March 27, 2023 - Tandem Investment Advisors, Inc.

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MARKET MOVERS & SHAKERS

Though volatility has remained quite elevated, equity markets have moved higher over the last two weeks. This welcomed positive performance came despite very little easing in terms of headwinds coupled with an especially volatile Treasury market. In fact, in the last week alone, the 2-year U.S. Treasury traded as high as 4.26% on Wednesday and as low as 3.44% by Friday's lows. Since the March 9th failure of SVB, the policy-sensitive 2-year Treasury has traded in a 163-basis point range. In terms of just total move and distance covered in its recent swings, the 2-year has been its most volatile in at least 30 years. Really, the only period close in terms of volatility was the post-Lehman world in late September and early October of 2008. Similarly, the ICE BofAML MOVE index, which acts as a volatility gauge for treasuries (similar to the VIX for equities) is at levels last seen during the periods of peak fear and uncertainty during the Financial Crisis. However, if one could just tune out all of that noise, they would find an equity market that is surprisingly and modestly higher. Both the Nasdaq and the S&P 500 have posted back-to-back weekly gains. The dramatic decline in yields has actually served as a tailwind for growth – which has outperformed value for the past 5 weeks now, according to FactSet. Elsewhere, Crude, which has fallen precipitously from its summer highs of $120+/barrel got a nice little reprieve last week – leading to some weekly outperformance in the energy space relative to the broader market. The dollar continued with its recent weakness, while gold has continued to catch a bid higher.

The gain in the major equity indices has been a welcome sight – though perhaps a little bit of a head scratcher. Few of the cracks that have been cause for concern have been shored up. If anything, some more concerning cracks have begun to pop up. First, following the 25-bps hike last week out of the Federal Reserve, it became clear that the market and the Fed were clearly in disconnect. The Fed's own updated Summary of Economic Projections showed a median fed funds rate of 5.1% by the end of 2023. Meanwhile, as of Friday morning, the market was already pricing in 100 bps of cuts by yearend. Clearly, there is a difference of opinion between Mr. Market and the FOMC. Second, messaging around deposit guarantees has been very mixed. Without a deposit guarantee, the lack of confidence in banks for depositors could resume. Though banks have remained relatively calm since the SVB and Signature Bank debacle, little has changed since then. The issues that caused runs on those banks, by and large remains present for many regional banks still. It's a fickle thing, given that this is more of a psychological crisis, rather than a credit crisis like 2008, it could be done, or it could resume at any time for any bank. Janet Yellen sent market's lower during Jerome Powell's Wednesday press conference as she testified on Capitol Hill that she was not considering a way to guarantee deposits. Third, the commercial real estate market is beginning to create some more worries, especially for banks and insurers. Commercial real estate vacancies in the post-COVID world, mixed with higher interest rates, has caused the value of some commercial properties to drop swiftly. According to the FT and JPMorgan, small and mid-sized banks account for 70% of commercial real estate loans. The Financial Times went on to report that the valuation crush that is being felt in CRE has led to a much tougher lending environment coming out of banks – which could potentially slow down further development. Some fear has begun spreading out of the banking system and into insurers as a handful of insurers have seen their credit default swaps rising (a bearish signal for an entity) while their stock price has largely remained under pressure.

The good news is that despite all these cracks, stocks have remained resilient by and large. Yes, there are pockets of weakness, regional banks, commercial REITs, and some insurers to name a few, but the broader market remains tough. The VIX, which can indicate fear becoming pervasive, has remained somewhat subdued. In fact, the VIX is actually well below its year-to-date highs and far below what felt normal for most of 2022. The Fed appears set to pause, which has historically led to a strong period for equities – though rate cuts might cause stocks to behave a little more frenetically. JPMorgan also recently noted that despite the macro uncertainties, consumer spending remains largely unchanged. On the inflation, there is also hope that some of these rising credit standards, some of the tightness we are seeing in banks, and some of the macro uncertainties will lead to tighter financial conditions – which can help choke off inflation. Now, too much of those things could push us into a recession, which seems like an increasingly likely scenario. However, a recession need not be the Financial Crisis.

TRANSITION UPDATES & NEWS **

Volatility remains the name of the game. The recent volatility provided Tandem with the opportunity to transition and rebalance portfolios at an accelerated rate than a more normal market environment. As the market lost its footing in the premarket last Friday, Tandem took the opportunity to purchase ten names on the transition level. Names like Johnson and Johnson, Lab Core, and Abbott were bought in the early hours of the trading session as the overall health care sector gained momentum to the upside to close out the week +1.49%, according to FactSet.

In terms of news, Accenture reported on March 20th and noted a 100-basis point increase in their operating margin, outperforming estimates by 100 bps. Reported EPS was $2.69, above the Street's estimates of $2.49. For Fiscal Year 2023, the company now expects revenue growth to range between 8 – 10%, compared to previous guidance of 8 – 11%.

Microsoft noted it is preparing to launch a new app store for games on smartphones as soon as 2024. Microsoft acquired Activision Blizzard at the start of 2022 with hopes of bridging its gap within the gaming industry. Dollar General reported Earnings on March 16th. For the most part, results were in line with analysts' estimates. Revenue for the quarter came in at $10.2 Billion, in line with estimates. DG reiterated its plans to execute 3,170 real estate projects in FY23, including 1,050 new store openings, 2,000 remodels, and 120 store relocations. AbbVie has continued to make headlines with clinical trials receiving FDA approval and continued success in their tiered phases of studies.

Fear mongering and emotions have been pivotal players considering the recent Banking crisis. Jack Henry, a payment processor for financial institutions like smaller or mid-sized banks and credit unions, released a statement considering recent events. Management noted that fear in the banking system had affected the recent performance of its stock. Management sought to remind its investors that they are here to serve Main Street America, not the Venture Capitalists of Silicon Valley. Management reiterated its confidence in their core business while stating that their pipeline remains strong with a lot of interest in JKHY's technology.

In the wake of the confidence crisis surrounding Credit Suisse, a spokesperson for BlackRock stated that BLK is not participating in any plans to acquire all or any part of Credit Suisse and has no interest in doing so. This came after the Financial Times cited sources that BLK has drawn up a rival bid for Credit Suisse that would trump a plan of UBS's forced marriage.

– 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.*

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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.

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