

# THE TANDEM REPORT

Volume XIX, Issue 3, July 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](http://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: Sideways Movement is a Good Thing

It may not feel like it but the first half of 2018 has been very constructive for the stock market. It has also proven to be rewarding to Tandem's portfolios. Certainly returns have not been as robust as they were last year, but thus far they have been solid and healthy.

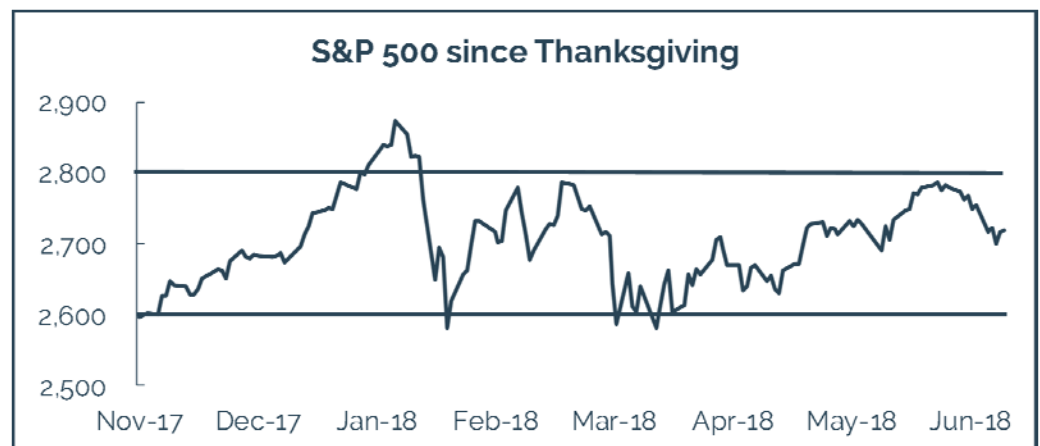
Since reaching an all-time high on January 26<sup>th</sup>, the market has corrected 10% and then recovered but failed in subsequent attempts to return to the previous high. It seems to be a bit range-bound now. There is some volatility but mostly just sideways movement.

As we discuss in this month's *Commen-*

*tary* (below), company fundamentals are improving at a faster pace than share prices are advancing. The longer this remains the case, the more attractive stocks will become. Believe it or not, this sideways action is just what the doctor ordered.

It is important to remember that not all stocks behave the same. The "Market" is an index, or average, constructed to reflect broader movement. The S&P 500 is an index of 505 (not 500) stocks meant to represent a broad swath of corporate America. Inside the index, those 505 companies can rise or fall in price for their own reasons. For the first

*(Continued on page 2)*



## COMMENTARY: The History of Cash Reserves in Tandem Portfolios

By the end of the third quarter in 2016, cash levels in Tandem portfolios were sitting at historically high levels. Not to stroll too far down memory lane but let us quickly revisit the economic and fundamental backdrop at that time. In light of today's robust economic growth it could be easy to overlook the fact that 2016

came and went without a single quarter of real GDP growth above of 2%. This was a feat so rare that it had only occurred four other times in the previous 30 years, two of which happened during the Financial Crisis. The manufacturing sector of the U.S. economy was actually contracting at one point in

*(Continued on page 4)*

## MARKET COMMENTARY (CONTINUED)

(Continued from page 1)

half of the year, the price of the S&P was up 1.67%. The average increase for the 505 stocks that comprise the index was 4.17%. The average Tandem holding across all strategies increased 4.21%.

The actual performance of an index or portfolio reflects the fact that not all stocks are represented equally. In the case of the S&P 500, the largest companies, like Amazon, Apple, Google, Microsoft and Netflix, have the most influence on the index's return. In the case of a portfolio, like Tandem's, the companies that make up the largest percentage of the portfolio exert the most influence on overall performance.

It should be clear that the "average" performance of the stocks in an index or portfolio does not reflect the actual performance of that index or portfolio. The stocks that comprise the S&P had performance for the 1<sup>st</sup> half of the year ranging from +125.96% (American Mobil Dental Corp) to -47.36% (L Brands). Tandem holdings experienced a much narrower range, from +27.39% (Nike) to -20.79% (Dollar Tree).

The wide disparity of returns within the index reflects the volatility of the market in 2018. This volatility is a welcome change to the market of 2016 and 2017. It has provided us with better opportunities. When the price of a good company's stock falls, we get an opportunity to buy it. When prices rise to levels we think are rich, we get to take profit. Last year presented very few opportunities. This year has enabled us to add to the portfolio, reduce cash levels a bit and take advantage of what the market has given us.

A handful of our companies have had a rough start to the year. Some of our larger companies, like CVS and Walgreens, have been "Amazoned" unjustly (in our view) and thus have become more attractive. Others are just going through a rough patch but remain fundamentally strong.

The vast majority of our businesses are enjoying this market and benefitting our portfolios. 28 of our 41 companies have performed better than the market thus far in 2018. Not every stock (or money market) in a portfolio will outperform the market over a given period of time. Don't judge the quality of a portfolio by a sampling of a few holdings within it.

Judge the quality of a portfolio by the way it behaves over time, through many different markets, and how it aligns with your goals, values and tolerance for risk. Our businesses grow through any economic environment, and they grow the dividends they pay to you. These are our values, and they have proven to work over time.

Tandem Holdings thru 6/30/2018 Across all Strategies	YTD Price Change
NIKE	27.39%
TJX COS	24.48%
RESMED	22.30%
MICROSOFT	15.28%
O REILLY AUTOMOTIVE	13.73%
PAYPAL	13.11%
FISERV	13.00%
EXPEDITORS INTERNATIONAL	13.00%
COSTCO	12.28%
CME GROUP	12.24%
VERISK ANALYTICS	12.13%
BECTON DICKINSON & CO	11.91%
COGNIZANT TECH SOLUTNS	11.22%
T. ROWE PRICE GROUP	10.64%
STRYKER	9.05%
BROWN & BROWN	7.77%
NEXTERA ENERGY	6.94%
ABBOTT LABORATORIES	6.87%
ACCENTURE PLC	6.86%
WASTE CONNECTIONS	6.12%
DOLLAR GENERAL	6.01%
ROSS STORES	5.61%
ECOLAB	4.58%
INTERCONTINENTAL EXCHANGE	4.24%
FACTSET RESEARCH SYSTEMS	2.77%
TRACTOR SUPPLY	2.33%
HORMEL FOODS	2.25%
NATIONAL RETAIL PROPERTIES	1.92%
<b>S&amp;P 500</b>	<b>1.67%</b>
REPUBLIC SERVICES	1.11%
UNITED TECHNOLOGIES	-1.99%
YUM CHINA	-3.90%
EBAY	-3.92%
YUM BRANDS	-4.15%
ABBVIE	-4.20%
SIGNATURE BANK NEW YORK	-6.83%
BROWN FORMAN CL B	-10.79%
CVS HEALTH	-11.24%
JM SMUCKER	-13.49%
DOMINION ENERGY	-15.89%
WALGREENS BOOTS ALLIANCE	-17.36%
DOLLAR TREE	-20.79%
<b>Average</b>	<b>4.21%</b>

*The price changes reflected above are for the period 12.31.2017–6.30.2018 and do not include dividends. This data should not be construed as performance of any investment or portfolio that Tandem manages. Such data is not meant to imply past or future performance for Tandem or any securities market.*

# THE AMAZON EFFECT

You may have noticed that we do not own Amazon. We do, however, own plenty of companies that have been "Amazoned".

Companies get "Amazoned" any time Amazon buys, or is rumored to be buying, a competing business. When Amazon bought Whole Foods, share prices of Tandem holdings such as Costco and Dollar General suffered meaningful declines. When rumors circulated that Amazon was moving into the auto parts business, O'Reilly sold off. Now that Amazon has purchased a tiny little on-line pharmacy business, shares of pharmacy giants Walgreens and CVS have taken it on the chin.

Amazon is a remarkable company. Its founder is a true visionary and now the wealthiest person on the planet. It deserves all the credit in the world for its many innovations. The stock price certainly reflects this, having risen 55.09% this year through the end of June. It has risen by more than 2,400% in the last 10 years. It is a truly remarkable story. And yet we don't own it.

The market's reaction to any corporate move Amazon makes seems to be approval for Amazon and fear for any business now in Amazon's way. Amazon earned its reputation as a competition killer early on when its direct assault on Barnes & Noble left Amazon the clear winner. Amazon's strategy is to drive out other businesses by making prices so low that others can't compete. Amazon historically has cared little about profit, instead placing emphasis and sales and market share.

Typically investors buy shares in a business in order to have a claim on earnings. The more the business earns, the more the share price rises in value. For whatever reason, the market seems to value Amazon by a different measure than it uses for most other companies.

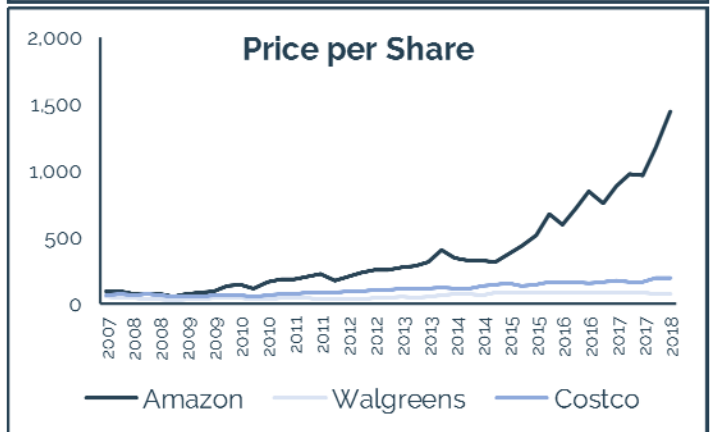
In the charts to the right we draw a comparison of 3 metrics between Amazon and two of our core holdings, Walgreens and Costco. The comparison companies directly compete with Amazon and their share prices at various times have taken a hit to reflect the market's fear of this competition. We begin the comparison in 2007 and track earnings per share, cumulative earnings per share and price per share. The only measure in which Amazon emerges as the winner is price. Maybe that's the only measure that matters.

At Tandem, we value earnings and believe that price will follow. It is clear that Walgreens and Costco have delivered consistent earnings growth over the years, while Amazon's profit has been erratic to say the least. Amazon seems as likely to lose money as it is to grow profits year over year. This is not a trait we seek in our portfolio companies.

On price, Amazon emerges as the clear winner by a

wide margin, particularly of late. Maybe price really is the only thing that matters, and we should just buy what is going up in price.

We are reminded of the famous saying by George Santayana - "Those who cannot remember the past are condemned to repeat it." In October of last year we asked if history was rhyming. We recalled that Walgreens, for one, has been counted out before, only to emerge bigger and better for the competition. We remain convinced that ultimately earnings matter. After all, the share price of Amazon fell more than 90% in 2001 and 65% in 2008. We prefer a different sort of experience. We may get "Amazoned" again and we may not. It's hard to say. But our businesses will continue to grow, and we are good with that.



## COMMENTARY (CONTINUED)

(Continued from page 1)

2016. By the end of the third quarter of that year, the unemployment rate had ticked up from 4.7% in May to 5.0% by the end of September – a fairly sharp move in the labor market. The economy was moving forward at a snail's pace. Nowhere was the dearth of growth more evident than in the fundamental measurements of companies. Corporate earnings growth, as measured by the year over year change in the S&P 500's earnings,

had been negative for six consecutive quarters. For comparative purposes, earnings contracted for seven quarters during the Financial Crisis and only five quarters during the recession following the Dot Com Bubble. Yet despite the slowing economy, the S&P 500 rose 12.9% for the one-year period ending September 2016. Price was increasing while earnings were contracting. As a result, the S&P's trailing PE Ratio hit a post-financial crisis high of 24.34.

Tandem Purchases Since 9.30.2016			
Date	Tandem Strategy	Stock	Type
Q4 2016	Equity, LCC, MCC	Hormel	New
Q4 2016	LCC, MCC	JM Smucker	Add
Q4 2016	Equity, LCC	Abbott Labs	Add
Q1 2017	Equity, LCC, MCC	Brown Forman B	Add
Q1 2017	MCC	DollarTree	Add
Q1 2017	Equity, LCC, MCC	T. Rowe Price	Add
Q1 2017	Equity, LCC, MCC	Tractor Supply	Add
Q2 2017	Equity, LCC	DollarGeneral	New
Q2 2017	MCC	DollarTree	Add
Q2 2017	Equity, LCC, MCC	FactSet Research	New
Q2 2017	LCC, MCC	National Retail Pty	Add
Q2 2017	Equity	Signature Bank NY	Add
Q2 2017	Equity, MCC	Verisk Analytics	New
Q3 2017	Equity, LCC	CVS Health	New
Q3 2017	Equity, LCC	DollarGeneral	New
Q3 2017	Equity, LCC, MCC	FactSet Research	Add
Q3 2017	LCC, MCC	National Retail Pty	Add
Q3 2017	Equity, MCC	O'Reilly Autoparts	Add
Q3 2017	MCC	Ross Stores	Add
Q3 2017	LCC, MCC	JM Smucker	Add
Q3 2017	Equity, LCC	TJX Cos	Add
Q4 2017	Equity, LCC, MCC	Cognizent Tech Solutions	Add
Q4 2017	Equity, LCC	CVS Health	Add
Q1 2018	LCC	Cognizent Tech Solutions	Add
Q1 2018	Equity, LCC	CVS Health	Add
Q1 2018	LCC	Dominion Energy	Add
Q1 2018	Equity, LCC, MCC	Hormel	Add
Q1 2018	MCC	Henry Schein	New
Q1 2018	LCC, MCC	National Retail Pty	Add
Q1 2018	Equity, LCC	TJX Cos	Add
Q1 2018	Equity, LCC, MCC	Tractor Supply	Add
Q1 2018	Equity, LCC	Walgreens Boots Alliance	Add
Q2 2018	Equity	Celegene	New
Q2 2018	Equity	Celegene	Add
Q2 2018	LCC	Cognizent Tech Solutions	Add
Q2 2018	Equity, LCC	CVS Health	Add
Q2 2018	LCC	Dominion Energy	Add
Q2 2018	MCC	Euronet Worldwide	New
Q2 2018	MCC	Henry Schein	Add
Q2 2018	Equity, MCC	Signature Bank NY	Add
Q2 2018	LCC, MCC	JM Smucker	Add
Q2 2018	Equity, LCC	Walgreens Boots Alliance	Add

The 3 Tandem Strategies referenced in the table above are Equity, Large Cap Core (LCC) and Mid Cap Core (MCC). These purchases are not recommendations and do not indicate performance of any investment.

Since that time, the stock market has generally continued its march higher. Surprisingly, the market has actually become less expensive in some ways. Real GDP growth has accelerated every quarter since Q3 2016. The unemployment rate has hit lows that the U.S. has seen only one other time since the 1960s. The manufacturing and non-manufacturing sectors of the economy have both accelerated and hit market-cycle highs. What's more, companies are growing their bottom lines at a blistering rate. Using this quarter's estimate from Standard and Poor's, earnings will have grown 39.7% since September of 2016. The growth of earnings has outpaced that of price, as the S&P 500 price has only advanced 25.4% over the same time period. The result of earnings expanding faster than price has led to a PE of 22.88, down from 24.34. The market has actually gotten cheaper even as the S&P's price gained over 25%.

The improving economic and fundamental backdrop coupled with the recent return of volatility has allowed us to put some of our cash to work. Over the past 21 months, opportunities have arisen for us to both add to existing names and to welcome new names into our portfolios. The table to the left lists chronologically all purchases by investment strategy and whether we were adding or buying something new. While we have certainly found things worth buying over the past several quarters, cash remains at relatively high levels. This is a result of our discipline. Simply put, we still find ourselves in a bit of a seller's market. There are more stocks to sell in our universe than there are ones to buy. A key difference between today's market and the one we saw towards the end of 2016 is that earnings-based valuations have moderated as a result of economic growth, lifting of regulations and tax reform. However, stocks remain expensive on nearly every other metric. The S&P 500's Price-to-Sales ratio remains just shy of 20-year highs. Similarly, Price-to-Book and Price-to-Cash Flow valuations are exceeded only by their valuations during the Dot Com Bubble. The Shiller Cyclically Adjusted PE, which tracks stock market data dating back to 1871 (and is defined, as well as discussed in more depth, in the previous issue of *The Tandem Report*), is currently in its 97<sup>th</sup> percentile – meaning that, in the grand scheme of things, stocks are still expensive.

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## COMMENTARY (CONTINUED)

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As we wrote in the April 2016 Issue of **The TANDEM Report**, having a cash reserve can be an important element of investing. Wealth is created when assets are bought at low valuations. It is our job to buy low and sell high. These two actions rarely happen at the same time. To be able to buy when stocks are low, one must already have that cash on hand. Otherwise we would either have to ask clients for more cash or would be selling low to create cash in order to then buy low. Neither option makes much sense to us. Thus, it is logical

and natural to be a seller of stocks when they are at elevated levels, as they seem to currently be.

We have spent quite some time discussing the market and valuations in general. However, it is important to keep in mind that every decision we make is bottom-up. We operate on a stock-by-stock basis. No decisions are made because of opinions about the market. Sometimes, there are merely more stocks to sell than to buy. As a result, cash levels will rise. One day, that trend will reverse itself and there will be more stocks to buy than to sell. Then cash levels will recede. That is the way it is supposed to work (at least in our view)!

### 5 Year Annualized Dividend Growth for Tandem's Holdings by Strategy from Q2 2013 to Q2 2018

Tandem's average dividend-paying holding has increased its dividend by 12.65% 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	12.95%
CVS Health	17.32%
Dollar General	NA
Dominion Resources	8.22%
Ecolab Inc.	12.26%
Expeditors International	8.45%
FactSet Research	12.83%
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	18.98%
United Technologies	5.52%
Walgreens Boots Alliance	9.86%
Waste Connections	15.88%
<b>Average</b>	<b>12.32%</b>

Companies not paying a dividend on 6.30.2013 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%
Celgene	NA
Cognizant Tech Solutions	NA
Costco	12.95%
CVS Health	17.32%
Dollar General	NA
eBay	NA
Ecolab Inc.	12.26%
Expeditors International	8.45%
FactSet Research	12.83%
Hormel Foods	17.14%
Intercontinental Exchange,	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	18.98%
United Technologies	5.52%
Verisk Analytics	NA
Walgreens Boots Alliance	9.86%
Waste Connections	15.88%
<b>Average</b>	<b>13.01%</b>

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%
Euronet Worldwide	NA
Expeditors International	8.45%
FactSet Research	12.83%
Fiserv	NA
Hormel Foods	17.14%
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%
Henry Schein	NA
Signature Bank NY	NA
J. M. Smucker	8.45%
Stryker	12.14%
Tractor Supply	18.98%
Verisk Analytics	NA
Waste Connections	15.88%
Yum! Brands, Inc.	NA
Yum China Holdings, Inc.	NA
<b>Average</b>	<b>12.28%</b>

The list of holdings above for Tandem's 3 strategies are as of 6.30.2018. 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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**Contact Information:****Tandem Investment Advisors, Inc.****145 King Street  
Suite 400  
Charleston, SC 29401****(800) 303-8316  
(843) 720-3413****www.tandemadvisors.com**

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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	1.94%	1.73%	1.00%
2-year Treasury Note	2.53%	2.28%	1.34%
5-year Treasury Note	2.78%	2.63%	1.77%
10-year Treasury Bond	2.91%	2.84%	2.19%
30-year Treasury Bond	3.05%	3.09%	2.80%
Prime Rate	4.89%	4.58%	4.13%
Federal Funds Rate	1.82%	1.51%	1.04%
Discount Rate	2.39%	2.08%	1.63%

KEY MARKET DATA				
	6/30/18 Close	% Change 1 Year	% Change 3 Years	% Change 5 Years
S&P 500	2,718.37	12.17%	31.76%	69.23%
Dow Jones Industrial	24,271.41	13.69%	37.75%	62.79%
NASDAQ	7,510.30	22.31%	50.60%	120.68%
Russell 2000	1,643.07	16.09%	31.03%	68.09%
German Xetra DAX	12,306.00	-0.16%	12.44%	54.61%
London FTSE 100	7,636.90	4.43%	17.11%	22.87%
Shanghai Composite	2,847.42	-10.81%	-33.43%	43.87%
Crude Oil	\$74.15	61.06%	24.68%	-23.21%
Gold	\$1,251.30	0.85%	6.81%	2.25%
CRB Index	200.39	14.65%	-11.79%	-27.29%
U.S. Dollar Index	94.35	-1.12%	-1.37%	13.16%
Euro/Dollar*	1.17	2.27%	4.91%	-10.18%

*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.*

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