Tandem Investment Advisors

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Notes from the Trading Desk -
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by Benjamin “Ben” G. Carew, CFA

MARKET MOVERS & SHAKERS

The major U.S. equity indices were up for their second straight week. The Nasdaq led the way higher, climbing 2.4%, as the tech-heavy index bounced back from oversold conditions. The Russell 2000 was up 1.7%, followed closely by the S&P 500, up 1.6%. The Dow brought up the rear, gaining 1.1% on the week. The rotation was a cyclical one as Energy and Consumer Discretionary stocks were the best performing sectors. Yields, which have been the big story of the year, continued to move higher last week. The 10-year yield jumped another 15 bps to 1.93%. It’s now beginning to test the bottom end of its late 2019 consolidation range around 2%. A lot of last week’s spike came on Friday following the jobs number, as nonfarm payrolls gained 467k – well above the 155k expectation. The prior two months were also revised higher and hourly earnings grew 5.7% year-over-year and 0.7% month-over-month. Some of the jump in yields is also attributable to the continued hawkish tone coming out of the Fed and other central banks – looking at you Lagarde! Atlanta’s Bostic mentioned the possibility of a 50-bps hike if inflation warrants that to be necessary. However, some dismissed Bostic’s notion since he is currently a non-voter.

In Billy Little’s most recent Observations, he discussed the likelihood of the market entering a new regime. Each day in this market seems to confirm that view. Some of the abnormal effects of the overly easy monetary and fiscal policy we’ve seen over the last two or three years, or even the last decade+, is beginning to fade. According to Bloomberg’s John Authers, the total amount of negative yielding bonds is at its lowest level since 2019. The total, $6T, is down remarkably from its peak of $18T+ in early 2021. The 2-year Treasury yield has gone from yielding 10-11 bps to 130 bps. Volatility has been trending higher, having made a series of higher highs and higher lows, since the VIX bottomed around 15 in late October. The VIX had been in a very clear downtrend since March of 2020 as markets were becoming gradually calmer. The Federal Reserve has shifted from a dovish lean to a hawkish tilt – though a lot of ink has been spilled on that topic in Tandem columns already! However, even the ECB became increasingly hawkish as it seems our European counterparts might be forced to raise rates at least once this year to help stave off inflation. The economy seems less concerned with COVID, or perhaps it's just Omicron. However, January's jobs report was supposed to be disappointing as the measurement took place while Omicron was wreaking havoc throughout the country. Instead, during the worst COVID-surge we've seen yet in terms of number of cases, jobs posted a remarkable gain. That's a markedly different outcome than what we have seen over the last two COVID filled years.

Valuations also seem to be entering a new regime. In late 2020 and throughout 2021, the only other comparable period in terms of valuation was the Tech Bubble. It was a comparison made ad nauseum. Valuations have begun to revert to normal though. The forward P/E on the S&P 500 is currently closer to 20x – a number still above its long-term average, but one that is much closer to normal than the 24x witnessed within the last few quarters. Using a PEG, to include growth, the S&P 500's valuation has actually now gone below its long term-average! For that to hold, the S&P 500 must actually achieve its growth that analysts are currently estimating. However, even that seems to be changing. From Q2 of 2020 through Q4 of 2021 analysts were consistently revising their estimates higher. That in and of itself was unusual. Historically, analysts have typically brought their estimates down throughout a quarter. However, this trend has reverted to normal as estimates fell in January. Should this trend continue, it would insinuate that forward valuations are currently higher than they otherwise would be. In other words, if a company is currently trading at 10x forward earnings and a price of $10, that means that the $10 stock is estimated to earn $1 over the next year (hence the 10x because 10÷1 =10). However, if that $1 earnings estimate is being revised lower then the 10x is an overestimation. If the $1 is revised down to $0.90, then the market is actually trading at 11.1x (10÷0.90=11.1).
In hindsight, it seems unsurprising that markets bounced when they did. Sentiment swung negatively in a very short period. The Put/Call ratio was at its highest since March 2020, suggesting a hugely negative attitude in the marketplace. The AAII bull/bear sentiment was at its worst since mid-2020. The Nasdaq Volatility Index spiked above 40 for the first time since 2020, while the RSI for the Nasdaq was even lower than its COVID trough. None of this must mean the worst is behind us. In fact, it would be expected to see further bumpiness as the market continues to digest the everchanging backdrop and regime changes. However, it seems unsurprising to experience a slight reprieve from the volatility blitz that the market has seen since mid-November.

TRANSITION UPDATES & NEWS **

Between earnings and M&A news, it was a busy week here for Tandem. In terms of M&A, JM Smucker completed their divestiture of their natural beverage and grains business to Nexus Capital – the transaction was announced last quarter. Becton Dickinson's board voted unanimously to approve the spinoff of embecta on April 1st. The spinoff was announced last year as well.

On the earnings front, we had a slew of names turn in their quarterly results. AbbVie traded higher following their Q4 print which saw full year guidance slightly above estimates. Becton Dickinson also traded higher following their earnings beat and positive guidance. PayPal announced disappointing forward guidance which led to a severe reaction as the market sent it lower. Intercontinental Exchange beat their estimates and announced a 15% increase in their dividend, payable March 31st. Lastly, CBOE also beat on both the top and 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.*

Written By: Benjamin "Ben" G. Carew, CFA

Ben Carew is a shareholder and Portfolio Manager for Tandem Investment Advisors, Inc. Mr. Carew joined Tandem in 2013. His duties include quantitative and fundamental research and portfolio management. Mr. Carew also oversees Tandem's internship program. 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. 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.