Notes from the Trading Desk

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Market Mover & Shakers

U.S. Equites suffered their worst week since October 2008. The S&P 500 fell 11.5%, while the Russell Mid Cap and Russell 2000 fell 12% each. The Dow was the worst performer amongst major indices as it dropped 12.4%. The Nasdaq slid 10.5%. No sectors were spared either. Each sector, besides Communication Services, fell at least 10% last week. The damage was fairly evenhanded, though Energy dropped 15.4% as crude slid 16%. For the most part, defensive and cyclical sectors sold off in tandem. Elsewhere, Treasuries were bid higher. The 2-year, 3-year, and 5-year now all yield less than 1%. The 1.15% yield on the 10-year is at an all-time low, as is the 1.68% 30-year yield.

In the most recent *Notes*, we discussed how most viruses had a fairly minimal impact on markets. SARs, Ebola, and Swine Flu all caused 5-10% drops and the Spanish Flu in 1918 caused a 10% dip. This past week proved to buck the trend as markets fell more than 10%. The coronavirus is having an outsized impact relative to other virus outbreaks. The past 10-days have been the worst 10-days for the S&P 500 since 2011 and RSI (which is a momentum measure) is currently printing at the lowest level in over 30 years. Again, the drop last week was the worst since October 2008. At that time the market was digesting the very real possibility of a collapse in our financial system. Three months ago, the coronavirus was on no one's radar. However, what has been evident for the past 6 months or so is the fact that valuations were becoming increasingly stretched. When things are expensive, markets can get very jittery and anything can cause that first domino to fall from these elevated levels. A slowdown in China caused a 13% drop in 2015, followed by a slide in Crude that caused markets to drop 15% by early 2016. A burst of volatility and Federal Reserve missteps caused a near 20% drop in 2018. While the cause was different each time, the result was always the same. When stocks are expensive any sort of scare can easily shake the market.

Throughout the first two months of the year, we were undoubtedly net sellers. Our model was flashing plenty of sell signals, which we were fortunately able to take advantage of. That discipline paid off last week as we were able to initiate new positions in Disney and BlackRock — while adding to our positions in Check Point Software, C.H. Robinson, Henry Schein, Johnson & Johnson, PayPal, and Walgreens. Last week was easily the most buying we have done since Q4 of 2018.

The S&P 500 has an average forward P/E ratio of 15.7x over the last 20 years. Earlier this year, the S&P 500 was trading at 19.1x forward earnings. The index is now trading at 16.6x forward earnings. In other words, a further 5.7% drop would take the S&P 500 to its average valuation over the last twenty years (a period that incudes two bear markets and bull markets). However, a major caveat is worth noting — for these numbers to be accurate, it means that forward estimates cannot come down. But, it seems almost certain that earnings will come down if this virus is in fact impactful. According to FactSet, 2019 earnings are currently estimated to be $162, while 2020's current estimates are for $175. Goldman Sachs made a splash last week as they suggested that earnings growth would be 0% in 2020 due to the coronavirus. If Goldman is right, then earnings would hold steady at $162 for another year, which would make the forward P/E 18.2x. A drop back to average, not even undervalued, would imply a further drop of 13.7% percent in the S&P 500.

For those unaware, I was fortunate enough to marry Elaine Natoli last Saturday. This past week, we were sitting on the beach in Jamaica for much of the sell off. The team here at Tandem performed admirably. As I was enjoying the sunshine though, I was thinking about the market sell off and Tandem's underlying philosophy. By using a quantitative approach we are able to avoid emotional decision making. We are able to remain calm and follow our model in the midst of a market meltdown. It keeps our results consistent and repeatable. The last sell off like this was just prior to Christmas Eve in 2018. In the week leading up to Christmas, the S&P 500 dropped 10% and we were getting accounts invested in roughly 1 month — 4.5x faster than average. This past week, we were once more getting accounts invested at a rate that was more than 4.5x faster as well. Consistency matters. Consistency keeps investors invested. In the January *TANDEM Report* we discussed the average retail investor's experience. Too often retail clients sell when they ought not to sell. The fear investors feel can lead to permanent losses. What's more, they can miss the ever important bounce if they remain on the sidelines. So, it is worth stressing one more time that we are not the market. We do not behave like the market. We do not look like the market.

*Transition Update***

Last week we purchased 39 of our 47 core holdings. Rather than listing everything we bought on the transition level last week, it will be much easier to discuss what we didn't buy. We did not purchase any Fiserv, Dollar General, eBay, UMB Financial, ExlService, Yum! Brands, Ross Stores or Brown & Brown. FISV, ROST, UMBF, and YUM, are all more or less fully transitioned into. In the case of DG and EXLS, neither sold off nearly as much as the broader market.

***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.*

Upgrades/Downgrades & Dividends

ABBV — Initiated equal weight at Barclays with a price target of $97 (2/27).

ACN — Resumed overweight at Morgan Stanley with a price target of $240 (2/26).

DG — Upgraded to buy from hold at Jefferies, price target increased to $190 from $169 (2/27).

EXLS — Upgraded to neutral from sell at Citi, price target of $75 (2/28).

RSG — Upgraded to outperform at Oppenheimer with a price target of $109 (2/28).

TJX — Upgraded to buy from hold at Gordon Haskett, price target increased to $77 from $66 (2/27).

WCN — Upgraded to outperform at Oppenheimer with a price target of $107 (2/28).

Portfolio News & Notes

A lot of the portfolio news was covered in the previous section. Billy will also touch base on the buys more in his monthly *Observations*. However, just to reiterate how busy we were last week putting cash to work: we purchased BLK, CHKP, CHRW, DIS, HSIC (twice), JNJ, PYPL, and WBA (twice) in Equity; BLK, CHRW, DIS, JNJ, and WBA (twice) in Large Cap; CHRW, CHKP, and HSIC in Mid Cap. The sudden selloff created some opportunities for us.

In other news, TJX reported earnings on Wednesday and popped 7%. However, the market's tumble on Thursday and Friday caught TJX in its crosshairs and the stock ended the week down a little more than 5%. Management noted on the call that they have not seen any impact from the coronavirus yet, but they did not speculate on how they might be affected moving forward. On the other end of the spectrum, PayPal updated their Q1 revenue outlook as they said that international cross-border e-commerce has slowed due to the coronavirus by roughly 1%. Similarly, Microsoft guided lower on their Personal Computing segment's revenue due to supply chain disruptions.

It will be worth monitoring in other pre-announcements in the coming weeks surrounding the virus and its potential impact.

	WTD	MTD	QTD	YTD
Dow Jones	-12.36%	-10.07%	-10.96%	-10.96%
S&P 500	-11.49%	-8.41%	-8.56%	-8.56%
Nasdaq	-10.54%	-6.38%	-4.52%	-4.52%
Russell Mid Cap	-11.95%	-8.81%	-9.60%	-9.60%
Russell 2000	-12.04%	-8.53%	-11.51%	-11.51%
Comm. Svcs	-9.45%	-6.34%	-5.72%	-5.72%
Con Disc	-11.18%	-7.69%	-7.15%	-7.15%
Con Staples	-10.44%	-8.18%	-8.00%	-8.00%
Energy	-15.37%	-15.27%	-24.74%	-24.74%
Financials	-13.54%	-11.34%	-13.82%	-13.82%
Health Care	-10.62%	-6.79%	-9.47%	-9.47%
Industrials	-12.17%	-9.61%	-10.07%	-10.07%
Info Tech	-11.13%	-7.45%	-3.84%	-3.84%
Materials	-12.73%	-8.65%	-14.30%	-14.30%
Utilities	-11.76%	-10.35%	-4.42%	-4.42%
REITs	-12.37%	-6.50%	-5.17%	-5.17%

Earnings Calendar

Date	Time	Ticker
3/3	Post-Market	ROST
3/4	Pre-Market	DLTR
3/4	Pre-Market	BF.B
3/5	Post-Market	COST