July 26, 2022 - Tandem Investment Advisors, Inc.

July 27, 2022

MARKET MOVERS & SHAKERS

It has been a pleasant start to the quarter – a welcome change of pace from Q1 and Q2. So far, the major indices have all rallied, yields and commodities have been stable, and volatility has meaningfully dissipated. Never short a dull market, or so goes the adage, and July, on pace for the lightest month of volume this year, has not been an exception to that rule. Yet, none of the headwinds that roiled markets in the first half of the year have changed in any material manner. Inflation remains ubiquitous, while labor shows continued strength. One minor development has been the emergence of the dollar's strength as a corporate earnings issue. Many C-Suite executives for multinational companies are citing the dollar as a key contributor to topline impediments. The dollar's headwind is not a complete surprise. After all, the Dollar Index has appreciated more than 11% year-to-date – a strong move for a currency. Although, the companies citing dollar headwinds are the same companies that would have benefitted throughout 2020 and 2021 from the declining dollar's tailwind. The dollar giveth and the dollar taketh away.

The bounce back this month has been spearheaded by those that led the way lower for the first half the year. Tech and Consumer Discretionary have been leaders to the upside after a lousy start to 2022. First half underperformers like REITs, Financials and Industrials have been pockets of strength these past few weeks. Meanwhile, more defensive corners of the market like Utilities, Staples, and Healthcare, which all buoyed the market for the first 6 months of the year, have lost a little bit of their shine. Given that the backdrop remains mostly unchanged, it seems like this may be more of a bear market rally than a true turning of the tide.

Warnings of a weakened consumer have so far been largely unnoticed by the broader investor class. AT&T noted a delay in the payment of customer bills, which they said happens in times of economic stress. Walmart, just this week, pre-announced their Q2 earnings – a move typically done to get out in front of bad news. Sure enough, their guidance given just two months ago is to be thrown out completely. Instead of the prior guidance of flat to up slightly, earnings are now expected to drop 8.5% year over year. Walmart blamed the impact of inflation on the consumer. The double-digit food inflation has affected their customers' ability to spend on general merchandise. As general merchandise has languished, Walmart has been forced to mark down goods in order to continue to move inventory. They specifically cited apparel as a particularly weak pocket. It would be surprising to not hear similar sentiment these next few weeks as more companies report their quarterly results.

The inflation-hampered consumer has clearly led to weakened demand. But, the labor market remains resilient and strong. These two conflicting ideas have led to debates as to whether we are in a recession. Usually, a recession has been defined as two consecutive quarters of negative GDP growth. This coming Friday's GDP print should meet that textbook definition. Q1 was negative, and Q2 is currently expected to be, at least according to the Atlanta Fed's most recent estimate. So, are we in a recession? Well, it depends on whom you ask. Treasury Secretary Janet Yellen said just last Sunday "this is not an economy that's in a recession." Similar sentiment was echoed by the President, who on Monday stated, "We're not going to be in a recession." To be honest, it's probably futile to get caught up in the discussion of what is and what is not a recession. Regardless of whether we are in, or headed for, a recession, it's clear that companies are being impacted and that growth is slowing. This quarter will be the slowest quarter of growth since Q4 of 2020. According to FactSet, earnings are currently expected to show 4.9% growth in Q2. This is down from the nearly 6% that was estimated at the end of March; estimates were already low, but they've been slashed lower. The bulk of the S&P 500's market cap is reporting earnings this week. That, coupled with the Federal Reserve meeting, should provide ample fodder for the market to become a bit more interesting heading into the end of the month and start of August.

TRANSITION UPDATES & NEWS **

As volatility has slowed, some opportunities have dried up as well. Money is being invested a bit more slowly than it was last time we wrote here, which was on the heels of a volatile two-week stretch in broader markets. However, earnings season usually provides ample opportunity for transition activity as names fall or rally depending on their reported numbers.

News for the past few weeks has been fairly tepid. We've had a few names begin reporting earnings – BlackRock, Johnson & Johnson, Abbott Labs, MarketAxess, SEI Investments, Intuitive Surgical, Roper Technologies, and NextEra Energy. Outside of Intuitive Surgical, which is facing a tightening of budgets at hospitals that is making the purchase of their da Vinci surgical robot a bit harder to place, earnings have been fair. JNJ and Abbott cited some headwinds from the dollar, though Abbott continues to benefit from COVID testing. Believe it or not, Abbott has actually delivered more tests in 2022 than they did in all of 2021. Clearly testing is here to stay for a bit longer. Roper guided higher following the divestiture of their industrial businesses. The resulting asset-light tech-focused company should be less cyclical as their recurring revenue stream will be a larger part of their business moving forward. BlackRock and SEI have both seen their assets under management shrink in the face of declining markets, though they both continue to invest and position themselves for future growth. MarketAxess has seen the benefit of widening credit spreads and credit volatility be offset by the inversion of the yield curve. The electronic bond trading platform favors an operating environment with a steep yield curve. As traders trade more longer dated bonds, MKTX is able to charge more. Last, but certainly not least, NextEra continues to chug along. They reaffirmed their guidance moving forward and anticipate ~10% dividend growth through 2024 – barring any sort of significant change.

***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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