November 13, 2023 - Tandem Investment Advisors, Inc.

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Market Movers & Shakers

Since the last edition of *Notes from the Trading Desk*, the S&P 500 has showcased a remarkable display of resilience, recording a gain in nine out of the last ten trading sessions and achieving an impressive 7.2% increase over the past two weeks. The winning streak comes as the S&P 500 recaptured the 4,400 level and is back trading above its 50- and 200-day moving averages. The recent performance stands out as the most robust stretch of gains for the index for all of 2023, signaling renewed optimism in the market. However, not all pockets of the market have participated to the same extent as of late. In stark contrast, small-cap stocks (as represented by the Russell 2000) logged their 12th weekly decline in the past 15 weeks, highlighting the continued divergence in performance between large-cap and small-cap stocks that has persisted throughout the year. Crude oil logged its third consecutive weekly decline, with WTI settling below $80/barrel putting pressure on the Energy sector. Volatility, as measured by the VIX, has plummeted from its October highs. The VIX slid for eight consecutive sessions from a 21 handle down to just above 14. A decline of this nature in such a short period of time indicates a notable shift in sentiment.

The rapid resurgence in the S&P 500 can be attributed to a confluence of factors. The largest factor influencing stock prices undoubtedly continues to be the direction and level of U.S. Treasury yields. The unabated move higher in Treasury yields that we touched on last month seemingly ran aground after October's weaker-than-expected jobs report and an uptick in unemployment. Nonfarm payrolls increased by 150,000 for the month of October, which fell short of consensus forecasts for a rise of 170,000. The unemployment rate rose to 3.9%, the highest level since January 2022 – though it is worth noting that the UAW (United Auto Workers) strikes were primarily responsible for the gap as negotiation gridlock resulted in a net loss of jobs for the manufacturing industry. After breaching 5% for several trading days in October, the 10-year U.S. Treasury yield retreated by nearly 50 basis points following the Bureau of Labor Statistics' report. The rally in long-term U.S. Treasuries provided support for bullish sentiment and helped to ease financial conditions. For example, the average rate on a 30-year fixed mortgage, which tends to be closely linked to Treasury yields, decreased by 25 basis points last week. This marks the largest weekly decline in mortgage rates in nearly 16 months. Another factor influencing the direction of equity markets is expectations of future policy easing from the Federal Reserve. The FOMC's decision to leave interest rates unchanged at its November meeting has been met with consensus that the Federal Reserve is done raising rates for the cycle. Fed Funds Futures are now pricing in rate cuts to arrive by mid-2024. Recent hawkish-leaning comments from Fed Chair Powell, emphasizing the Fed's cautious stance on policy, have contributed to prevailing uncertainty as the majority of FOMC participants believe the full impact of previous rate hikes has yet to hit. Fed officials continue to signal a "higher-for-longer" interest rate environment which stands in direct contrast to what the market is signaling.

With the S&P 500 sitting on a 15% gain for 2023 and the Nasdaq Composite up 32%, equity market bulls continue to point to factors such as sustained disinflation momentum, the notion of "Peak Fed", better than anticipated corporate earnings, contrarian signals from positioning and sentiment indicators, and positive seasonality to maintain an optimistic outlook in the face of evolving economic and geopolitical conditions.

– Jordan Watson, CFA

Updates & News*

Earnings season has come and gone. A handful of Tandem's names have reported since our last update. Earnings season historically has provided Tandem with more opportunity to transition new accounts and monies into holdings. This season was no different. Tandem has been active on the transition level, taking advantage of the frenzy that often surrounds earnings announcements.

Republic Services, Inc., a waste collection company, beat on their Q3 revenues and adjusted EBITDA. Their organic revenue growth was up 4.6%. Total revenue growth was up 6% and adjusted EBITDA grew by 9%. They guided fiscal year 2023 higher and surpassed analysts' expectations. Management expects mid-to-high single digit revenue growth for 2024. The company also announced a $3 billion share repurchase program that will commence in 2024.

Church & Dwight Co., Inc., which produces household and personal care products, provided investors with an update on Q4 guidance. According to management, **Church & Dwight's** specialty products segment is expected to be a drag in Q4, with the possibility of continuing into Q1 2024. Management noted their net sales increased by roughly 10.5% in Q3. Their gross margin expanded by 270 basis points, due to improved pricing, volume, productivity, and the HERO acquisition. HERO specializes in the treatment of acne and is most popular for its patch solutions. This acquisition had a price tag of $630 million. Q3 EPS was down ~6.6% compared to last year. The decrease was the result of higher marketing investments and incentive compensation. Full year adjusted operating profit is expected to increase by 8%. Full-year sales growth is expected to be 9%, with 5% organic growth.

Stryker Corporation, a medical devices and equipment manufacturer, projected full year 2023 growth at 10–10.5%. Management cited currency translation as a headwind but does not expect the problem to amplify in the near future. **Stryker** beat earnings expectations by a smidge. Their Q3 2023 EPS increased 16% YoY. Management noted double-digit growth in MedSurg and Neurotechnology, with single-digit growth in Orthopedics and Spine. Organic sales growth of 9.2% was posted for the quarter, primarily due to power tools, Steri-Shield, waste management, and smoke evacuation.

Intercontinental Exchange, Inc., an exchange operator and provider of financial data, saw record EPS for Q3 2023. Its Q3 $1.46 EPS was an increase of 11% from last year. This beat estimates by ~5%. Q3 net revenues hit a record $2 billion, which was a 4% increase from last year. This growth was due to double-digit performance in their Exchanges segment, with 22% growth on their futures platform. Operating expenses came in on the low end of their range because of less spending on technology and reduced cloud exposure. In the last two months, **Intercontinental** has fully integrated their acquisition of Black Knight. Black Knight provides mortgage software, data, and analytics. The acquisition was completed for $11.9 billion. Management plans to intertwine Black Knight's technologies with their existing mortgage platform for seamless integration of their customer base and giving its interface a revamp.

Touching on the **J.M. Smucker Company's** acquisition of Hostess Brands, management has updated their strategic business segments. **Smucker's** spheres of influence will be coffee, frozen handhelds (uncrustables!) and spreads, pet, and sweet baked snacks. This new outlay is meant to redefine and retarget growth.

Becton, Dickinson and Company reported underlying strength, which was shown in their FY 2024 guide. Management is expecting 6% organic growth for 2024. Their pharmaceutical systems (including pharmaceutical automation), bioscience research, peripheral vascular disease, and molecular diagnostics are paving the way for growth opportunities. Management was intent on emphasizing their mission to generate free cash flow. FY 2024 should reflect double-digit FCF growth, even in the wake of FX headwinds. **Becton, Dickinson** is a medical company that provides innovative solutions to medical researchers and physicians.

On the composite front, we added to our stake in **Terreno Reality Corporation** in mid-October. **Terreno** resides in Large Cap Core and Mid Cap Core. The company operates as an industrial REIT in America's major port cities.

– Annie Klopstock

**The transition level activity taken by Tandem is applicable to new accounts and new money, not the composite or firm-wide level. 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. Strategy level activity is applicable to the composite and action is taken at the firm-wide level.*

- Jordan Watson, CFA
  Jordan Watson is an Associate Portfolio Manager for Tandem Investment Advisors, Inc. Mr. Watson joined Tandem in 2019. His duties include conducting quantitative and fundamental research, as well as portfolio management. In addition, Mr. Watson assists in overseeing Tandem's internship program. Mr. Watson is a regular member of the CFA Institute and the CFA Society South Carolina. Mr. Watson is a graduate of the College of Charleston's School of Business, earning a Bachelor of Science in Finance with a minor in Real Estate.

- Annie Klopstock
  Annie Klopstock is an Investment Management Associate for Tandem Investment Advisors, Inc. Ms. Klopstock joined Tandem in 2021. Her duties include conducting quantitative and fundamental research. Before joining Tandem, Ms. Klopstock completed an internship for Stanford Health and consulted for UCSF Department of Abdominal Transplantation. Her work focused on analyzing cost structures. Ms. Klopstock earned a Bachelor of Arts in Quantitative Analysis Economics with a minor in Statistics from San Diego State University.