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Market Movers & Shakers

The start of the third quarter has been strong as stocks have largely rallied. The first half of the year was marked by tremendous outperformance in just a few names. So far, the third quarter has seen broader participation in the rally – quite a positive development for stocks. Through last Friday, the Dow was up 3.06% for the quarter, the S&P 500 had gained 2.96%, the Nasdaq added 3.83%, while the Russell Mid Cap appreciated by 3.40%. Even the S&P 500 Equal Weighted Index was up 3.07%. Remarkably consistent performance across all the major indices is surely a positive sign. As equities have surged higher, volatility has continued to be drained out of the market. The VIX has been consistently below 15 for the month of July – marking its lowest monthly average since January of 2020. As the VIX has remained depressed, stocks have faced little resistance. At one point, the Dow had gained for 13 straight days – a feat not seen since 1987. One trend to keep an eye out for though – shorting volatility. According to Morgan Stanley, selling records were broken in April and again in June – meaning that market participants are largely betting on volatility to remain depressed. Similar bets were placed in 2017 and into early 2018 before "Volmageddon" blew that trade up in February of 2018.

The expectation for a soft-landing, the increasing likelihood of disinflation, and the belief that the Fed's rate hikes are drawing to a close have all been bullish talking points and have helped clear any sort of conflict for the market. One of the lone bearish talking points has been the Fed's consistent message of further rate hikes and higher for longer. Fedspeak remained quite hawkish in mid-July going into the June CPI report. Fed Governors Kashkari, Waller, and Daly all mentioned the need for further rate hikes should inflation remain entrenched. However, after headline CPI came in at a 3% year-over-year gain, its lowest since March 2021, the market is pricing in no more Fed action until a rate cut in May of 2024. This led to some intense moves in the bond market around the CPI print. The 2-year U.S. Treasury, which was above 5.1% in early July, got as low as 4.61% post-CPI. It's since settled out closer to 4.9% over the last week or so. Just last week, the FOMC chose to raise interest rates with another 25-bps hike. Chair Powell avoided saying that the Fed would be done hiking, though he did note that the Fed's staff is no longer predicting a recession. Long story short, according to the market and the Fed, the worst of inflation seems behind us – which could mean that a soft landing, or even no landing, is being viewed as more likely.

Investors are becoming more and more bullish on the backs of these market trends. According to a recent survey from American Association of Individual Investors, the retail investor is all in. Bullish sentiment is near its highest point since November 2021 and allocations to stocks are at their highest since mid-2017. It's not just retail either. According to the National Association of Active Investment Managers (NAAIM), equity exposure among active managers is at its highest level since November of 2021. Both of these measures can be viewed as contrarian indicators. The NAAIM indicator at the end of September 2022 showed net exposure of ~13%, the lowest since mid-March of 2020 – both were great short-term buying opportunities. The low VIX, coupled with the popularity of shorting volatility, and a bullish retail investor all point toward a market that might be getting a little bit ahead of itself.

One thing to watch – while inflation seems to be cooling, it also seems possible that the consumer may be cooling a bit as well. Amazon's Prime Day fell short of expectations. The latest Beige Book out of the Fed noted shifts away from discretionary spending (though travel/tourism activity remained robust). Back-to-school spending is now projected to be weaker than expected. Discover Financial saw credit card delinquency and net charge offs continue to rise. Research out of the Federal Reserve estimates that all excess savings from the Pandemic have now been spent and depleted. And, the New York Fed's Credit Access Survey showed a record high rejection rate for auto loan applicants and a tick higher in the rejection rate for credit card applicants. All in all, it's not a terribly inspiring picture of the consumer that is being painted. Thankfully, the labor market remains quite strong. Should it continue to be strong, then the consumer should continue to be resilient.

– Ben Carew, CFA

Transition Updates & News**

Tandem has made two purchases at the composite level through July. We increased our stake in Hormel Foods and NextEra Energy by half a percentage point. In our view, both Hormel and NextEra have been trading within an attractive range over the past several months. Hormel is included in all three strategies while NextEra is in Large Cap Core and Equity.

The overall market has continued to chug higher as rate hikes are juxtaposed with bullish sentiment. Tandem continues to see buying opportunities at the transition level in names such as Hormel, MarketAxess, Jack Henry, NextEra Energy, and Nike . Hormel has been tasked with overcoming supply chain headwinds. Jack Henry and MarketAxess are both within the Financial Services realm. Financials have been on the rebound since the March avalanche, and our two holdings have reiterated their strength. Utilities have had a rough go this year, as all are sensitive to interest rates. Lastly, Nike's stock has succumbed to falling revenue in China due to ongoing COVID restrictions.

Many of Tandem's companies have begun to report. Church and Dwight, a consumer goods brand focusing on personal care, beat on their Q2 Revenues and Earnings. EPS guidance for Q3 was softer than analysts' expectations. Guidance for the rest of the year's revenue growth was revised slightly higher, barely beating estimates.

AbbVie preannounced and updated their Q2 EPS to $2.75 – $2.85. Their prior guidance was $2.90 – $3.00. Management noted an unfavorable impact from acquired in-process research and development of $280 Million. As key products are now facing generic competitors, management notes that the blow is less than expected. One of AbbVie's largest products is HUMIRA. HUMIRA treats inflammatory conditions in adults. HUMIRA revenues have been under pressure due to similar drugs in the market. However, ABBV's SKYRIZI and RINVOQ year-over-year sales have been impressive. SKYRIZI sales were up 50% year-over-year, and RINVOQ saw a 55% increase. Combined, this accounts for $2.8 billion in sales.

Mastercard beat on their quarterly revenue and earnings. Management noted continued momentum and resilient consumer spending – especially in travel and entertainment. Cross border travel was 154% of pre-pandemic levels.

Roper Technologies, a software development company for niche markets, beat on revenue and adjusted EBITDA. Q2 EPS increased 4.3% compared to last year, also beating estimates.

Several Tandem companies have also recently increased their dividend. Steris, a medical equipment company, increased its quarterly dividend by roughly 11%. J. M. Smucker increased its quarterly dividend by 3.9% to $1.06 from $1.02. And Republic Services, a waste collection company, upped its dividend by ~8%.

On the topic of acquisitions, FactSet announced the acquisition of idaciti, Inc., an innovator in data structuring and collection technology. idaciti applies a "taxonomy-first" approach to structuring information from company disclosures, regulatory filings, and proprietary document repositories. Also, Brown and Brown is set to acquire New England Excess Exchange. New England Excess Exchange is a wholesale MGA providing commercial and personal lines insurance solutions for qualified independent retail brokers throughout the Northeast.

– Annie Klopstock

***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.*

- Benjamin "Ben" Carew, CFA

  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.

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