

THE TANDEM REPORT

Volume XIX, Issue 4, October 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 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: *Stocks Soar in 3rd Quarter, Stumble a Bit as We Enter October*

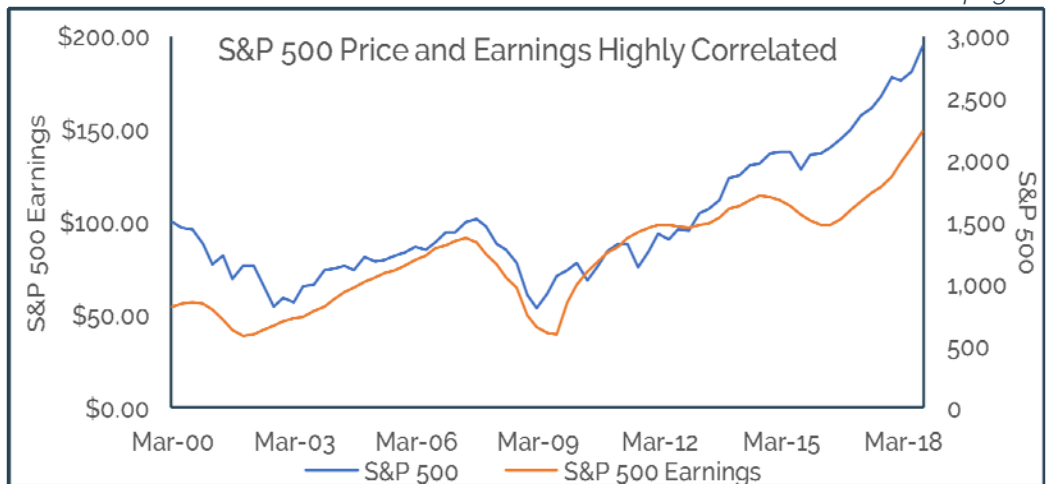
The stock market rocketed higher in the 3rd quarter. Seemingly unfazed by potential trade wars, rising interest rates, inflation, Supreme Court nominations or anything else, the S&P 500 closed up 7.71% for the three months ended September 30th. The index closed the month just 0.57% from its all-time high set 10 days earlier on September 20th. It was a good quarter for Tandem clients.

Corporate earnings growth was once again stellar and continued to provide the fuel the market required. When every S&P company has finally reported 3rd quarter earnings, the S&P's earn-

ings will have grown quarter-over-quarter for 7 consecutive quarters. Positive year-over-year growth will reach 8 consecutive quarters, after declining for 6 straight from June 2015 - September 2016. Earnings for the 4 quarters ended September 2018 are expected to grow by more than 25%. This is an impressive streak that has propelled stocks to new highs.

The chart just below paints a very clear picture of the strong correlation between earnings and price for the S&P 500. As earnings grow, so too does the price of the S&P. And earnings are anticipated to grow again in 2019, albeit

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COMMENTARY: *Sometimes We Can Learn from the Past, Sometimes It's Just Fun to Read About it*

One of the more frightening things about writing a quarterly newsletter, aside from having to think of something to say that might actually be worth reading, is that whatever we finally come up with is then permanently archived on the internet, for all to see and judge for years after.

Find out for yourself on our website (<https://tandemadvisors.com/tandem-report-archives/>). Anyone can see all the dumb things we've said over the years.

One of the truly humbling things about
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MARKET COMMENTARY (CONTINUED)

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at a slower rate than is expected for 2018. Earnings are projected to grow more than 26% this calendar year, while advancing a more modest 12% next year.

Clearly many investors anticipate an undeterred market advance. The economy is humming along at an impressive rate and consumer and investor confidence are quite high. And why shouldn't confidence be high? Even Fed Chief Jay Powell believes we are in unprecedented times. In a recent speech in Boston he said, "I am glad to be able to stand here and say that the economy is strong, unemployment is near 50-year lows, and inflation is roughly at our 2 percent objective. The baseline outlook for forecasters inside and outside the Fed is for more of the same." When a reporter asked if economic news was too good to be true, Powell acknowledged that this was a reasonable question. With inflation low, unemployment at its lowest level in 49 years and interest rates still historically low, what could possibly go wrong?

Stock markets do a pretty good job of anticipating the future. We are in the midst of a 9+ year bull market for a variety of reasons. One, no doubt, is because stock prices accurately anticipated economic expansion after the Financial Crisis. And by most accounts there is little on the horizon that is likely to derail this expansion. In fact, the expansion has picked up steam. Chair Powell certainly seems to be a believer.

Being habitually cautious investors, we constantly worry about the unexpected. We are not suggesting that we expect doom or some dramatic reversal of fortune. But it does seem at least plausible to us that when things can hardly get better, that maybe they won't.

We previously visited in these pages the inverse relationship that unemployment and stock prices share. The best time

to buy stocks in the last 25 years was in 2009 when unemployment was reaching generational highs. Why was this such a good time? Because things were so bad they could hardly get worse! And sure enough, as unemployment has fallen to near-record levels, stock prices have risen dramatically.

Now we find ourselves at unemployment levels not seen since 1969. Can they go lower? Of course they can. They likely will as a matter of fact. Can they stay this low for a long time? Maybe. But likely not. The

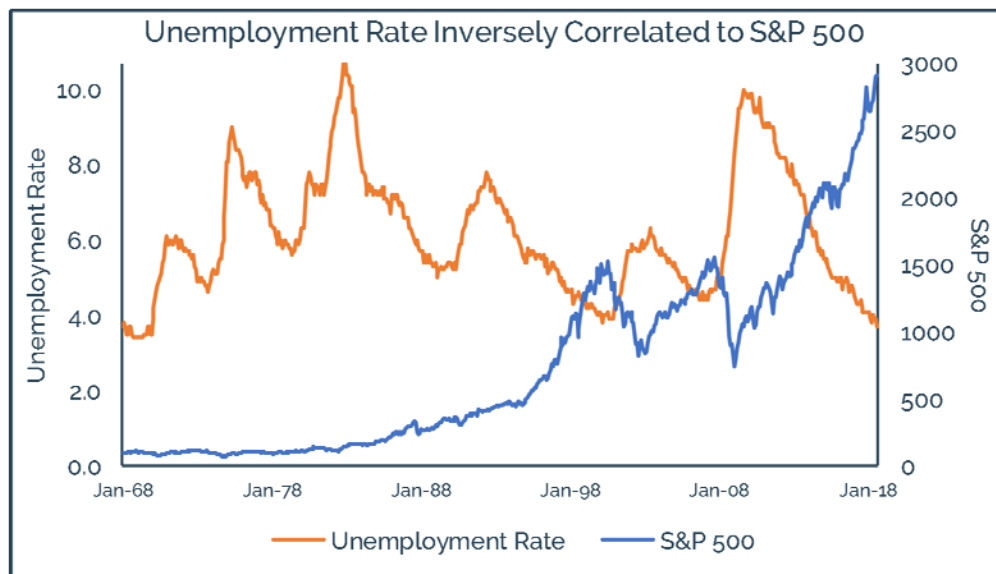


chart above tracks the unemployment rate since 1968. Two things are obvious at cycle lows for unemployment: first, the lows don't last very long; second, they nearly perfectly correspond with stock market tops.

Only time will tell if we are nearing the lows in unemployment for this cycle. It is reasonable, however, to begin to contemplate what factors could contribute to a reversal of the cycle. It certainly seems evident that

Stock Market Returns After Unemployment Rates Bottom and Begin to Head Higher				
Unemployment Cycle Low Date	Unemployment Cycle Low Rate	S&P 1 YR Return before Low	S&P 1 YR Return after Low	S&P 3 YR Return after Low
5/31/1969	3.4%	4.84%	-26.01%	-3.70%
10/31/1973	4.6%	-2.95%	-31.76%	-4.98%
5/31/1979	5.6%	1.89%	12.27%	12.92%
3/31/1989	5.0%	13.90%	15.28%	36.90%
4/30/2000	3.8%	8.78%	-13.97%	-36.87%
5/31/2007	4.4%	20.51%	-8.51%	-28.83%
9/30/2018	3.7%	15.66%	?	?
Average	4.4%	8.95%	-8.78%	-4.09%

MARKET COMMENTARY (CONTINUED)

(Continued from page 2)

we are closer to the end of a cycle than the beginning of one.

The table at the bottom of the preceding page illustrates precisely why habitually cautious investors might worry when economic conditions are nearly perfect, or at least too good to be true. Following the previous 6 lows in unemployment, the S&P 500 was lower 1 year later 4 of 6 times, with an average 1 year price decline of -8.78% . Curiously, the 4 periods that produced negative returns 1 and 3 years later were the 4 periods with the lowest unemployment rate. The present rate of unemployment, at 3.7% , would be the 2nd lowest rate since 1968, if it were to bottom today. It easily could become the lowest bottom at the end of a cycle if this trend continues lower. Whenever the bottom of this cycle occurs, the following 12 and 36 months are not likely to be kind to investors, if history can be our guide.

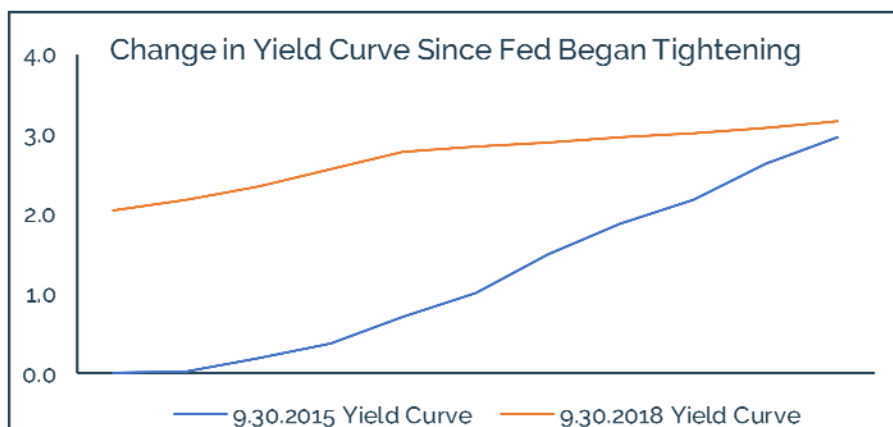
Perhaps unemployment is not a driver of the stock market. More likely, it represents a collection of economic conditions that drive the stock market by impacting the economy. But unemployment is definitely a pretty good proxy for these other things. So what are some of these other things that could impact corporate profitability, and thus increase unemployment?

With unemployment so low, it is possible that a tight labor market could result in troublesome wage inflation. Wage increases could eat into profits. If they eat into profits too much, employers are incentivized to reduce labor costs, either through the introduction of technology that replaces people, or simply by reducing headcount. Either way, people become unemployed and less likely to contribute to the economy.

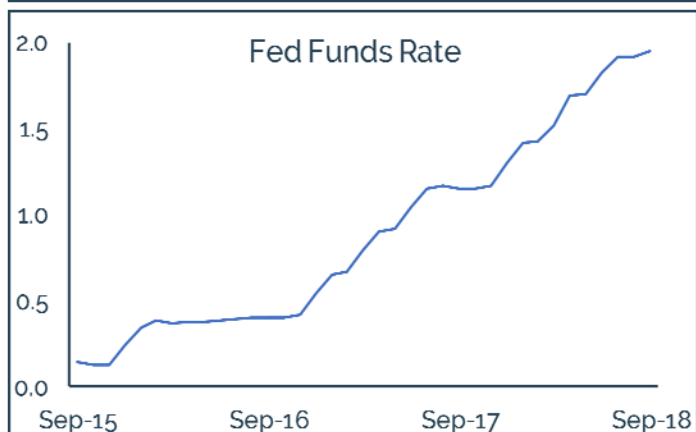
Higher interest rates could certainly reduce profitability. So could higher fuel costs and trade tariffs. Once again, if rising costs begin to eat into profits, employers are incentivized to reduce costs. One of the first costs to be reduced in the face of declining profits is generally labor. And then the spiral begins.

Since the Federal Reserve began tightening in 2015, the yield curve has changed significantly. So far, the rise in short term rates has failed to provide the headwind to earnings that many feared. The rate of increase really picked up steam in September and into October, and this appears to have given the stock market a scare.

Time will tell if rates go too high, unemployment rises and profits fall. For now, we like that the market got scared as we entered October. As of this writing, the market at its lowest point was only down -6.91% - just enough to put some fear in the market.



From our perspective, a little fear is a good thing. It induces volatility, which keeps a market healthy. A market that just goes up all the time, like 2017, breeds complacency. Volatility shakes out the complacent return-chasers, creating more opportunity for actual investors. It has been a good year thus far for Tandem clients. It has been a good market. We expect both of these things to continue. But as habitually cautious investors, we will be keeping one eye fixed on what could go wrong!



COMMENTARY (CONTINUED)

(Continued from page 1)

writing a quarterly newsletter is that many of you actually read it, and value our opinions. We appreciate that, respect that, and hopefully honor that with the words we use to try to guide you through the market's ups and downs, share our thinking about events, and convey (ad nauseum, perhaps) how we apply our time-tested investment discipline.

Recently I was given the gift of a leather-bound collection of every edition of *The TANDEM Report*, dating all the way back to the 1st edition in July 2000. It was an extremely thoughtful and greatly appreciated gift. And man has the time just flown by.

I recently found myself flipping through the pages of past reports, reliving the moments we had written about. Not surprisingly, I found some sentiments that I thought were worth sharing again.

From July 2000, in the midst of the Federal Reserve raising rates when many questioned the wisdom, our *Market Commentary* in part said this:

To argue the merits of the Fed's action at this point is fruitless. Attempting to ascertain the resulting impact on the economy and the market requires perspective. Two relevant points should be considered. First, hearken back to 1994, when the Fed last went on an anti-inflation crusade. The market staggered, growth slowed, and pundits pronounced the great bull market terminally ill. But reports of the bull's demise were premature, and the market went on to record five consecutive years of significant returns. Which brings us to point two. While it appears that economic growth is indeed slowing, this Federal Reserve cannot and will not impede the extraordinary technological revolution taking place. History will view this era to be every bit as pivotal as the printing press, the industrial revolution and manned space flight.

Unfortunately, as prophetic as those words turned out to be, they were written 3 months after the then all-time market high in March 2000. The Tech Bubble was already beginning to burst! Oh well. It still sounds good.

In July 2007, again during a time of Fed rate hikes, we shared this bit of wisdom in our *Market Commentary*:

Rising interest rates are indicative of a healthy, robust economy, which intuitively seems to be good news for stocks. Yet as rates rise, more investors find a higher fixed rate enticing, which can diminish demand for stocks. This may ultimately prove to be the case, but it certainly isn't right now.

In our last Report, we discussed our concern that a low global interest rate environment has produced a liquidity bubble. Because of the low cost of borrowing, investors have leveraged themselves dramatically and inflated the value of assets. The unwinding of such a liquidity expansion can be painful, and have a short-term detrimental impact on stocks.

This was written 3 months before the stock market reached its all-time high before the financial crisis.

Finally, in the January 2016 *Tandem Report Commentary*, after the market had fallen 10% after the first Fed rate hike since the Financial Crisis began, we dropped this pearl:

No matter what is in store for the stock market in 2016 and beyond, know that at some point prices will go down enough to scare a lot of investors. Whenever this has happened in the past, widespread fear has caused prices to fall further than they probably should have. But so far, stock prices have always come back. The Great Recession was pretty scary stuff, but the market recovered from that. It recovered from the Tech Bubble, Black Monday in 1987, the Cuban Missile Crisis and even the Great Depression.

Proper perspective will see you through whatever lies ahead. We have a plan, we are proactive, and you can understand your investments, which means you can filter out the noise and focus on what matters most - the companies you own.

These three excerpts are taken from periods when rates were rising, much as they are today. In 2000 and 2007, rate hikes were followed by market declines. So far, the present rate hike cycle has been greeted with new all-time highs accompanied by increased volatility.

In the two previous times, the Fed did in fact seem to overshoot the mark, resulting in bubbles bursting and substantial stock market sell-offs. It is important to note however, that not every Fed tightening cycle ends with a stock market bludgeoning. It can be argued that the bursting of the Tech Bubble only resulted in about a 25% market decline, and that the market was finding footing when the 9/11 attacks occurred, resulting in a further decline.

The point of looking to the past is to gain perspective. In 1994 the Fed raised rates and the ensuing market stumble was modest. In 1999 the Fed raised rates and the ensuing market decline (pre-9/11) was more severe, but fairly mild as bear markets go. Only the rate hikes preceding the Financial Crisis ended in a cataclysmic market decline.

Bear markets happen infrequently, but repeatedly. Many were caused by the Fed overshooting the mark. The fact that we have recovered from every previous bear market shouldn't make us optimists. Nor should the fact that the Fed is hiking rates now make us pessimists. Instead we should be realists with a plan.

This is a great market - one of the best in history. Let us celebrate it and participate in it and while still being

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COMMENTARY (CONTINUED)

Previous Fed Tightening Cycles

	Beginning Rate	Ending Rate	Beginning Date	Ending Date	Market Top Date	Market Bottom Date	Market Decline
Financ'l Crisis	1.00%	5.25%	May-04	Jun-06	Oct-07	Mar-09	-56.8%
Tech Bubble	4.75%	6.50%	May-99	May-00	Mar-00	Oct-02	-49.1%
Mid 90s	3.00%	6.00%	Jan-94	Feb-95	Feb-94	Apr-94	-8.9%
Late 80s	5.875%	9.8125%	Dec-86	May-89	Aug-87	Dec-87	-32.8%

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weary of it. No bear market lasts forever, but they needn't end catastrophically either. The perspective of the past is always instructive. We have written some pretty good stuff over the years, as

well as a few less fortunate assertions. The leather-bound gift containing all the past issues opens with the following inscription...

"May this collection be a reminder of what you continue to achieve by working vigorously, with integrity, and in the best interest of those you serve."

I sure hope so. Thank you Phillip.

~JBC

5 Year Annualized Dividend Growth for Tandem's Holdings by Strategy from Q3 2013 to Q3 2018

Tandem's average dividend-paying holding has increased its dividend by 12.02% 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	9.44%
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	10.44%
National Retail Properties	4.30%
NextEra Energy	10.96%
NIKE	13.75%
T. Rowe Price	13.00%
Republic Services	7.60%
ResMed	8.16%
J. M. Smucker	7.94%
Stryker	12.14%
TJX Companies Inc	21.88%
Tractor Supply	18.98%
United Technologies	5.52%
Walgreens Boots Alliance	6.91%
Waste Connections	15.88%
Average	11.80%

Companies not paying a dividend on 9.30.2013 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	9.44%
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	10.44%
NextEra Energy	10.96%
NIKE	13.75%
O'Reilly Automotive	NA
PayPal Holdings	NA
T. Rowe Price	13.00%
Republic Services	7.60%
ResMed	8.16%
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	6.91%
Waste Connections	15.88%
Average	12.27%

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	4.30%
O'Reilly Automotive	NA
T. Rowe Price	13.00%
Republic Services	7.60%
ResMed	8.16%
Ross Stores	21.49%
Henry Schein	NA
Signature Bank NY	NA
J. M. Smucker	7.94%
Stryker	12.14%
Tractor Supply	18.98%
Verisk Analytics	NA
Waste Connections	15.88%
Yum! Brands, Inc.	NA
Yum China Holdings, Inc.	NA
Average	11.80%

The list of holdings above for Tandem's 3 strategies are as of 9.30.2018. 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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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	2.13%	1.90%	1.03%
2-year Treasury Note	2.77%	2.53%	1.38%
5-year Treasury Note	2.89%	2.78%	1.80%
10-year Treasury Bond	3.00%	2.91%	2.20%
30-year Treasury Bond	3.15%	3.05%	2.78%
Prime Rate	5.03%	4.89%	4.25%
Federal Funds Rate	1.95%	1.82%	1.15%
Discount Rate	2.53%	2.39%	1.75%

KEY MARKET DATA				
	9/30/18 Close	% Change 1 Year	% Change 3 Years	% Change 5 Years
S&P 500	2,913.98	15.66%	51.77%	73.29%
Dow Jones Industrial	26,458.31	18.09%	62.47%	74.88%
NASDAQ	8,046.35	23.87%	74.16%	113.35%
Russell 2000	1,696.57	13.80%	54.14%	58.00%
German Xetra DAX	12,246.73	-4.54%	26.77%	42.50%
London FTSE 100	7,510.20	1.86%	23.90%	16.22%
Shanghai Composite	2,821.35	-15.75%	-7.58%	29.74%
Crude Oil	\$ 73.25	41.77%	62.45%	-28.42%
Gold	\$ 1,191.50	-7.02%	6.81%	-10.18%
CRB Index	195.16	6.59%	0.72%	-31.65%
U.S. Dollar Index	95.13	2.20%	-1.27%	18.59%
Euro/Dollar*	1.16	-1.74%	3.87%	-14.17%

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.*