%	14.07%
Election	13.27%	16.46%	18.23%

More of the same can be expected for the 2nd half of the year if history can be our guide. From the useless facts department we have learned an unusual statistic. For every year since 1988, if the S&P is up at least 6% by June 30, the full year has been up double digits.

There had been some concern that the market was too reliant upon pro-growth fiscal policy implementation. While any new fiscal policy seems unlikely in the near future, the market is paying little notice, relying instead on improving corporate earnings and a lack of inflation. Supported by a mildly weaker dollar, the earnings picture for at least the next couple of quarters should not disappoint.

Future Fed policy has the potential to be a damper. Much discussion has taken place publicly about the Fed finally beginning to shrink its balance sheet from its present level to something more reflective of current economic circumstances.

The Fed has also indicated its intention to continue to raise interest rates. While either of these policy implementations could produce headwinds for stocks, the market is rightfully suspicious of the Fed's willingness to cause such disturbances. This Fed has consistently

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Commentary:
Common Sense Investing

Our investment philosophy is grounded in common sense. Companies capable of growing earnings regardless of economic circumstances are more likely to reward patient shareholders. Companies that consistently grow their dividend as a result of consistent earnings and cash flow growth are even more likely to do so. We try to buy these companies when they are cheap, take profit when they are expensive and liquidate when they no longer meet our criteria. This is pretty straightforward stuff in our opinion.

Sometimes the stock market rewards

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our type of stocks more than other types, and sometimes it doesn't. The current market doesn't love our type of stocks.

We have been doing this for more than 26 years. On a few occasions over the course of our history our methodology has been out of favor. Each time, we have stuck to our discipline. Stuck to what we know and why people hire us. Sometimes avoiding the big miss is more important than making the big gain.

When prices were lower, the odds of making a big gain were greatly increased. With prices at record highs, the likelihood of big gains going forward is diminished, at least for our type of investing. We spoke in the last issue of the importance of playing offense and defense simultaneously. In today's market, playing defense is definitely a penalty.

As we have already stated, we want to own companies that grow, regardless of what the economy does. Most companies do not produce the type of consistency we demand. In markets where optimism is high based on great expectations for the future (like this one), consistency is often less rewarded than potential

Economic and earnings growth have been stagnant for some time now. But expectations for future earnings growth is quite high. Most anticipate that earnings growth for the S&P 500 will be around 20% this year. Naturally stock prices rise with such growth!

The problem is that prices have already risen dramatically before any growth has materialized. At the end of September, 2014, earnings for the S&P 500 peaked at $114.51 for the preceding 4 quarters. They then declined for 7 consecutive quarters before recovering. When all the companies in the S&P finally report for the 2nd quarter ended in June, earnings are expected to be $116.41. In other words, in almost 3 years, S&P earnings are virtually unchanged, Yet the S&P's price has increased by about 25%. Over the same time period, the average Tandem holding has grown earnings over 20%! Why haven't our prices kept pace with the market?

The simple answer is that the market isn't rewarding past performance. It is looking forward, as it rightly should. Looking forward, the market expects robustness that our math doesn't recognize. Amazon may in fact come to dominate the world, along with Netflix, Alphabet (Google), Facebook and a few others. Their prospects are far more exciting than those of typical Tandem holdings like Becton Dickinson, Smucker, Walgreens, Republic Services or Scripps Networks.

It is likely that many of these lofty expectations will be met. It is at least as likely that more will not. Then what happens?

As stock prices have risen, companies have invested far less in future growth than they once did. The chart below clearly illustrates that S&P 500 companies have a greater appetite for buying their own shares and supporting their dividends than they do for investing in the future. Companies have increased share buybacks and

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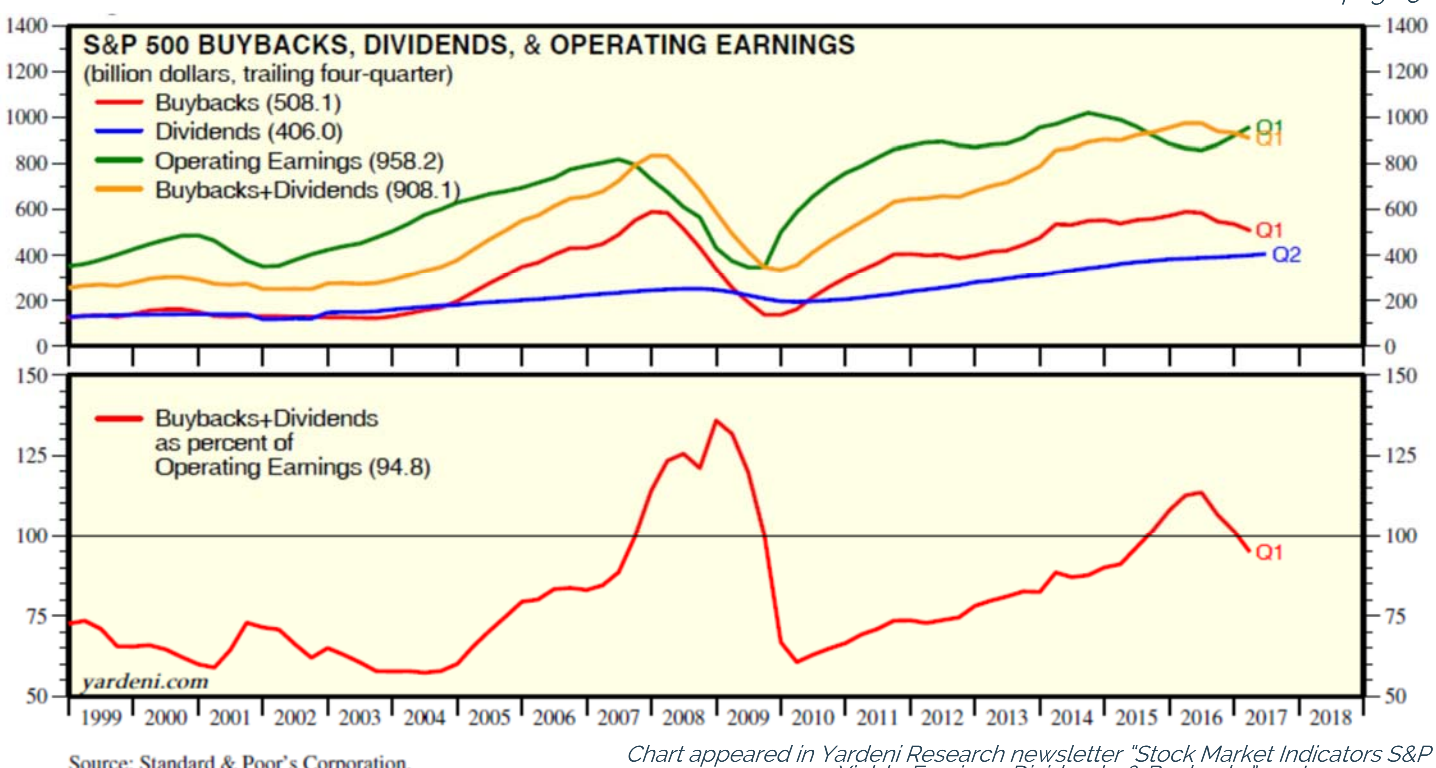

Chart appeared in Yardeni Research newsletter "Stock Market Indicators S&P 500 Yields: Earnings, Dividends, & Buybacks" on June 21, 2017

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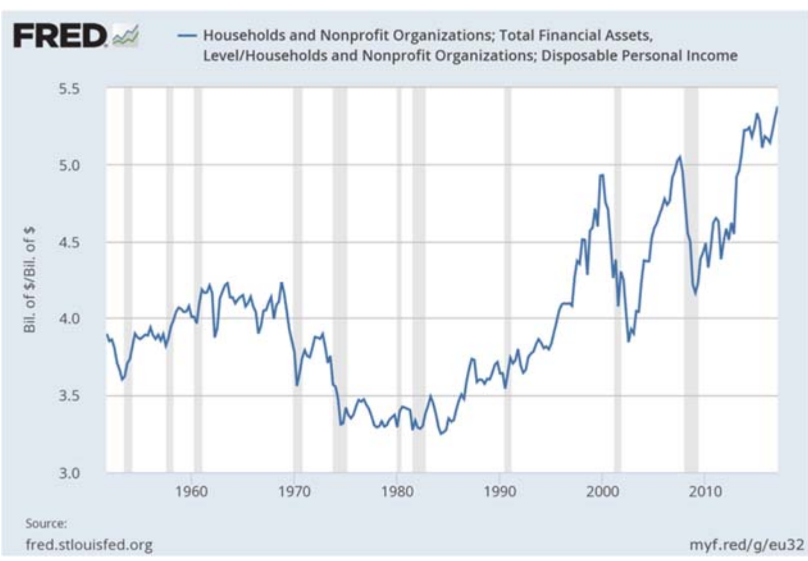
dividends to such an extent that they now consume nearly all of the S&P's operating profits. With little to no earnings being reinvested, how likely is it that the anticipated earnings growth materializes and sustains itself?

As we have said numerous times before, we love taking risks when the odds are in our favor. While this market is undoubtedly poised to continue to set new record highs, the odds are now less in our favor. We are not arguing that the stock market is in danger of imminent decline. Momentum and investor sentiment clearly favor higher highs. There is an old Wall Street saying that the trend is your friend, and the trend is definitely higher. But we cannot buy just to buy. It has to make fundamental sense. We have to follow our process or we face a greater risk than simply making less money than the stock market for a time.

The number of hours of work required to buy a unit of the S&P 500, assuming median US Wages, reaches an all-time high.

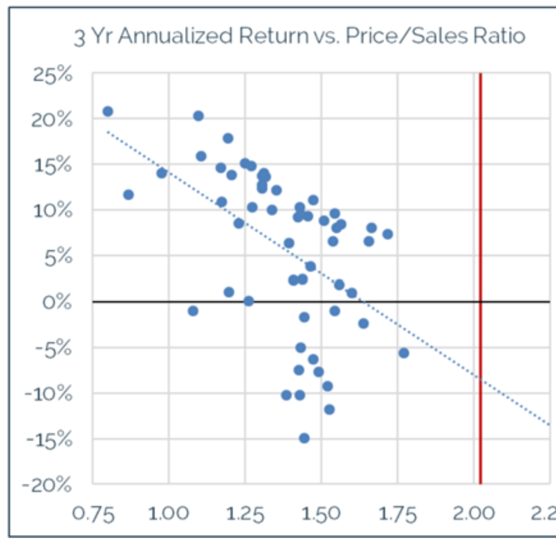
Households and Nonprofit Organizations; Total Financial Assets, Level/ Households and Nonprofit Organizations; Disposable Personal Income



Instead, it strikes us that right now, the market is bringing future price gains forward. In the past, this has resulted in a period of unspectacular gains at best. Sustained unspectacular gains for the S&P does not mean that all individual stocks will have a similar fate. There are always opportunities. We just have to be more selective at these levels of valuations.

We have provided a few charts below that express our concerns about risk levels. On the left side of the page are a couple unique ways to look at valuation levels for assets. The top left shows the cost of the S&P 500 in terms of U.S. median wages. The bottom left expresses financial asset valuations relative to disposable personal income. In both instances, we have reached historic levels in excess of anything previously seen since the 1960s. Immediately above, we revisit the S&P's future 3 year returns for various valuation levels as measured by the Price/Sales ratio. As we have not seen this lofty valuation since 2000, past experience indicates dim prospects for returns going forward.

S&P 500 3 Yr Returns by Valuation since 2000



None of these examples provide concrete evidence of anything. They are merely anecdotes that tell one side of a story. Maybe the 9th year of this Bull isn't also the 9th inning. Maybe there is plenty more room for the Bull to run. Based on the amount of money flowing into passive investments, investors are clearly indicating that they believe the greatest risk lies in missing out.

We respectfully disagree. We would rather have our biggest mistake be something we did NOT do, rather than something we did. In the meantime, we will enjoy these very real gains we are given while also preparing for future opportunities. Buy low and sell high. It's common sense.

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erred on the side of not rocking the market's boat. There appears to be clear sailing ahead for stocks.

Lest we sound positively bullish, we should point out that there are chinks in the market's armor that are being overlooked. We devote significant space to this discussion in *Commentary* so we will try not to repeat ourselves here.

Our overriding concern continues to be that investors fail to appreciate the level of risk they are incurring. Risk is difficult to perceive in the face of unceasing stock market gains. But history informs us that it is precisely this lack of risk-awareness that can cause markets to fall. The crash of 1987 and the Tech Bubble of 2000 immediately come to mind when we think of markets that were drawing people in right until the end.

Many argue that valuations are nowhere near the levels they attained in 2000. For the most expensive stocks, this is certainly true. Unexciting companies like GE and Coke sported PEs in 2000 that should have sent up red flags, yet didn't. It cannot be questioned that the most expensive stocks today do not yet approach the levels of the most expensive stocks in the Tech Bubble.

But that claim can only be made about the most expensive stocks. The rest of the stock universe is indeed more expensive today than it was in 2000. The chart at the bottom of this page makes this case rather clearly. The 80% of stocks not considered the most expensive are more expensive today than they were 17 years ago. In short, nothing is grossly overvalued, but everything is equally overvalued.

The price we pay for an asset will help determine our future return. Price absolutely matters in the long run, even if it can be overlooked in the short run. If you really believe price doesn't impact long term performance, let's recall a few real life examples.

In 2000, General Electric was run by a man many considered to be the greatest American CEO of all time - Jack Welch. GE was the bluest of Blue Chips. Under Welch's guidance, General Electric became the largest company in the world and shareholders reaped the rewards. In 2007, the stock traded over $57 per share. It has never seen that price level since, and trades below $26 per share today - an amount less than half its value 17 years ago.

In 1999, Microsoft dominated the tech world and Bill Gates was the richest man on the planet. That year, the stock traded for over $58 per share. It took another 17 years just to return to that level.

In 2003 a 2 BR 2 BA condominium in a popular South Carolina resort sold for $299,000. In 2007 the same condo sold for $407,000. It was listed for sale again in May of this year for $319,000. It has yet to sell.

When we see asset prices rising, as they are today, the absolute price of the asset seems less relevant than the price direction of the asset. We see lofty returns and imagine that they will continue. And they often do - for far longer than they should! But ultimately the price of the asset will matter, as it did in the 3 examples cited

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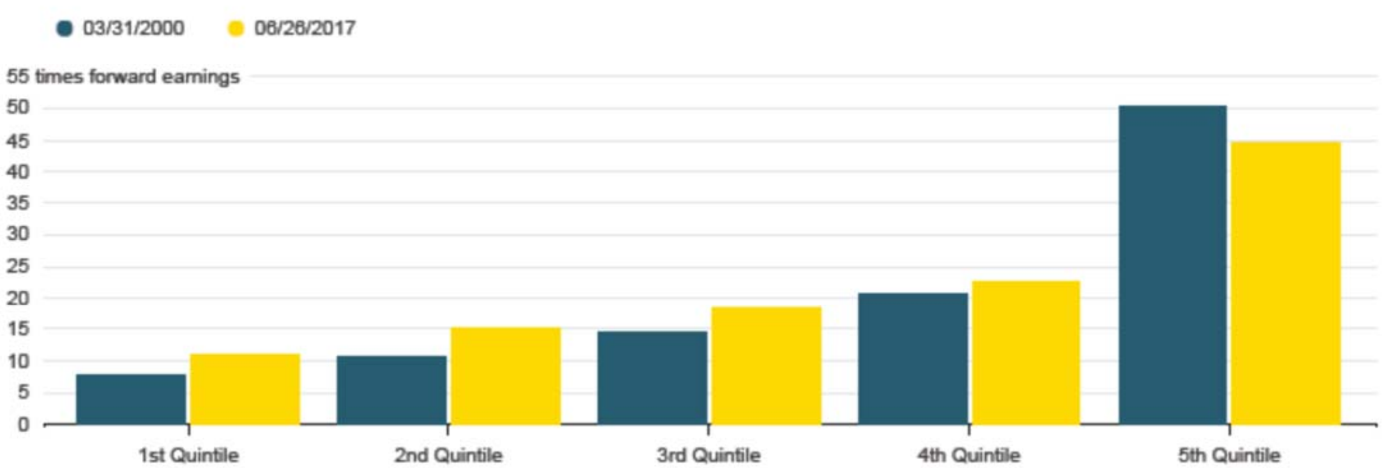
Cheap Is the New Expensive

Even compared wtih the early 2000 stock market bubble, the lowest P/E stocks in the S&P 500 look expensive



Source: Bloomberg

Note: Universe is the stocks in the S&P 500. Quintiles are ranked by Forward 12 Month P/E multiples, lowest to highest.

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above.

This is the risk that most investors are unaware they are undertaking. Overpaying may lead to short term gain, but those gains are never sustainable. When the S&P's earnings remain virtually unchanged over the last 3 years, why does the S&P's price increase by 25%? Were prices that undervalued 3 years ago? Tandem's average holding saw earnings increase by nearly 20% over the same 3 year period. We would argue that price gains based upon earnings gains are more sustainable,

The Bull Market charges ahead. Enjoy it! But leave at least a little room for skepticism.

5 Year Annualized Dividend Growth for Tandem's Holdings by Strategy
from Q2 2012 to Q2 2017

Large Cap Core 5Yr. Annualized Dividend Growth	
Company	**Dividend Growth**
Average Tandem Stock	**12.99%**
S&P 500	**11.07%**
Abbott Laboratories	NA
AbbVie, Inc.	NA
Accenture Plc Class A	12.38%
Aptargroup, Inc.	7.78%
Bank of the Ozarks	23.87%
Becton, Dickinson	10.16%
Brown & Brown, Inc.	9.69%
Brown-Forman Class B	9.36%
Coca-Cola Company	7.73%
Costco	12.70%
Dollar General	NA
Dominion Energy Inc	7.43%
Ecolab Inc.	13.09%
Expeditors International	8.45%
FactSet Research Systems	12.56%
W.W. Grainger, Inc.	9.86%
Hormel Foods Corporation	17.78%
Intercontinental Exchange,	NA
ITT, Inc.	7.06%
Microsoft Corporation	14.29%
National Retail Properties	3.40%
NextEra Energy, Inc.	10.37%
NIKE, Inc. Class B	14.87%
T. Rowe Price Group	10.89%
Republic Services, Inc.	7.78%
ResMed Inc.	NA
SCANA Corporation	4.35%
Scripps Networks	20.11%
J. M. Smucker Company	9.34%
Stryker Corporation	14.87%
TJX Companies Inc	22.13%
Tractor Supply Company	21.98%
United Technologies	6.58%
Westinghouse Air Brake	46.14%
Walgreens Boots Alliance	10.76%
Waste Connections, Inc.	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	**13.61%**
S&P 500	**11.07%**
Abbott Laboratories	NA
AbbVie, Inc.	NA
Accenture Plc Class A	12.38%
Aptargroup, Inc.	7.78%
Bank of the Ozarks	23.87%
Becton, Dickinson	10.16%
Brown & Brown, Inc.	9.69%
Brown-Forman Class B	9.36%
Cerner Corporation	NA
Coca-Cola Company	7.73%
Cognizant Technology	NA
Costco	12.70%
Dollar General	NA
eBay Inc.	NA
Ecolab Inc.	13.09%
Expeditors International	8.45%
FactSet Research Systems	12.56%
W.W. Grainger, Inc.	9.86%
Hormel Foods Corporation	17.78%
Intercontinental Exchange	NA
ITT, Inc.	7.06%
MEDNAX, Inc.	NA
Microsoft Corporation	14.29%
NextEra Energy, Inc.	10.37%
NIKE, Inc. Class B	14.87%
O'Reilly Automotive, Inc.	NA
PayPal Holdings Inc	NA
T. Rowe Price Group	10.89%
Republic Services, Inc.	7.78%
ResMed Inc.	NA
Scripps Networks	20.11%
Signature Bank New York	NA
Stryker Corporation	14.87%
Thermo Fisher Scientific	2.90%
TJX Companies Inc	22.13%
Tractor Supply Company	21.98%
United Technologies	6.58%
Verisk Analytics Inc	NA
Westinghouse Air Brake	46.14%
Walgreens Boots Alliance	10.76%
Waste Connections, Inc.	14.87%

Mid Cap Core 5 Yr. Annualized Dividend Growth	
Company	**Dividend Growth**
Average Tandem Stock	**13.49%**
S&P 400	**10.81%**
Aptargroup, Inc.	7.78%
Bank of the Ozarks	23.87%
Becton, Dickinson	10.16%
Brown & Brown, Inc.	9.69%
Brown-Forman Class B	9.36%
Cerner Corporation	NA
Cognizant Technology	NA
Dollar Tree, Inc.	NA
Ecolab Inc.	13.09%
Expeditors International	8.45%
FactSet Research Systems	12.56%
Fiserv, Inc.	NA
W.W. Grainger, Inc.	9.86%
Hormel Foods Corporation	17.78%
ITT, Inc.	7.06%
MEDNAX, Inc.	NA
National Retail Properties	3.40%
O'Reilly Automotive, Inc.	NA
T. Rowe Price Group	10.89%
Republic Services, Inc.	7.78%
ResMed Inc.	NA
Ross Stores, Inc.	NA
SCANA Corporation	4.35%
Scripps Networks	20.11%
Signature Bank New York	NA
J. M. Smucker Company	9.34%
Stryker Corporation	14.87%
Thermo Fisher Scientific	NA
Tractor Supply Company	21.98%
Verisk Analytics Inc	NA
Westinghouse Air Brake	46.14%
Waste Connections, Inc.	14.87%
Yum! Brands, Inc.	NA
Yum China Holdings, Inc.	NA

The list of holdings above for Tandem's 3 strategies are as of 6.30.2017. 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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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	1.00%	0.74%	0.27%
2-year Treasury Note	1.34%	1.31%	0.73%
5-year Treasury Note	1.77%	2.01%	1.17%
10-year Treasury Bond	2.19%	2.48%	1.64%
30-year Treasury Bond	2.80%	3.08%	2.45%
Prime Rate	4.13%	3.88%	3.50%
Federal Funds Rate	1.04%	0.79%	0.38%
Discount Rate	1.63%	1.38%	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

	6/30/17 Close	% Change 1 Year	% Change 3 Years	% Change 5 Years
S&P 500	2,423.41	15.46%	23.63%	77.91%
Dow Jones Industrial	21,287.03	18.72%	26.51%	65.27%
NASDAQ	6,144.35	26.88%	39.39%	109.34%
Russell 2000	1,416.20	22.94%	18.71%	77.36%
German Xetra DAX	12,416.19	28.27%	26.27%	93.51%
London FTSE 100	7,312.72	12.43%	8.43%	31.26%
Shanghai Composite	3,192.43	8.97%	55.86%	43.45%
Crude Oil	$46.04	-4.74%	-56.31%	-45.81%
Gold	$1,242.03	-5.79%	-6.03%	-22.54%
CRB Index	174.78	-9.24%	-43.29%	-38.50%
U.S. Dollar Index	95.42	-0.81%	19.56%	16.72%
Euro/Dollar*	1.14	2.89%	-16.55%	-9.75%

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

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