May 2, 2022 - Tandem Investment Advisors, Inc.

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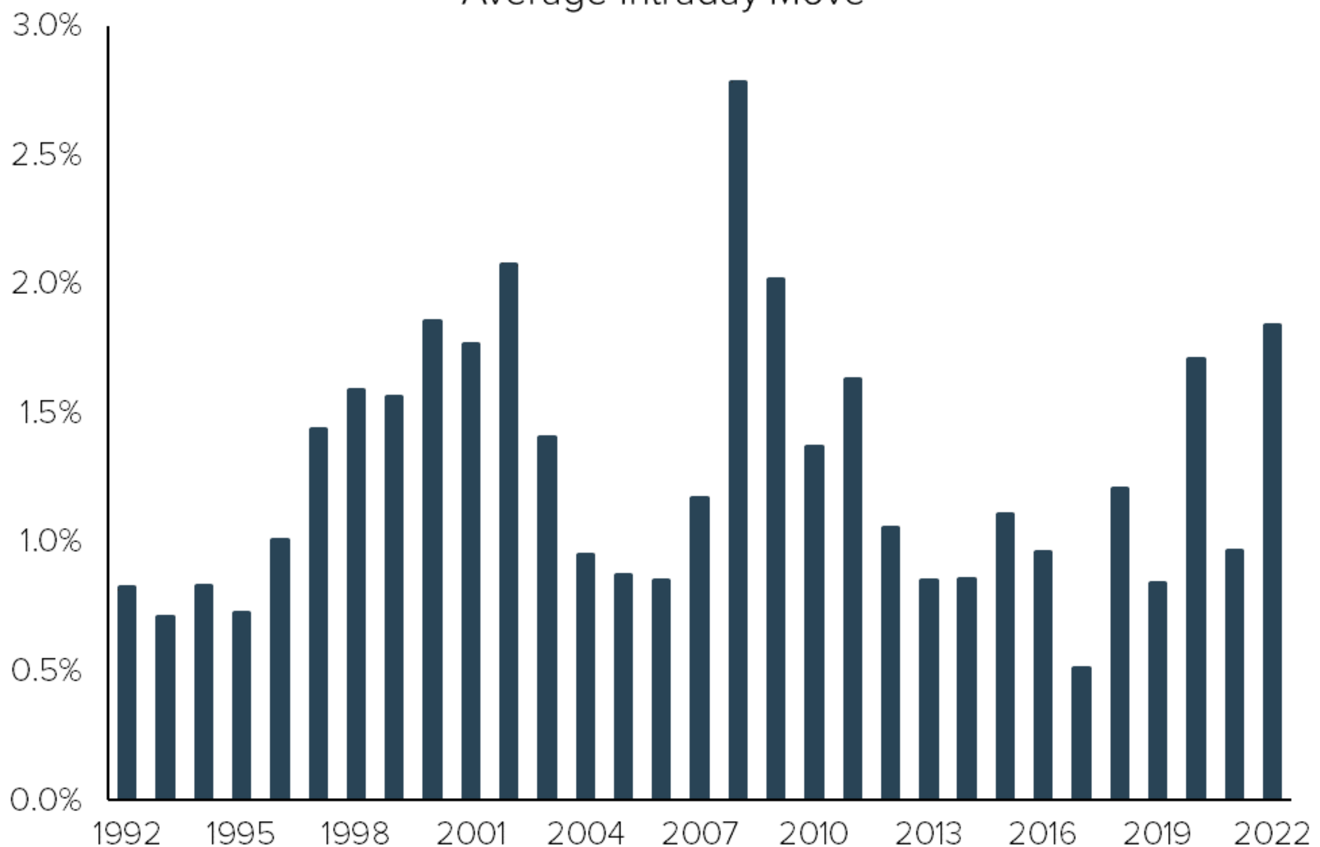
MARKET MOVERS & SHAKERS

It has been a little over a month since *Notes* was last published and what a month it was. The Nasdaq's 13.3% decline was its worst since the depths of the financial crisis in October 2008. The Tech heavy index closed the month down nearly 24% from the all-time high set in late November. The S&P 500 dropped 8.8% in April. It ended the month having closed in the red four straight weeks. For the month, the Russell Mid Cap and Russell 2000 fell 7.8% and 10%, respectively. The Dow held up a bit better than its counterparts, as it just dropped 4.9%. The pain continued to extend beyond equities and bled into the bond market as yields surged throughout the month. The 10-year U.S. Treasury finished April close to 2.93% after having ended March around 2.32%. The 30-year fixed rate mortgage ended the month at its highest level since April 2010. Gold fell nearly 8%, while Bitcoin dropped 15%. In the economy, inflationary pressures remain ever present as evidenced by April's Producer Price Index, which leapt more than 11% year over year. The Consumer Price Index, which some argue severely understates inflation coming in the form of rising rent and housing prices, jumped its most since 1981. Real GDP was negative for the first time since the onset of COVID. Meanwhile, with earnings season well underway, many companies have been crystal clear that macro headwinds are challenging – whether they be geopolitical issues out of China and Russia, supply chain disruptions, inflationary pressures driving up their cost of goods, or shortages in labor or rising labor costs – and all are impacting their bottom line. After such a month of negative headwinds, where are the green shoots? Are there any?

Thankfully, it's not all negative news. Investor sentiment has gone from tepid to outright fearful. Bank of America's *Flow Show* report recently pointed out that equities experienced their largest three-week outflow since March 2020. CNN's Fear and Greed Index is somewhere between "Extreme Fear" and "Fear". Bearish sentiment, according to AAII, has only been more prevalent than today in October 2008 and March 2009 – the S&P 500 bottomed in March 2009. It was nearly this high in February 2003 (market bottomed in March 2003), July 2010 (coincided with a market bottom), February 2016 (market bottomed in February 2016), December 2018 (market bottomed Christmas Eve in 2018), and March 2020 (coinciding with the COVID bottom). Warren Buffett once said, "Be fearful when others are greedy and be greedy when others are fearful." Fearfulness is currently omnipresent across

nearly all asset classes. The economic and macro backdrop leaves a lot to be desired for all the reasons discussed in the first paragraph – yet investors seem to know that and they all, as indicated by sentiment readings, seem to be fearful.

Looking forward, the Federal Reserve will hold global investors' attention when they meet May 4th. The market is currently pricing in a 97% chance of a 50 bps hike this week followed by an 89% chance of 75 bps in June. All in all, the market is currently pricing in 10 rate hikes by the Federal Reserve by the end of the year. If, and it certainly is a big if, the Fed does in fact hike that many times by December, it will be their most aggressive hiking cycle in one calendar year since the mid-80s. The probabilities around rate hikes are fairly easy to discuss because the probabilities are so readily available. But what will likely be more important to the market is the rate at which the Fed allows its balance sheet to run off. The Fed grew its balance sheet to unprecedented levels in the post-COVID world. This inevitably assisted in both the economic recovery, and perhaps even more so, the market recovery. The CFA Institute and the *Financial Analysts Journal* recently published an article titled "Free Markets to Fed markets: How Modern Monetary Policy Impacts Equity Markets". In the article, the author observed that a "10% expansion of the Fed's balance sheet is estimated to result in a positive 9.1% impact on cumulative stock market returns over the following five to ten weeks… following the Fed's intervention." The author highlights this as support of the old adage, "Don't fight the Fed." Except, now the Fed is not growing their balance sheet. They are talking instead of shrinking their balance sheet. The same adage should apply to the current environment. The Fed is removing accommodation. If the most recent example of this is any indicator (see 2018), volatility is likely here to stay. It's important to note that volatility does not mean a market crash. Volatility does mean more violent market swings **in both directions**. Last week, the market was up 2.5% on Thursday and then fell 3.6% on Friday. That has been a staple of this year's market and it is noticeably different from recent years – outside of the COVID lows. As seen in the chart below, the intraday move from low to high is at its broadest range since 2009 – no wonder this feels different. In the post Financial Crisis world, volatility was subdued, abnormally so. This is a little more normal now.



TRANSITION UPDATES & NEWS **

The continued volatility has allowed for more opportunity to transition into Tandem name's more quickly throughout new accounts and newly deposited money. The heightened volatility, coinciding with earnings season, served to only create even more opportunities. Speaking of earnings season, we are now roughly halfway through. 55% of the S&P 500 has reported and growth has been marginally higher than expected. Last quarter, the highest percentage of companies in over a decade were discussing "inflation" and the "supply chain" issues as being pervasive and disruptive. Little seems to have changed as we surpassed the halfway point of this earnings season. Earnings should continue to be busy for the next two weeks, with a lot of retail stocks on deck. It will be worth monitoring these upcoming reports to gauge the consumer's appetite in this macro-challenged environment.

***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 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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