January 30, 2023 - Tandem Investment Advisors, Inc.

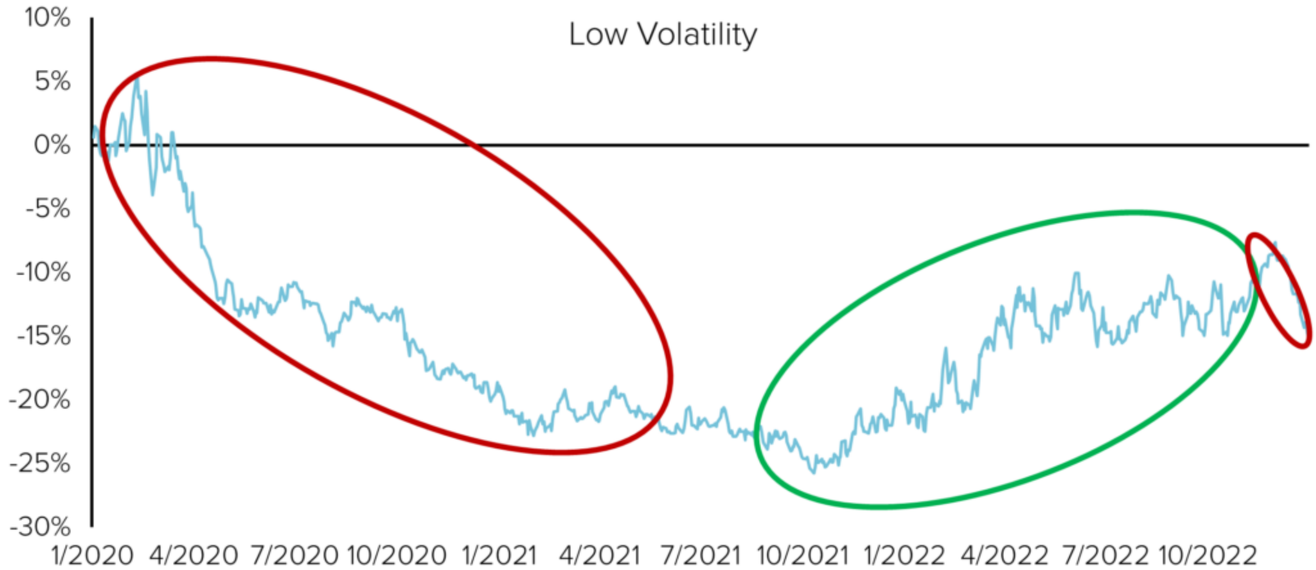
February 1, 2023

MARKET MOVERS & SHAKERS

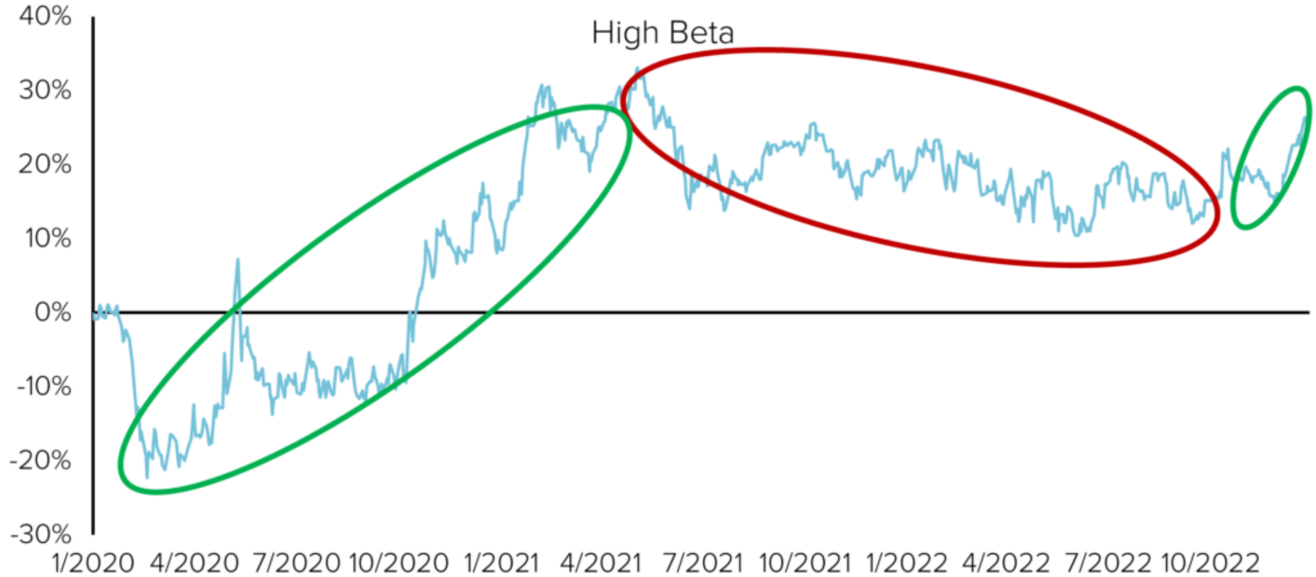
2023 has thus far been a pleasant reprieve from its tumultuous predecessor, 2022. Through Friday, the S&P 500 had risen 6+% so far in the month of January. The major U.S. index is on pace for its best start to the year since 2019. The month's gain, should it hold, would mark only the third 6+% January rally in the past 33 years for the S&P 500. Tech and cyclicals have been enjoying the new year as well. The best performing sectors have been Communication services, consumer discretionary, tech, materials, and REITs. The reemergence of tech has led to a gain of 11.2% through Friday's close for the Nasdaq 100 – a monthly gain that would be its best start to a new year since the runup into the Tech Bubble in the late 90s. As stocks have rallied, the VIX (often referred to as the market's fear gauge) has continued to retreat towards levels that were last seen during the market's all-time highs in late 2021 and in the very early sessions of 2022. The long end of the yield curve and the U.S. Dollar have also been in a steady decline. The yield curve, almost regardless of how one prefers to measure it, is in a deep state of inversion. In fact, one could purchase 3-month Treasury bills and currently expect an annualized yield of ~4.6%. Or, that same individual could go out and buy a 30-year U.S. bond with an annualized yield of ~3.6%. The roughly 1% spread between the two is the largest since the early 80s. Elsewhere, one of the only continued trends from 2022 has been the outperformance of commodities once more. Commodities like gold and lumber, as well as industrial metals such as copper, iron, and aluminum have all soared higher in early 2023. Agricultural commodities have been a bit of a different story. Hogs, pork bellies, soybeans, wheat, and coffee have all stumbled out of the gates. Eggs, thankfully, have been in retreat mode as well. According to FactSet, the spot price of eggs has fallen 38% YTD – which means they have retreated to their October levels.

As a quick aside, we are about to discuss the performance of high beta stocks and low volatility stocks, as measured by two ETFs that attempt to track those factors. Tandem seeks to deliver a less volatile capital appreciation strategy. In other words, Tandem also seeks low volatility. Some may think then that the ETF is similar to a Tandem portfolio. In reality, the ETF we mention below specifically attempts to provide less volatility by investing in the names that were the least volatile over the previous 12 months. There are many ways to invest, and that certainly is one of them. But, Tandem attempts to limit volatility by investing in names that have consistently grown their key fundamental metrics through different economic environments. We hope that this results in a less volatile experience. The approach that we take, and the approach of the low vol ETF, could not be more different. We may share a few characteristics with the ETF, but the holdings and the approach are quite different. Similarly, we look for high quality companies. Yet, we do not have a lot of overlap with Quality ETFs. We also require dividend growth, if dividends are paid. This may result in some overlap with dividend growth strategies. Whether it be a dividend growth factor, a quality factor, or a low vol factor, we may have some overlap. In reality, those different characteristics are just a by-product of what we do. Quality ETFs seek quality, low vol ETFs seek names that have been less volatile over the past 12 months, and dividend growth ETFs seek names that have displayed dividend growth. Tandem merely seeks consistent fundamental growth through any economic environment. As a result, our portfolio hopes to limit volatility and hopes to display strong dividend growth as we invest in what we hope to be high quality companies.

In terms of equities, January has really been a tale of two tapes. The charts below show the relative performance of a low volatility (as measured by the ETF SPLV) and High Beta (measured by the ETF SPHB) to that of the broader market (as measured by the ETF SPY). Low volatility dramatically underperformed throughout the back half of 2020 and the first three quarters of 2021. Low volatility then found its footing during the regime change that took place throughout Q4 of 2021. The market may have still been setting all-time highs back in Q4 of ‘21, but by mid-November, inflation expectations were changing, the volatility regime was changing, and low volatility was mounting a comeback that persisted, more or less, through all of last year. This year, low volatility has been dramatically underperforming. That’s also evidenced by the recent sector rotation. We’ve already touched on the higher beta outperformance of sectors like materials, even energy, year-to-date. The only sectors that are negative for the year – utilities and consumer staples. Meanwhile, as low volatility has waned, high beta has taken off. High Beta was in favor throughout the back half of 2020 and the first two or three quarters of 2021. As low volatility took its place as market leader, the high beta trade cooled materially. That has reversed course the past few weeks though. The shift in sentiment is not unusual. It could mark the start of something bigger and broader – like a new bull market. It could also just signal one more bear market rally. Even in a year like last year, there were weeks of consistent outperformance by high beta before the market would roll over once more.



Source: FactSet



Source: FactSet

So, is this recent market rally that the start of something bigger? Or will it roll over and flop like the rallies of 2022? While only time will tell, there are certain points worth observing. First, this rally started like the rallies of 2022. It was mostly short covering. The Nasdaq's impressive run so far year-to-date is easily surpassed by the performance of Goldman Sachs' "Most Short" basket, which is up 20+% so far in January. That means a lot of the buying that has been pushing this market higher has been investors covering their shorts. Goldman highlighted the performance of semiconductor stocks as being a prime beneficiary of the short covering activity. Sure enough, the Semiconductor Index (SOX) is up 16+% through Friday's close and an astounding 41% since it's late October lows. Semis, often considered to be a leading indicator, showing such strong outperformance is encouraging – even if it began as the result of short covering. While short covering may have sparked this rally, there is now positive momentum that is building. In fact, the Russell 2000, the Nasdaq Composite, and the S&P 500 are now all above their 200 day moving averages for the first time since January 4^{th} of 2022 – the last time the S&P was at an all-time high. In short (no pun intended), the rally may have began because investors were short covering, but it has quickly built momentum into something potentially larger than that. However, with Jay Powell on deck this week, the Fed may bring market expectations crashing back to reality.

In fixed income land, bonds are clearly back in vogue. The iShares 20+ Year Treasury Bond ETF (ticker TLT) was down nearly 30% in 2022. This year its already up 6%. That's right – long dated U.S. Treasury's are basically neck and neck with the S&P 500 one month into the year. Recently, we have begun receiving some questions on the debt ceiling and its potential impact of different markets. Perhaps it will be problematic, but the bond market doesn't seem to think so. In fact, according to JPMorgan Asset Management fixed-income portfolio manager Kelsey Berro in a recent Bloomberg quote, "Every single Treasury auction so far this year has gone incredibly well and the interest is coming from foreign buyers, so for those that think the debt ceiling is scaring away that foreign interest, we're not seeing it at all." The heavy interest in fixed income, could be due to higher yields. After all, being able to roll a 90-day T-bill and pick up 4.6% is nothing to sneeze at for a more risk averse investor. However, the clamor into the bond market could also be a sign of consensus being that the Fed is near the end of their hiking cycle. The Fed's own projections have rates coming down 1-2% in the next two years. If that is to believed, then fixed income investors should want to snap of yields at these more elevated levels. The Fed is set to raise interest rates once more on the 1^{st} of February. Consensus is that it will only be a 25-bps rate hike in February and another 25 bps in Mach with a pause from there on out. It very well may be, but we already discussed some of the rising commodities (which could lead to further inflationary pressures) and believe it or not, financial conditions are actually easier today than they were the day Russia invaded Ukraine. The Fed has been fighting tooth and nail to tighten up financial conditions, and they are easier today than they were 11 months ago. Crazy.

TRANSITION UPDATES & NEWS **

Earnings season is officially underway once more. We are currently in one of the busiest two week periods for the S&P 500, with 200+ companies reporting their results between 1/23 and 2/3. So far, it's been tough sledding for a lot of companies. There have been a slew of downward revisions and negative guidance that has been issued across the board. According to FactSet, companies issuing negative EPS guidance are currently outpacing companies issuing positive EPS guidance by a ratio of 8.5 to 1. Also according to FactSet, the S&P 500 is currently set to see an earnings decline of 5% in the 4th quarter – the first negative quarter since Q3 of 2020. This tough earnings season has led to 2023 and even 2024 estimates to begin declining – making the index potentially more expensive on a forward basis.

Among our own names, its been a mixed bag in terms of earnings and market reception of those earnings. A few names have surprised positively to the upside and have been well rewarded, while others have reported disappointing results which have sent some names reeling. This intra-name volatility has created a lot of opportunities for Tandem at the transition level. At times, the market can get so caught up in quarterly results of companies that we intend to hold for the long term. When the market's reaction is to the downside, the negative reactions within the marketplace can actually end up creating attractive opportunities for us to transition new monies into existing Tandem names. The same is also true to the upside. There are times where the market can react in such a frenzy to positive earnings that a name ends up soaring higher. Moves like that can create attractive opportunities for Tandem to rebalance some names that folks are overweight relative to desired weightings, or continue to trim and sell non-Tandem names that we are transitioning out of an individual's portfolio. As earnings season continues, one would expect this trend to continue.

***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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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.