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Notes from the Trading Desk
- April 12, 2021
by Benjamin “Ben” G. Carew, CFA

MARKET MOVERS & SHAKERS

The major U.S. equity indices kept their rally hats on as the second quarter has gotten off to a hot start. The Nasdaq is already up 4.9%, with the S&P 500, not too far off its heels, up 3.9%. The Dow Jones Industrial Average has gained 2.5%, while the Russell Mid Cap and Russell 2000 have gained 3% and 1%, respectively. In addition, several commodities continue to surge higher. Lumber is up nearly 12% quarter-to-date, while food and grains such as sugar, wheat, hogs and corn are all up close to mid-single digits. Moving on to Treasuries, yields have somewhat stalled out so far this quarter. The 10-year Treasury, which was knocking on 1.8% towards the end of March, has traded between 1.6% and 1.7% for the last few sessions. Similarly, the 30-year Treasury has retreated from its March 18th high of 2.52% to its current level around 2.3%. The rally in bonds, as yields have waned, has certainly benefitted stocks – growth stocks, specifically. iShares S&P 500 Growth ETF (IVW) is up 5.7% since March 31st, while the iShares S&P 500 Value ETF (IVE) is up a much more modest 2%. Finally, these recent developments in various markets have coincided with a collapse of volatility. The VIX closed below 17 on Friday for the first time since February 20th, 2020.

Earnings season will begin in earnest over the next few weeks. A major theme to monitor will be management’s comments and attitudes with regard to inflation. Earnings calls will be key to getting a better read on inflationary pressures. As *The Financial Times* recently pointed out, there is a cacophony of inflationary concerns. 3M indicated that they are already feeling the effects of increased freight/air costs, while everyone from Legacy Homes to Williams-Sonoma has seen increases in wages. Even Mattel, the maker of Barbie, recently noted the costly rise in raw materials following an increase in the price of plastics. The Sealed Air CEO recently summed up the environment fairly succinctly stating, "Costs are going up everywhere. It's Def Con 4 [for] us right now." Though we just noted the retreat in yields over the past few weeks, these inflationary concerns have been an important driver of rates moving higher. Clearly inflationary fears persist in the bond market as long-dated Treasuries just finished their worst quarter since 1980 – a time when the year-over-year change in CPI was *just* a meager 14.4%. The move in Treasuries was bound to abate, even if just for a moment, as hardly ever do assets move perpetually in one direction. Has the stagnation in yields for the past two weeks been indicative of the market moving past the inflationary trade, or is it just giving that trade some breathing room? Time, and earnings over these next few weeks, will certainly shed more light on that question.

One recent development that investors seem to be glossing over is the likelihood of an increase in the corporate tax rate. I will avoid the political discourse on the subject as readers will have varying opinions on the rightfulness of such measures. However, one thing that is likely not up for debate is the fact that an increase in the corporate tax rate will almost certainly impact corporate bottom lines. As a result, earnings should reset to a lower level following any potential tax hikes. This would make a company inherently more expensive based on metrics like price-to-earnings, price-to-cash flow, and price-to-free cash flow. On a valuation basis, the only comparable period like the one we currently find ourselves in is the Tech Bubble in the late '90s and early 2000s. However, if a tax hike is imminent, the market will naturally be more expensive post-tax hike than it is today.

TRANSITION UPDATES & NEWS **

The quarter started with a flurry of activity. We trimmed our position in Expeditors International (EXPD) across all three strategies. We also continued to trim our position in Lab Corp (LH) in the Equity and Mid Cap strategies. Outside of that firm-level activity, there were just a few opportunities on the transition level over the last few weeks. In new accounts, we had an opportunity to add to names like AbbVie, Euronet, and FactSet on recent pullbacks. With earnings season right around the corner, I would expect transition activity to pick up shortly. Earnings season is typically a great opportunity to add to names on the transition level as volatility within individual names seems to accelerate during earnings – allowing for more action during that window.

***The transition update describes activity taken by Tandem on the transition level, not the composite or firm-wide level. The transition update is applicable to new accounts and new money. New accounts and new money are not automatically invested on the first day. Rather, they are transitioned into our strategy over a longer time period that is dependent upon market conditions. This update describes that transition.*

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