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Market Movers & Shakers

The first half of August was tough for equities. Through the first two weeks, the Nasdaq pulled back almost 5%. The S&P 500 fared a bit better – falling 2.72%. Smaller cap stocks struggled as well, as the Russell Mid Cap and Russell 2000 pulled back 3.11% and 3.90%, respectively. The Dow was a bit of an outlier relative to the other major indices, as it dropped just 78 bps through Friday's close. Throughout July, the path of least resistance was higher thanks in large part to soft landing expectations, a tight labor market, earnings troughing, slowing inflation, and peak Fed Funds. None of that narrative has changed in any sort of significant manner. If anything, some of that narrative has been reinforced. Thursday's CPI print was largely in-line with expectations and further supported the narrative that the worst of inflation is now behind us. In turn, this strengthened the belief that the Fed will remain on hold in September. Despite all of that, markets have still slumped.

Perhaps the credit rating firms are partly to blame. At the start of the month, Fitch downgraded its U.S. credit rating from AAA to AA+. Fitch cited unsustainable spending and debt, coupled with rising interest costs and a weakening economy that Fitch expects to recess in Q4 of 2023 or Q1 of 2024. This marked just the second time that the U.S. credit rating had been downgraded. Moody's then decided to further muddy the waters and not let Fitch have all the fun. Just a few days later, Moody's downgraded several U.S. banks. After cutting the rating of 10 banks, they also put BNY, US Bancorp, State Street and Truist on review for potential downgrades. Like Fitch, Moody's cited economic weakness and a "mild U.S. recession" in early 2024. The note said that banks have seen profitability pressures that are undermining the ability to generate internal capital. Moody's went on to say that with a recession on the horizon and weakness in commercial real estate, asset quality appears set to deteriorate. According to Reuters, a total of 11 lenders also had their outlooks slashed to negative – including Capital One, Citizens and Fifth Third. The announcements from Fitch and Moody's were met with some weakness in equities.

However, the drivers of concern for banks cited by Moody's are not new. Commercial Real Estate exposure and diminished profitability following the need for more competitive savings rates have been known about for months now. The downgrade by Moody's seemed more like a formality at this point rather than earth shattering news. Likewise, the debt levels here in the U.S. have been discussed for years. Sure, some of this was brought to a head by the political posturing around the debt ceiling in May and June. But again, Fitch's reasoning could hardly be called a surprise.

Perhaps then the market pullback was inevitable, and the reasons could have been any number of things. Entering the month, the Nasdaq was up a blistering 43% from its October lows. That pace was never sustainable. A reprieve in the upward march should have been expected. Recent winners like Nvidia and Tesla were up 345% and 194% from their lows within the past year. That sort of price action is unlikely to continue in perpetuity. They've since cooled a bit – Nvidia having fallen 15% from recent highs while Tesla has pulled back a bit more than 20%.

For the back half of 2021 and throughout 2022, yields and the dollar remained quite correlated, and shared an inverse correlation with the growth-heavy Nasdaq. The relationship paused throughout Q2. Yields moved higher and the Nasdaq moved higher as well. The relationship seems to be in play once more. The Nasdaq's recent 52 week high was set on July 19th. The 10-year U.S. Treasury yield began moving higher at the same time. The Dollar Index also put in a relative low and has been strengthening since then. TIPs began moving higher as well around that time. Lastly, the VIX began an upward move off of its base towards the end of July. These trends are not dissimilar to what we saw back in November of 2021 – a time in which market leadership had become quite narrow as well. We seem to be on the precipice of slipping back into the previous market regime – one that was driven by the direction of yields and the Dollar, and one that was marked by more volatility. Outside of the SVB scare in March, which seems long forgotten by markets, 2023 has been a year devoid of volatility. Perhaps that will change. Perhaps this is just a momentary dip before markets begin their upward ascent once more.

Transition Updates & News**

So far, August has provided an opportunity to accelerate the transition a bit more. Stocks like **Abbott Labs, Ansys, Dollar General, Hormel, MarketAxess, NextEra, PayPal, ResMed,** and **Essential Utilities** have all been transitioned into multiple times in August. We've also had the opportunity to transition into a total of 17 other names as well. Unrestricted accounts that have been with Tandem for one month are currently ~40% of the way through their transition. Accounts that have been here for two months are closer to 60% of the way through. We remain patient with some of our more expensive names but have had opportunities in some of our more attractively valued stocks to transition new money at prices we think are reasonable.

Earnings season is behind us for the most part. Despite that, we still had a few names report earnings last week. Akamai Technologies raised its full year guidance as the business is seeing continued momentum from the first half. Expeditors International (EXPD), a third-party logistics company, also reported earnings. Like most logistics firms, they are seeing a decrease in demand as supply has come back on-line. Thanks to rising commercial flight demand, passenger belly space has returned. This has in turn led to air cargo capacity exceeding pre-pandemic levels. As a result, pricing has become "critical". EXPD expects softer conditions to continue through the end of the year as the economy remains uncertain. Essential Utilities reported numbers that were inline with analyst expectations and reaffirmed its growth guidance through 2025. Lastly, Henry Schein reaffirmed its full year guidance following a slight beat on the bottom line.

***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.*

- Benjamin "Ben" Carew, CFA

  Ben Carew is a shareholder, Vice President, and Portfolio Manager for Tandem Investment Advisors, Inc. Mr. Carew joined Tandem in 2013. Mr. Carew manages Tandem's trading desk, overseeing day-to-day investment operations, including trading, quantitative and fundamental research, and portfolio management. Mr. Carew also oversees Tandem's internship program. Mr. Carew is a regular member of the CFA Institute and the CFA Society South Carolina. Mr. Carew currently serves as the Vice Chair for College of Charleston's School of Business Investment Program, a student program seeking to provide the opportunity for a select group of students to distinguish themselves academically, professionally, and personally. Mr. Carew is a graduate of the College of Charleston's School of Business, earning a Bachelor of Arts in Economics with a minor in Finance.

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