Notes from the Trading Desk

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Market Mover & Shakers

U.S. equities finished higher once more last week. They have now closed higher 15 of the last 19 weeks. Tech has remained firmly in the driver seat as the Nasdaq gained another 2.21%. Small Caps were not too far behind; the Russell 2000 grew 1.86%. The S&P 500 gained 1.58%, and the Dow Jones brought up the rear as it gained 1.02%. Defensive stocks continued to perform well. REITs were the largest gainer as the sector climbed nearly 5%. Utilities were up 2.43% as well. Elsewhere, Treasuries were largely mixed, though the curve continued to flatten.

The market is back to setting highs almost every other day. However, it is doing so with a mixed tone. On the one hand, Utilities and REITs are two of the best performing sectors year-to-date. Even TLT — the iShares 20+ Year Treasury Bond ETF — is outperforming every sector except Utilities, REITs, and Tech. However, even with defensive sectors surging, riskier corners of the market are still doing exceedingly well too. Semis (as measured by the SOX) are up more than 9% this month alone and are up a remarkable 83.5% since their December 2018 bottom. Money is rushing into growth and defensive names rather indiscriminately. According to the American Association of Individual Investors, cash allocations have only been lower three times, which all were met with 20+% declines — just prior to the top in early 2018, the height of the Tech Bubble at the turn of the century and just prior to the Russian Ruble Crisis in 1998. Current cash allocations would indicate a euphoric market that is getting ahead of itself. Cash allocations have been this low three other times in the last 30 years and they have all been met with ~20+% declines. However, despite the excessively low allocation to cash, there are pockets of sentiment that could hardly be described as extreme. In fact, bullish sentiment, as measured by the American Association of Individual Investors, is basically at its 30-year average right now.

So, what could truly derail this market? Despite low cash allocations, it does not seem that sentiment is too far offsides. Barring an outright melt up, it does not seem likely that sentiment will be the first domino to fall — as it was during the Tech Bubble. Some have begun suggesting that the coronavirus could cause the global economy to further slow. There could be some validity to this suggestion — though viruses have never caused steep declines before. According to Of Dollars and Data, the three most recent epidemics — SARS, Ebola, and the Swine Flu — all caused 5-10% declines in the S&P 500. Even the Spanish Flu, which led to a 3% decline in the global population, only coincided with a 10% drop in the Dow in 1918. So, unless this time is different — which it always could be — viruses have tended to not be correction causing events. Elsewhere, some Bears have begun highlighting the concentration atop the S&P 500 as a cause for concern. After all, Microsoft, Apple, Amazon, Alphabet (Google), and Facebook now account for 18% of the S&P 500. In fact, according to Fortune, these 5 stocks accounted for more than 20% of last year's 31% gain in the S&P 500. In 2010, the top 5 names accounted for nearly 11% of the S&P 500. In 2000, the top 5 names made up more than 14% of the index. And yes, we are higher in terms of concentration today. Yes, slowdowns in any of these companies could bring a little pain to the market. However, the concentration in and of itself does not need to end cataclysmically.

While none of those aforementioned factors might be the first domino to fall in terms of a pullback, any and all of them could be the first piece. When valuations are as stretched as they are today — and the only more expensive time than today on nearly any and all metrics was the Tech Bubble — anything can cause markets to get a little jumpy. At the end of the day, and over the long-term, earnings will continue to be the driver for this market. So rather than fretting over the potential macro affects of a coronavirus sparked slowdown, or what a change in guard in Washington might do to markets, it is best to just look at the data and earnings on a company by company basis. The effects of the coronavirus will impact some stocks more than others. Excessive sentiment and a rush into passive investments could continue to expand the FAANG stocks valuations. And, yes, investors could become even more bullish than they are today. But it is worth repeating, when valuations are as stretched as they are today, risk is actually very high. Hardly any investors have the foresight to correctly predict the timing of, and the cause of, a stampede for the exits. Rather than trying to peer into a crystal ball, we will continue to manage stocks with the same discipline that we always have — using math, forgoing emotion, and taking things one stock at a time.

Transition Update**

As markets popped back to all-time highs in relatively short order, it seems like some of our opportunities have dried up with it. This past week we continued transitioning into some familiar names. Becton, Dickinson and Company (BDX) was bought twice as we have had the ability to add to the company at the transition level following a recent sell-off after their most recent earnings call. Similarly, recent selloffs in Euronet Worldwide and O'Reilly Automotive created the opportunity to transition into those names in some of our Equity and Mid Cap accounts. We have also continued to transition into names that have become quite familiar in this part of the column, Expeditors International, Dollar Tree, and C.H. Robinson continue to be bought in new accounts.

***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

ABT — Initiated neutral with a target of $96 at Goldman Sachs (2/12).

COST — Initiated neutral with a price target of $328 at Credit Suisse (2/13).

ICE — Upgraded to overweight from equal weight at Wells Fargo, target increased to $105 from $100 (2/10).

MSFT— Remains outperform at Evercore ISI, though the price target was increased to $212 from $190 (2/13).

NEE — Increased its dividend 12% to $1.40 from $1.25 (2/14).

SYK — Initiated buy with a $248 target at Goldman Sachs (2/12).

YUM — Initiated hold at Deutsche Bank with a $97 target (2/14).

Earnings Calendar

Date	Time	Ticker
2/18	Pre-Market	EXPD
2/18	Pre-Market	ECL
2/18	Post-Market	VRSK
2/20	Pre-Market	HRL
2/20	Pre-Market	HSIC

Portfolio News & Notes

Last week was rather busy here at Tandem. On Wednesday we took some profit in Brown & Brown, Microsoft, and Republic Services — names that have become overvalued of late. As such, we sold 25% of each position following the sell signal from our quantitative model. Each company remains fundamentally sound and will continue to be held in the portfolio, it was just time to take a little bit of each position off the table as their valuations became a bit stretched.

It was also a fairly hectic week in terms of earnings. Tandem had seven companies report their quarterly results last week. Six of the seven met their EPS estimates — only Tyler came in below estimates. Tyler and Euronet both sold off following their earnings. However, Waste Connections, Republic Services, and Lab Corp are all now trading at, or near, all-time highs. The next week should remain busy as well as another five companies are set to report earnings.

	WTD	MTD	QTD	YTD
Dow Jones	1.02%	4.04%	3.01%	2.95%
S&P 500	1.58%	4.79%	4.62%	3.56%
Nasdaq	2.21%	6.34%	8.45%	6.68%
Russell Mid Cap	2.19%	4.45%	3.55%	2.14%
Russell 2000	1.86%	4.56%	1.15%	0.54%
Comm. Svcs	1.38%	4.74%	5.43%	3.88%
Con Disc	2.61%	5.09%	5.70%	3.31%
Con Staples	0.81%	2.64%	2.84%	1.84%
Energy	0.31%	1.08%	-10.22%	-9.82%
Financials	0.72%	3.84%	0.94%	0.57%
Health Care	0.86%	4.82%	1.80%	1.75%
Industrials	1.08%	4.19%	3.67%	3.28%
Info Tech	2.27%	6.84%	11.00%	9.61%
Materials	0.73%	4.98%	-1.51%	-0.77%
Utilities	2.43%	1.78%	8.52%	6.28%
REITs	4.95%	6.65%	8.17%	3.02%