Notes from the Trading Desk

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Market Mover & Shakers

The holiday shortened trading week was, by and large, a good one for U.S. Equities. The Dow, the S&P 500, and the Nasdaq all closed the week higher gaining 67 bps, 58 bps, and 91 bps, respectively. The Russell 2000 fell ever so slightly as the small cap index dropped 17 bps. Mid caps fared a little better as the Russell Mid Cap inched 12 bps higher. Cyclicals were undoubtedly the leader last week. Consumer Discretionary stocks climbed 1.48% — leading all sectors — as reports of strong holiday spending hit the tape. Tech was not too far behind as the sector gained 1.11%. Yields fell ever so slightly as the 10-year Treasury and 2-year Treasury's yields fell 4 and 5 bps, respectively. Finally, gold — which has had a strong year— ended last week with a bang. The precious metal gained 2.34% and is now up 18.29% YTD.

What a difference one year makes! 2019 could not have looked any more different than 2018. In 2018, every asset class — except cash — closed the year lower. This year, it has not really mattered which asset class someone has parked their money in, as they have all seemingly climbed higher. The MSCI World Index is up 25.53% YTD after dropping 9.13% in 2018. Emerging Markets are getting in on the action as well. The MSCI Emerging Markets Index, which fell more than 12% last year, is now up nearly 16% this year. However, the gains have not just been limited to equities. The Barclays US Aggregate Index (a broad based bond market index) is up 5.69% YTD — this will be the best year for the index since 1995. The Bloomberg Commodity Index — a broad-based commodities index — is up 6.04% as well. It has been a good year for investors in nearly every corner of the market. However, it is especially true here in U.S. Equities. Through Friday's close, the S&P 500 is up 29.3%, the best year since 2013. If the S&P 500 can clear 3,249.13 by Tuesday's close, it will mark the Index's best year since 1997. Yes, 2019 could be even better than each of the last 2 years of the Tech Bubble. It could even surpass the rebound in 2003 following the 3-year slide in U.S. Equities, and the bounce back following the Financial Crisis. It certainly has been a historic year.

The economy and the market are now sending mixed signals though. On the one hand, we have received a number of classic late cycle indicators throughout 2019. First, yields inverted across the curve this past summer, with 10s to 2s inverting in late August. The spread has historically inverted about 2 years prior to a recession. Per Credit Suisse, the inversion between the two yields has also correctly predicted the last 5 recessions. Second, though the economy has continued to add jobs over the last couple of years, the rate at which we are adding jobs has clearly slowed. So, while jobs have not rolled over completely, they are beginning to decelerate — which is quite common late in the economic cycle. Lastly, sentiment has begun to get a little greedy. Bank of America Merrill Lynch's Monthly Fund Manager Survey for December certainly raised the contrarian's eyebrows. The survey indicated that expectations among managers for global growth had the biggest 2-month jump ever recorded. The quick swing to optimist is evident in the reported cash levels amongst managers as well. Cash levels have fallen to their lowest levels since 2013.

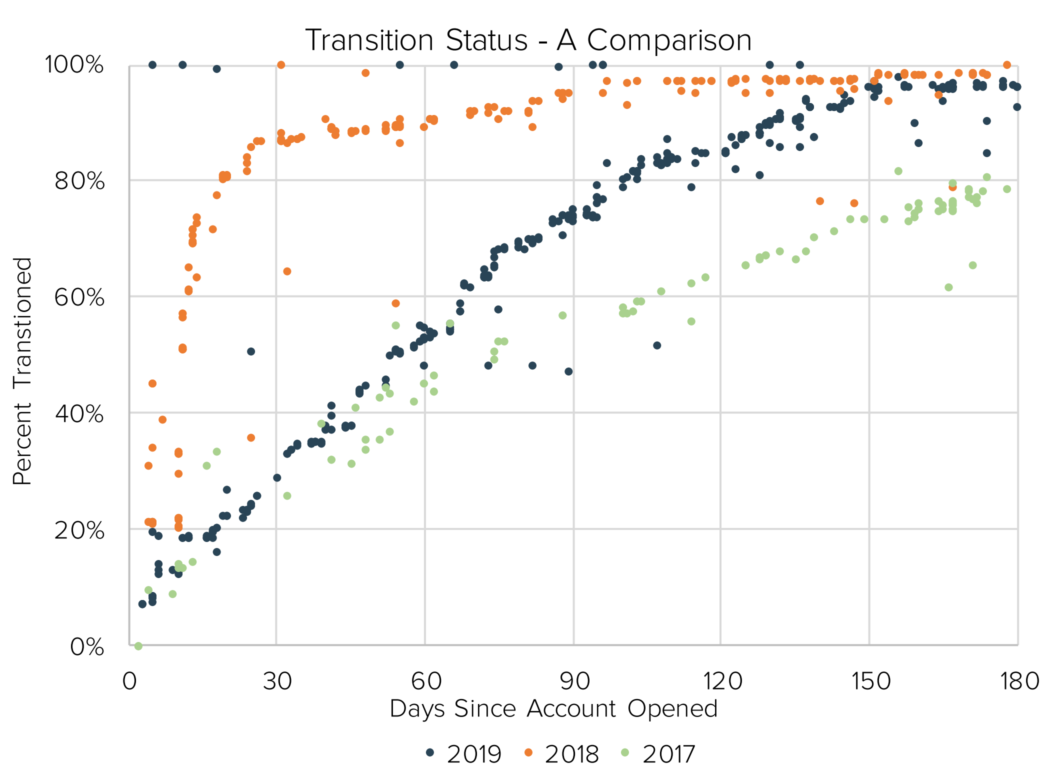
However, the backdrop is hardly all doom and gloom. There is plenty to be cheerful about. It seems that the trade war is beginning to wind down. At the very least, the previously harsh rhetoric has been minimized, clearing the way for optimism in the global economy. Elsewhere, Central Banks are once more priming the pump. According to Haver Analytics and Yardeni Research, major Central Bank assets declined throughout 2018, as markets simultaneously slid. However, Central Banks have stopped winding down their balance sheets — with the Fed actually growing theirs once more (just don't call it QE). Finally, there are even some fundamental reasons to be optimistic. Some pundits have pointed to the pure multiple expansion that the S&P 500 has experienced this year as being a sign of excess. The Index is up 29.3% YTD, but earnings are only expected to grow 4.4% year over year — according to Standard and Poor's. That means that more than 27% of this years gain has been multiple expansion — surely this must be sign of a bubble. However, it is worth noting that over the last two years the market is up roughly 20%, while earnings have grown 23%. Yes — when measured on a P/E basis, the market has actually gotten cheaper over the last two years.

So what gives and where do we go from here? Well, for starters, it would probably be fairly reasonable to think that next year won't look quite like this year. 25+% yearly gains — which seems astounding — are actually pretty common. Since 1928, the S&P 500 has gained 25+% 18 times (or, roughly once every five years). However, we have only had back to back 25+% years three times. What's more, next year is an election year. Over the last 90+ years, election years have underperformed non-election years by more than 200 bps. Additionally, it would not be surprising to see some volatility in the first half of 2019. The S&P 500 is currently showing signs of being very overbought in the short term. The index's RSI (the Relative Strength Index, or RSI for short, is a technical indicator which measures the momentum of an asset or asset class) closed north of 78 on the 26th and 27th. Over the last 30 years, the average 1-month return for the S&P 500 is 0.73%. However, the average 1-month return following an RSI reading of more than 78 is –0.22%.

*Transition Update***

The Christmas holiday certainly impacted markets last week. It was the second slowest week of the year in terms of volume for the S&P 500 — only surpassed by Thanksgiving. As a result, it was a fairly slow week here at Tandem as there was not a ton of opportunity. However, we did get the chance to add to some of our names that have gotten recently beaten up. Dollar Tree, J.M. Smucker, and Walgreens all remain attractively valued and were added on the transition level. We also continued to transition into Ross Stores in our Mid Cap accounts. The discount retailer seems to be in a strong uptrend. Finally, we transitioned into Henry Schein, National Retail Properties, and Yum! Brands as all three have recently slid from shorter-term highs.

All in all, this past quarter has looked much more like 2017 than 2018. Nearly anything and everything has been rising this quarter. Opportunities have, more or less, been drying up as a lot of names traded higher. Of Tandem's 47 core holdings, 28 of them are within 5% of 52 week highs. Of the 19 names that are more than 5% away from their 52-week highs, all but two (Walgreens and C.H. Robinson) are up for the year. As such, our transition speed, as one can see in the chart below, has been much more similar to 2017 than 2018 over the last few months. We had enough volatility back in August and early October that accounts that have been here roughly 6 months are nearing the end of their transition — whereas the dearth of volatility in 2017 left accounts only 80% implemented through 6 months. Regardless, with earnings season right around the corner, plenty of opportunities to continue our transition could arise shortly.



***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.*

Upgrades/Downgrades & Dividends

None.

Portfolio News & Notes

With most of Wall Street seemingly away for a Christmas Vacation, it was a painfully slow week for trading volumes and news. No major news broke for any of Tandem's core holdings. A few minor blips hit the tape though. Comcast is reportedly in talks to acquire a video-streaming company, Xumo. This should bolster both technical and business support for Comcast's recently announced Peacock streaming service. Elsewhere, the definitive agreement between AquaVenture Holdings Culligan and AquaVenture Holdings Limited sent shares for AquaVenture Holdings Limited 24.5% higher on Thursday. The pop sent shares of Ecolab higher as some analysts thought ECL could emerge as another bidder. Other than those two minor pieces of news, there was not a lot of action within the portfolio last week.

	WTD	MTD	QTD	YTD
Dow Jones	0.67%	2.12%	6.42%	22.80%
S&P 500	0.58%	3.15%	8.84%	29.25%
Nasdaq	0.91%	3.94%	12.59%	35.74%
Russell Mid Cap	0.12%	2.15%	6.65%	28.34%
Russell 2000	0.23%	-0.16%	-0.42%	5.69%
Comm. Svcs	0.19%	2.76%	9.51%	31.98%
Con Disc	1.48%	3.24%	4.72%	26.93%
Con Staples	0.15%	2.50%	3.27%	24.54%
Energy	0.55%	5.47%	4.08%	7.28%
Financials	0.34%	2.59%	9.96%	29.30%
Health Care	0.17%	3.81%	14.29%	19.11%
Industrials	0.49%	0.38%	5.56%	27.51%
Info Tech	1.11%	4.65%	14.25%	48.37%
Materials	0.64%	2.47%	5.44%	21.44%
Utilities	-0.44%	2.66%	-0.51%	21.67%
REITs	0.52%	0.12%	-2.23%	23.70%

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