NOTES FROM THE TRADING DESK

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MARKET MOVERS & SHAKERS

U.S. Equities rallied once more last week. The Nasdaq and the Russell 2000 both jumped more than 3%, while the S&P 500 climbed 1.3% higher. The Dow, hindered by weakness across a few names, gained only 44 bps. Performance was narrow as only the Tech, Consumer Discretionary, and Materials sectors outperformed the S&P 500. Energy, despite the continued strength of oil, was by far the weakest sector, dropping 4.3%. Elsewhere, the U.S. Dollar Index continued its slide as it closed below 90 for the first time since early 2018. Gold extended its recent rally with the precious metal is now up more than 6% month to date.

This past week marked the final Federal Reserve meeting of the year, as the Federal Open Market Committee (FOMC) met on Wednesday to discuss and set monetary policy. As expected, the Fed Funds rate was left unchanged. However, Jerome Powell and company indicated that they would continue with asset purchases until "substantial further progress" with regards to inflation and labor market targets are met. Reading between the lines, it is becoming quite clear that the Federal Reserve has every intention of letting inflation run hot before trying to hit the brakes. They will continue to pump $120b each month into the Treasury and Mortgage-Backed Securities market until they achieve their goals. At one point during the Wednesday press conference, Powell was pressed on current valuations within the equity market. His answer was noteworthy, stating, "Admittedly P/Es are high but that's maybe not as relevant in a world where we think the 10-year Treasury is going to be lower than it's been historically from a return perspective."

In the November 9th edition of *Notes*, we discussed TINA (There Is No Alternative). To quickly rehash for those unfamiliar, TINA is the argument that with yields so low, investors are unable to generate their required rate of return within the fixed income market. As a result, despite high valuations in stocks, there is no alternative to owning stocks because where else would the investor generate their needed rate of return? TINA naturally pushes valuations higher as investors are herded into the equity market. Elevated valuations need not lead to the end of the party. As the old adage goes, bull markets don't die of old age (just ignore the Tech Bubble when discussing this adage). While this bull market is still quite young (only 9 months old in fact!), its valuations are those of a much older market!

What becomes concerning in a marketplace like today's is investor sentiment, a theme discussed in the previous edition of *Notes*. In the most recent Bank of America Fund Manager Survey, they noted that cash levels had fallen below 4%. Traditionally, BofA has indicated that this level of cash within the survey should be viewed as a contrarian sell signal. The last time we had such a signal was this past February. Citi's Panic/Euphoria model, which was equal to Tech Bubble highs during the last edition of *Notes*, has now surpassed its Tech Bubble highs.

Elevated sentiment and extreme valuations can often become problematic for markets, especially in the face of a decelerating economy. In the short run, some economic measures like Retail Sales and the ISM Non-Manufacturing Activity Index have begun to roll over. However, there are plenty of economic positives to highlight. New Orders continue to build and accelerate. New Business applications have strongly rebounded from their March lows. Finally, while the employment picture is not as rosy as it was back in February — the unemployment rate has dropped precipitously from its April highs to just 6.7% this past November. There are promising developments throughout the economy. Couple these green shoots with the economic potential following widespread vaccine rollout and it's not too hard to find reasons to be optimistic from an economic standpoint.

Heightened valuations do not have to end poorly. Take a P/E ratio for example. It measures price divided by earnings to ascertain the price one is paying per unit of a company's profit. It is a textbook valuation metric. The S&P 500 is currently trading at a trailing P/E of 30.8 — the highest quarterly number ever recorded by Standard and Poor's (see chart on the next page). The longer-term average for the past 30+ years is closer to 20x earnings. There are two obvious ways for these valuations to normalize. First, price could drop 35% and the index would be

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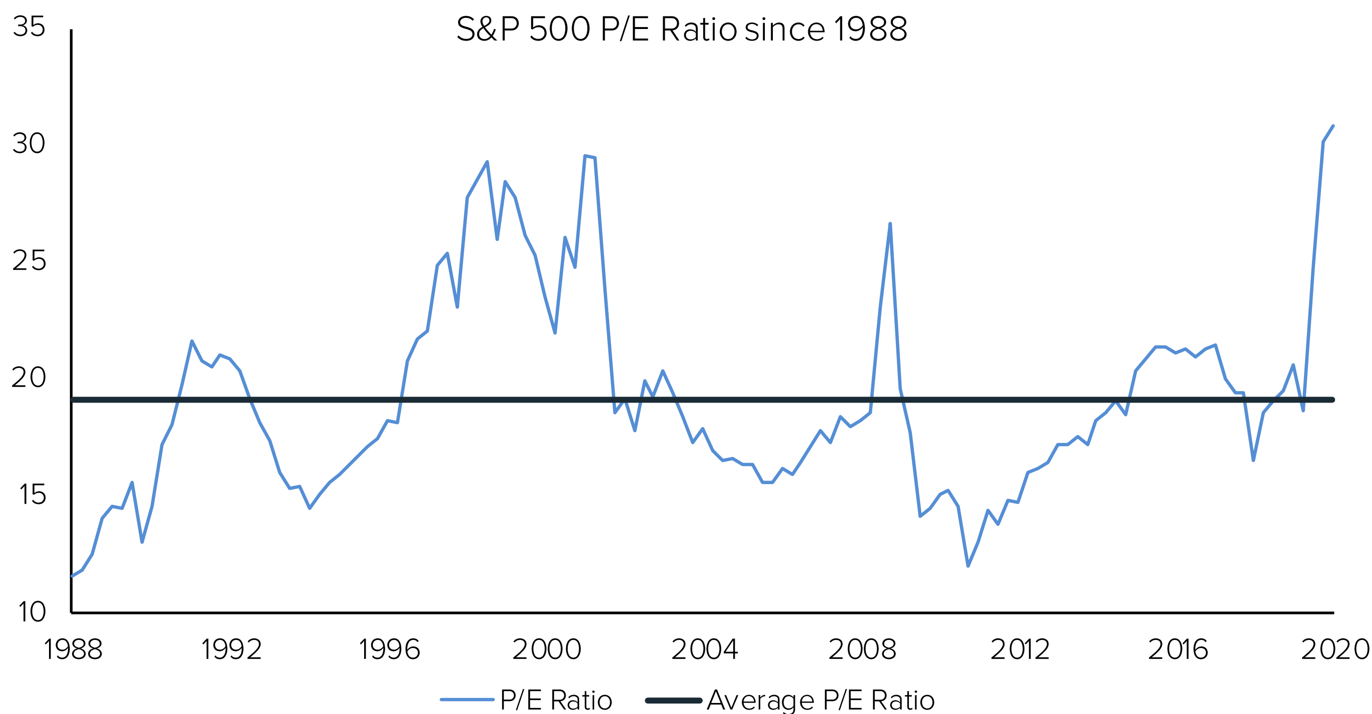
trading back at its long-term average. The second method, that gets talked about seemingly far less, is that earnings could grow. If earnings grew close to 50%, we would again be at an average valuation. If 50% earnings growth seems like a lot, that's because it is. On average, EPS has grown 7.7% on a yearly basis over the past 30 years. However, we saw nearly 30% earnings growth in the early 90s following the 1991 recession. We saw earnings growth in the mid-20s following the recession in the early 2000s. Finally, we saw earnings growth of nearly 100% coming out of the financial crisis. Clearly, price does not need to fall for earnings valuations to normalize. Instead, it is conceivable that we could ultimately grow into today's valuations.

TRANSITION UPDATES & NEWS **

Since we last wrote here, a quick flurry of activity has taken place in our portfolios. First, we trimmed some of our PayPal position in our Equity strategy. PayPal has risen nearly 190% since its March lows. The stock flashed sell in our model, and as our discipline demands, we took some of the position off the table. We also recently sold Accenture in our Large Cap and Equity strategies. Like PayPal, Accenture's valuation signaled a sell in our model. This led to the position being trimmed as well. Lastly, we most recently sold some of our position in Ecolab within Mid Cap and Large Cap. Ecolab is up more than 75% from its March lows, and like Accenture and PayPal, was also signaling a valuation sale in our model.

On the news front, Costco (a Large Cap and Equity holding) recently paid out a $10/share special dividend. This marked their third special dividend since 2015. In 2017, they paid out a $7 special. Similarly, they paid a $5 special in 2015. The aforementioned Accenture also reported earnings last week. They guided their 2021 earnings higher, as well as their revenue for the next quarter. The market rewarded the stock as it popped nearly 7% following their report.

***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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KEY MARKET DATA

	WTD	MTD	QTD	YTD
Dow Jones	0.44%	1.82%	8.63%	5.75%
S&P 500	1.25%	2.42%	10.30%	14.81%
Nasdaq	3.05%	4.57%	14.22%	42.16%
Russell Mid Cap	2.08%	4.28%	19.19%	14.89%
Russell 2000	3.05%	8.25%	30.66%	18.07%

	WTD	MTD	QTD	YTD
Comm. Svcs	-0.46%	2.27%	12.64%	21.23%
Con Disc	2.32%	1.39%	6.74%	30.70%
Con Staples	0.77%	1.41%	5.60%	7.58%
Energy	-4.26%	6.89%	28.94%	-35.74%
Financials	0.12%	2.09%	17.95%	-7.68%
Health Care	1.09%	2.85%	6.63%	10.47%
Industrials	0.07%	0.98%	15.04%	8.86%
Info Tech	3.20%	3.87%	9.61%	39.78%
Materials	1.92%	1.64%	13.17%	17.33%
Utilities	0.07%	-1.04%	4.16%	-4.25%
REITs	0.35%	-0.64%	1.89%	-6.78%