Tandem Investment Advisors

Notes from the Trading Desk - June 8, 2021

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- June 8, 2021
by Benjamin “Ben” G. Carew, CFA

MARKET MOVERS & SHAKERS

Some familiarity has come back to the marketplace since the May 14th edition of *Notes.* It feels like a return to the market we found ourselves in at the start of the year with meme stocks in vogue once more! GameStop has gained more than 70% over the last month, while AMC is up 475+% during the same period. The Nasdaq has outpaced the S&P 500 and the Dow, adding 3.4% versus 1.3% and 0.7%, respectively since May 14th. Meanwhile, the Russell 2000 has led all major indices – climbing 4.3% over the same window. Small caps are outperforming, while Energy and REITs have both been market leaders. Lastly, yields have been fairly range bound. It certainly feels like déjà vu across the tape!

Despite the similarities between today’s market and that of January, there are some key differences. I know we have discussed inflation ad nauseum in recent editions of *Notes*. However, it is worth reiterating that inflation expectations are rapidly turning into actual inflation. *The Financial Times* recently reported that global food prices had their largest jump in a decade after rising 40% in May. In a recent Bloomberg article, Former Fed official Bill Dudley opined that “the Fed is risking a full-blown recession” due to their handling of the inflationary threat. Dudley goes on to argue that the Fed’s steadfast insistence that they will not raise short-term rates until “employment has reached its maximum sustainable level, inflation has reached 2%, and inflation is expected to remain above 2% for some time,” will cause the Fed to remain on the sidelines as things overheat before forcing them to react quickly to cool things off on the other side. Dudley argues that this deviation from the Fed's historical action of raising rates sooner, rather than later, could potentially cause volatility in short-term rates and economic hardship.

Another ex-Fed official, Kevin Warsh, began ringing the alarm regarding Fed policy in a recent *Wall Street Journal* Op-Ed. Like Dudley, Warsh was critical of the Fed's policy surrounding inflation. However, Warsh highlighted another distinct threat looming on the horizon, global tapering. The People's Bank of China, the Bank of Canada, the Bank of Korea, and the Bank of England, to name just a few, have all started removing accommodation and have begun the trudge back to a more normal and tapered monetary stance. In doing so, many other banks are once again rearming their arsenal of tools, while the Fed continues to spend. It is like a game of musical chairs, the music has stopped and global central banks are beginning to take their seats while the Fed continues running in circles, not even noticing that the music is no longer playing. The result has been a weakened dollar. Of late, the ICE US Dollar Index is trading back near its January lows – having given up much of its gains that it had made through the end of March. In his op-ed, Warsh goes on to argue that the most prominent threat to the economy is not inflation, but the unparalleled scope of government spending. Warsh made a point of highlighting that the Fed has bought 56% of the total Treasury issuance since last February. Their purchases represent more than ¾ of the cumulative federal deficit. With an additional $6tn recently proposed by the Biden Administration for the 2022 Budget, the question must be asked: Will the Fed continue to soak up all new issuances at this torrid pace, or will other buyers step in? If other buyers step in, what sort of interest rate could they demand for this new era of fiscal ***and*** monetary looseness?

The case for higher rates is apparently now championed by the one who arguably left rates too low for too long, Treasury Secretary Janet Yellen. In a recent interview, Treasury Secretary Yellen stated, "we've been fighting inflation that's too low and interest rates that are too low now for a decade." Surely it is a bit ironic given that Yellen spent more time than both Bernanke and Powell at the head of the Fed over the last decade, having played a heavy hand in ensuring rates remained lower for longer. Treasury Secretary Yellen went on to say that "if we ended up with a slightly higher interest rate environment it would actually be a plus for society's point of view and the Fed's point of view." Given that roughly 1/3 of President Biden's proposed $6tn budget for 2022 is reportedly unfunded, it seems like Treasury issuance must pick up the pace. However, if interest rates rise, the cost of servicing that debt could become quite large. It seems unlikely that that scenario would "actually be a plus."

TRANSITION UPDATES & NEWS **

The pace of the transition has slowed a bit since the May 14th edition of *Notes*. Our average stock today is slightly more expensive than it was just three weeks ago. As some of our holdings have traded back towards recent highs, the opportunity to put cash to work has slowed. However, that is not to say that the opportunity has dried up all together! Last week, we were able to purchase a handful of various stocks where opportunity was still present. Among them were names like Abbott Labs on a sell-off following a change in their 2021 guidance due to a decline in COVID testing, as well as Check Point Software and AbbVie which remain attractively valued in our model, to just name a few.

***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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