Notes from the Trading Desk

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January 12, 2018

Market Movers & Shakers

Welcome to the new year! So far, it appears little has changed from 2017. All major indices are up, with the Nasdaq and FAANG leading the way. Similar to our 2017 playbook, Tech started the year off with a bang! For all you Dow theorists out there, both the Dow Jones Industrial Average and the Dow Jones Transportation Average are resting nicely at all-time highs. Not to be left out, the VIX also is hovering near all-time lows — a supposed sign of a dearth of fear in the marketplace. The yield curve has continued to flatten as both the 10 year and the 2 year have 2 handles. Evidently, the markets were not made aware of a new year, as the script remains the same thus far. So where does that leave us?

Let's start with sentiment — an oft-discussed indicator here in the past. The first print of the year according to FactSet's Investors Intelligence Bullish Sentiment Data, was 64.40. We also had prints north of 64 in November, as well as December. Again, we've discussed the contrarian nature of bullish and bearish sentiment in the past at length, so I won't spend too much time rehashing it here. The last time we printed a number higher than 64 before these most recent months? All the way back to 1987! It has been 31 years since investors have been this bullish on the equity markets. The last time the market was this bullish, stocks were being bought hand over fist as the market ran up nearly 40% in the first 9 months of trading before turning in the worst few days in stock market history. Is history likely to repeat itself? Not necessarily. Sentiment was north of 68 in 1986, a year in which the S&P rose rather quietly on the way to a 14.6% return. The point is, sentiment can be a fickle thing. It is quick to change. However, as we have seen recently, sentiment can also do wonders for an economy and markets.

YTD, the Dow Jones is up 4.4%, the S&P 500 is up 4.2%, the Nasdaq is up 5.2%, and the Russell 2000 is up 3.7%. The S&P is up more in these first two weeks than it was over the course of all of 2015. If we were to annualize these returns to get a guide for the year, the Russell would be the ultimate laggard with a measly return north of 125%! The Nasdaq's annualized rate would be higher than 280%. This is a totally ludicrous idea — I sincerely hope no one out there is expecting a return like that this year. However, the returns go to show just how hot the markets have been to start the year off. To expect a continuation of the markets we have experienced thus far to hold up for the duration of the year would be irrationally exuberant.

To highlight just how red hot these markets have become, look no further than their Relative Strength Index. RSI is a momentum indicator used in technical analysis. Typically, any reading over 70 indicates an asset is overbought, and any reading under 30 is interpreted as an oversold asset. On a 30 year chart, the Nasdaq closed today with an RSI of 85.01. This is good for the 5th highest RSI over the last 30 years. Yes, the Nasdaq Composite is now more overbought than it was at the very top of the tech bubble. The S&P 500's RSI of 87.01 is the 3rd highest reading over the last 30 years. Finally, the Dow just closed with an RSI of 89.42 — the most overbought in at least 19 years! The markets are hot, red hot, right now. Neither the extended RSI, the ludicrous annualized returns, or the excessive sentiment mean that markets must go south from here. Unfortunately, markets are not that simple. Rather, all it means is that to expect markets to continue to go up in a straight-line, as they have year-to-date, is foolhardy.

Boeing, a leader in the Dow, is continuing where it left off last year. It is already up 14% YTD. Last year BA was up a meager 94.77%. What's more, Boeing is currently trading at 29.15x forward earnings. Facebook, an uber growth company, is currently trading at 26x forward earnings. Since 2012, FB has grown their earnings by more than 1,000%. Yet BA trades at a higher forward multiple. For what its worth, according to FactSet, BA has never traded at these multiples in 30 years of data.

In *The Remarkable Story of Risk*, Peter Bernstein describes the rise of the Nifty-Fifty in the 60s and 70s and the willingness to pay whatever for the companies in the Nifty-Fifty. Bernstein says that "Investment managers defined the risk in the Nifty-Fifty, not as the risk of overpaying, but as the risk of not owning them." Listening to CNBC these days, or reading various pieces of research and year—end targets, we seem to have found ourselves in a similar environment. The risk to so many investors currently seems to be not the risk of overpaying, but the risk of not owning these assets. What are other times we have heard these arguments? In the mid-2000s, one must own real estate so as to not be left behind. Before that, you had to own internet stocks or else your portfolio was left in the dust. In '87, you would've been nuts to not own portfolio insurance. The point is, there is always something that you just have to own! Listen to CNBC, they'll tell you it's cryptos — you just gotta own 'em! Don't let all the craziness around cryptos cover up the fact that we are now paying more for some high profile stocks than we ever really have before. That is risk.

Upgrades & Downgrades

BF.B — Initiated equal-weight at Barclays with a price target of $72 (1/10).

COST — upgraded to buy from accumulate at Gordon Haskett; target increased to $225 from $200 (1/12).

DLTR — Initiated buy at Guggenheim Securities; target of $125 (1/10).

PYPL — Upgraded to outperform from market perform at Cowen; target increased to $88 from $67 (1/9).

TROW — Upgraded to buy from neutral at Bank of America Merrill Lynch; target increased to $125 from $113 (1/8).

TROW — Upgraded to neutral from sell at UBS. Target increased to $110 from $82 (1/9).

TSCO — downgraded to neutral from outperform at Wedbush Securities; Target actually increased to $80 from $72 (1/11).

UTX — Upgraded to buy from neutral at Goldman Sachs; price target raised to $173 from $1224 (1/7).

WBA — removed from US Focus List at Credit Suisse; remains an outperform with a $97 price target (1/9).

Earnings Calendar

Date	Time	Ticker
1/18	Pre-Market	SBNY

Portfolio News

The year began with a liquidation of a long held position here at Tandem. Scana (SCG) has been written about extensively here the last couple of months. Scana fell off of its highs on the news of their failed nuclear plant and the subsequent bankruptcy of its partner, Toshiba. Several weeks later, the 2016 Bechtel report came out and the discussion of customer refunds and the rollback of rates commenced. Though we never believed Scana to be in any sort of financial distress from a fundamental standpoint, the stock price certainly took it on the chin. However, Scana began the year with a bang as Dominion Resources (D) stepped in with a buyout offer for an all-stock transaction. Since the deal was all-stock, the buyout price was going to fluctuate in step with Dominion's price. Large Cap already holds Dominion, so there was no sense in more or less doubling our exposure to Dominion. The risk would be having the deal fall apart, and Scana's price subsequently falling. Thus, we liquidated Scana.

Outside of Scana, we've had a broad range of performance in our names — however, most of it has been positive. The lone exceptions are Tandem's more rate sensitive names. D, NEE, and NNN are all down more than 3.5% YTD. Their lagging starts to the year are or more less directly related to the recent move in rates. The 10 Year has basically made a 20 bps move higher to start the year out. As such, interest rate sensitive assets (such as utilities and REITs) have broadly sold off.

However, the rest of the portfolio is holding up quite well! We currently have 26 names within 2% of their all-time highs. Some of last years biggest winners are off to fast starts again this year. YUMC, TROW, and PYPL are all up nearly double digits already.

	WTD	MTD	QTD	YTD
Dow Jones	2.0%	4.4%	4.4%	4.4%
S&P 500	1.6%	4.2%	4.2%	4.2%
Nasdaq	1.7%	5.2%	5.2%	5.2%
Russell 2000	2.0%	3.7%	3.7%	3.7%
C.D.	3.1%	6.5%	6.5%	6.5%
C.S.	-0.6%	-0.4%	-0.4%	-0.4%
Energy	3.2%	7.2%	7.2%	7.2%
Fins	2.9%	4.6%	4.6%	4.6%
H.C.	1.7%	5.0%	5.0%	5.0%
Ind.	3.2%	6.1%	6.1%	6.1%
I.T.	0.9%	5.1%	5.1%	5.1%
Mats	0.8%	4.8%	4.8%	4.8%
Utes	-2.1%	-4.5%	-4.5%	-4.5%
REITs	-3.6%	-5.5%	-5.5%	-5.5%