May 14, 2023 - Tandem Investment Advisors, Inc.

May 16, 2023

MARKET MOVERS & SHAKERS

Since our last Notes from the Trading Desk, the market has essentially gone nowhere. The S&P 500 has been range bound and flat, the Nasdaq has risen slightly, while the small cap focused Russell 2000 has dropped a smidge. Yields have not moved much – the 10-year is down 10 bps since our mid-April update, while the 2-year has fallen 20 bps. Even the VIX, the market's so-called fear gauge, hasn't really gone anywhere over the past four weeks. Gold is more or less flat. Crude stands out a bit, as the commodity has been a little more volatile – WTI is down more than 10% since mid-April. Outside of Crude it's been a rather boring market. The lack of volatility is surprising given the market backdrop. Since mid-April, the debt ceiling has remained unsolved, the Fed continued to hike, and the second largest bank failure on record took place – marking the fourth failure of a large bank this year alone.

The word resilient seems to be popping up over and over again when describing the current macro environment. The economy is resilient. The labor market is resilient. The stock market is resilient. Is it though? In Billy Little's May Observations, he discussed the poor market breadth and the S&P 500's narrow market leadership. And he's right, leadership has become incredibly narrow. Philip Grant of Grant's Interest Rate Observer recently noted that the market cap of the NYSE FANG+ Index, which includes large cap growth names like Meta, Apple, Amazon, Microsoft, Alphabet, Tesla, and Nvidia, has increased by $8 trillion this year – nearly matching the gain of the entire S&P 500. In other words, exclude a few of these highflyers and the S&P would be somewhere closer to flat for the year. At first glance, it looks like the market may be once again considering large cap growth to be a safe haven – much like it was in March of 2020. However, upon further review, it looks more akin to speculation related to the recent AI phenomenon that has been a hallmark of rallies over the past few years. Previously, it was anything related to bitcoin, blockchain, or crypto that was catching a bid. Now, AI is clearly the topic du jour. Statista and Philip Grant recently noted that Alphabet, Meta, Microsoft, Amazon, and Apple mentioned "AI" 190 times on their recent conference calls. AI will no doubt be world changing technology. Investors are chasing AI anywhere and everywhere though – and dumping anything that seems to be disrupted by AI. Chegg, an online learning platform that has textbook rentals and offers homework help, dropped nearly 50% in one day after a recent earnings call in which they noted that ChatGPT was luring students away from their platform.

While investors have been zeroed in on Tech and AI, discussions around the U.S. debt ceiling are beginning to pick up in earnest. The political game of chicken has continued of late, though some reports of progress sprung up over the weekend following Treasury Secretary Janet Yellen's statement that some agreements are beginning to be made. Republicans are shooting for a debt ceiling over the next 10 years, while Democrats are shooting for two. However, if they are unable to reach an agreement, the two parties could always kick the can down the road with a short-term extension that could push the deadline into the late summer or fall. An outright default would have the potential to be devastating. It also seems very unlikely. It's not a 0% chance, but it is something that would be extremely improbable. To date, the markets have been relatively calm in the face of the debt ceiling. Investors are demanding a slight premium on Treasuries that mature in early June – pricing in the potential hiccups that could come without a debt ceiling raise. The VIX has not been pricing in fear that would surround a default either. The impact of a true default by the U.S. government would wreak havoc on markets – both domestically and globally. Should talks deteriorate from here, it will become very apparent in financial markets very quickly. For now, the game of chicken continues.

– Ben Carew, CFA

TRANSITION UPDATES & NEWS **

The latest earnings season provided Tandem with the opportunity to act across all three of our strategies. We have been transitioning new accounts and new monies with a stable tempo.

On the earnings front, Jack Henry, a payment processor for financial institutions on the smaller side of the spectrum, was mixed on earnings. JKHY reported revenue growth of 6% during the quarter. Their support and service revenue fell short while their processing revenue exceeded expectations. Management delivered fully diluted EPS of $1.12. Management noted that revenue remains in their pipeline and their recent acquisition of Payrailz is still gaining footing. Over the last month, we have been consistently transitioning into JKHY. Becton Dickinson & Co. mostly beat estimates for their Q2 earnings. BDX operates in 3 segments: Medical, Life Sciences, and Interventional. Medical and Interventional revenues largely beat while Life Sciences was in line. Surgery revenue was up 12% year-over-year. Steris reported very strong earnings last Thursday. The Company reported revenue of $1.38 billion for Q4. This overwhelmed analyst estimates by 8.6%. EPS for the quarter totaled $2.30 compared to estimates of $2.15. Management guided revenue growth of 7-8% year-over-year versus FactSet's estimates of 6.2%.

In AI news, Microsoft's Azure plans to sell a version of ChatGPT that will operate on servers separate from their main system. One source said the private version could cost as much as 10 times what users are currently paying, according to FactSet.

Akamai and Qualys, two more tech names, were purchased at the strategy level in our Equity Strategy. Akamai reported strong Q1 numbers, with both revenue and earnings beating on the top line. Qualys reaffirmed their revenue guidance of +13-14% for fiscal year 2023. We also added to our positions in Hormel and Jack Henry across all three strategies.

– 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.