Notes from the Trading Desk

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It was a mixed week for major equity indices. The S&P 500 and the Dow were down 25 and 59 bps respectively. Meanwhile, the Nasdaq and the Russell 2000 were up 35 and 80 bps. Major news seemed focused on geopolitical risks. Turkey dominated headlines late in the week, as the Turkish lira slid 20% relative to the U.S. dollar. Following the lira's initial slide, President Trump threatened Turkey with additional metal tariffs. These in turn accelerated the downward move in the lira. European markets declined, reportedly due to the fear of contagion and European banks' potential exposure to the lira. The Russian ruble and Russian stocks both took a hit as well midweek as the Trump Administration levied new sanctions against Russia. For the most part, emerging markets moved lower. The Russian RTS was down over 7%. The Brazilian Bovespa and the Argentinian Merval were down 6% and 8% respectively. Even the Hang Seng was down nearly 2.5%. We also received the most recent CPI report on Friday. The Consumer Price Index, ex food and energy, has ticked up to 2.35% on a year over year basis, which is the highest reading since late 2008. The 2.95% yoy read including food and energy is the highest reported number since late 2011. Otherwise, it was a seemingly light week domestically. The yield curve flattened some — 10s to 2s got back down to 25 bps. Meanwhile 30s to 10s currently rests just over 15 bps — near cycle lows, though up from its July low of 10 bps.

The VIX seems to be in a late summer lull. On Thursday it traded down to 10.17 intraday — the lowest level since January 15th. Meanwhile, options traders are betting heavily that this trend of subdued volatility will continue onward. According to the Wall Street Journal, the short-volatility trade (which blew up so spectacularly in February) is at its highest level since November. We detailed the effects of the last time this trade was so crowded in the February 11th edition of *Notes from the Trading Desk*. However, the market seems to have forgotten how events unfolded — or maybe this time is different.

According to the Leuthold Group, using data going back to 1952, market correlations are in their third percentile, while valuations are in their 83rd percentile. The Leuthold Group determined that historically, when correlations are in their lowest quintile and valuations are in their highest quintile, forward one-month returns are much more subdued than their long-term average. While low correlations and high valuations do not necessitate the end of our aging bull market, it could mean that some volatility is in store going forward. Using the VIX as a contrarian indictor, and the data and results suggested by the Leuthold Group, it seems that there might be some turbulence in store for us heading into the end of the year.

A little more than 90% of the S&P 500 has now reported earnings and the results have been nothing short of stellar to say the least. Per Standard and Poor's, Q2 year over year earnings growth is coming in at 26.78%, essentially matching last quarters 26.79% growth. This represents the best growth since we were coming out of the financial crisis. Some of that growth is surely a boost from the tax reform. However, companies are actually growing again as well. Using FactSet data, sales growth for the S&P 500 is growing at its fastest clip, 7.68%, since late 2011— great news compared to the 5 straight quarters of contracting toplines throughout much of 2015 and 2016. Even margins are getting in on the action as both net margins and gross margins are near cycle highs. All in all, the underlying health of the market appears to be rather robust.

Upgrades/Downgrades & Dividends

NNN — Downgraded to neutral from buy at Janney, price target remains $44 (8/7).

SBNY — Upgraded to outperform from market perform at Hovde Group, though the target was decreased to $133 from $144 (8/8).

Portfolio News

Earnings season is beginning to wind down for us here at Tandem — though we have a couple of names reporting next week. Reported earnings growth for our core names has been 19.18% for the quarter, according to FactSet. Sales growth has also been strong coming in at 11.49%.

On the earnings front, CVS reported seemingly strong numbers last week. They beat on the topline and tightened the lower end of their previous full year EPS guidance. The market rewarded CVS, as CVS gapped higher on the open last Wednesday. While CVS gapped higher, EXPD had gapped lower the day prior. The logistic firm's net revenue and operating income both came in lighter than expected.

If anyone was tuning into CNBC last week, it seemed that there was only one news story…Tesla. CEO Elon Musk tweeted last Tuesday that he is "considering taking Tesla private at $420. Funding secured." While the cash burning and money losing company is a far cry from a Tandem holding, the idea of taking a company private got many analysts thinking who else could benefit from going private? On Wednesday, Celgene had a nice little pop following an RBC note which reiterated their belief that CELG has a lot to gain from going private. RBC asserted that private status would help Celgene capture more value from sales of Revlimid, as well as cut costs going forward as they begin moving away from Revlimid. While taking a $65b company private would certainly be a large task, it is an interesting idea nonetheless.

	WTD	MTD	QTD	YTD
Dow Jones	-0.6%	-0.4%	4.3%	2.4%
S&P 500	-0.2%	0.6%	4.2%	6.0%
Nasdaq	0.3%	2.2%	4.4%	13.6%
Russell 2000	0.8%	1.0%	2.7%	9.9%
Con Disc	0.8%	1.3%	3.1%	14.2%
Con Staples	-1.9%	-0.6%	3.3%	-7.0%
Energy	-0.3%	-2.6%	-1.3%	3.9%
Financials	-0.6%	0.0%	5.1%	0.0%
Health Care	-0.2%	0.8%	7.3%	8.4%
Industrials	-1.0%	-2.3%	4.8%	-1.1%
Info Tech	0.3%	3.0%	5.1%	15.8%
Materials	-0.9%	-1.7%	1.2%	-2.9%
Utilities	-0.6%	0.1%	1.9%	0.4%
REITs	-1.8%	-0.3%	0.6%	-0.6%