Notes from the Trading Desk

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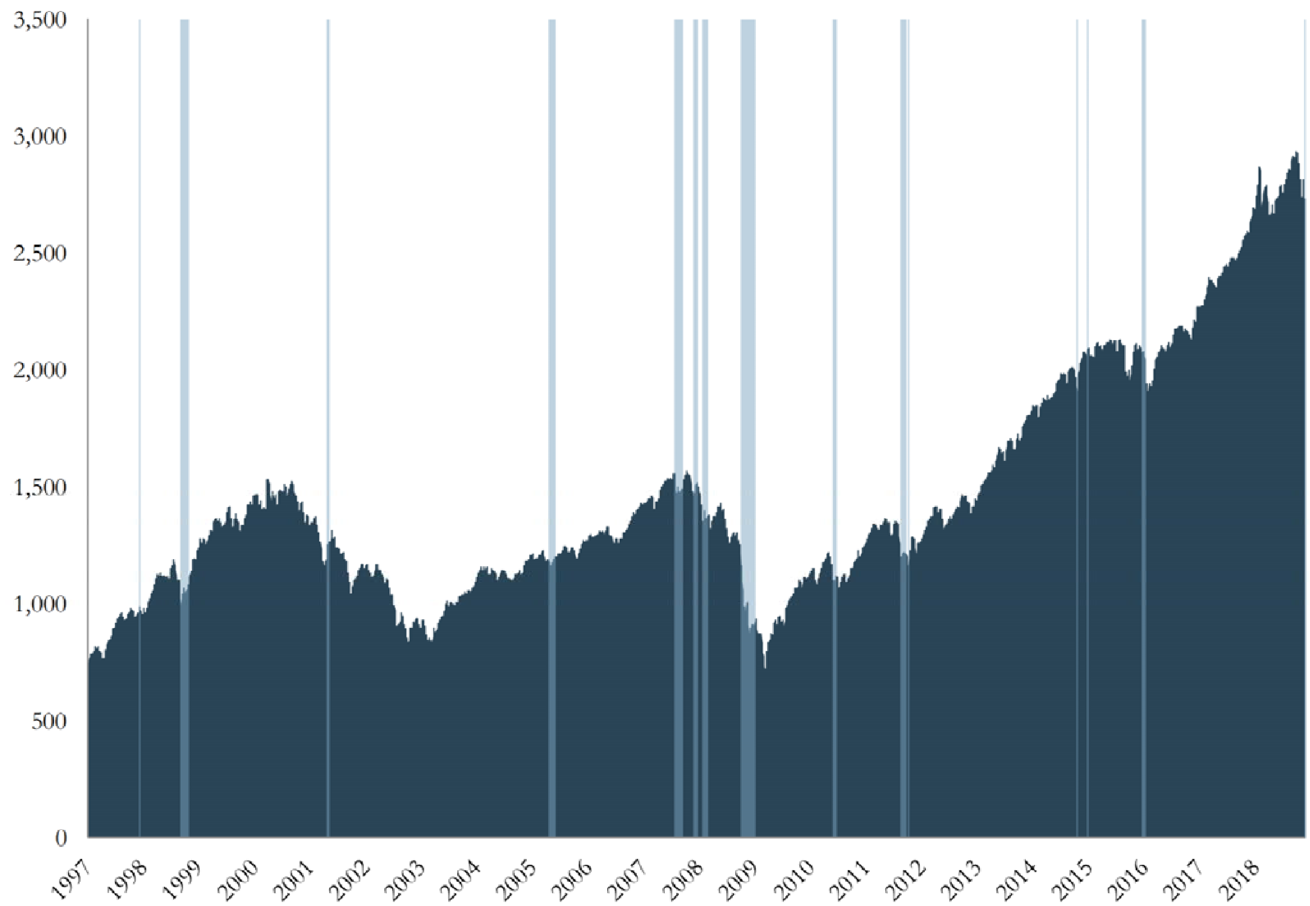
US equities finished lower last week as the Dow and Nasdaq were both down more than 2%. The S&P 500 and the Russell 2000 fared slightly better, though they were both still down 1.61% and 1.42%, respectively. For the second week in a row, there was a defensive tone in the marketplace. REITs and Utilities were two of the best performing sectors, while Healthcare outperformed the major indices as well. The Consumer Discretionary sector was the largest laggard, closing down 3.78%. Discretionary stocks have been dragged lower, thanks in large part to Amazon. The internet retailer, which makes up nearly 1/3 of the Consumer Discretionary sector, is down more than 22% since its September all-time high. Elsewhere in the market, Crude continued to slide for the 6th straight week, as it was down 5.6%.

February's quick 10% pullback affected little outside of the equity market. Gold barely flinched, as the traditional safe haven asset experienced a marginal decline. Crude fell slightly more than 10% as well, and Treasuries even sold off ever so slightly. By and large the volatility-implosion that sparked the February selloff was limited to the equity space. However, the most recent selloff appears to be exposing potential cracks in the market. Credit spreads have widened significantly in the past month. The BofAML US High Yield CCC or Below Option-Adjusted Spread has widened 206 bps since October 3rd. The spread has widened more than 27% in the last 30 trading sessions. This sharp spike in junk spreads is the largest percentage increase since the Fall of 2015. In the chart below, one can see that the spike in credit spreads (marked by the light blue columns) have typically corresponded with market declines. The 1998 Russian Ruble Crisis marked a quick blow out in spreads, as did the Spring of 2001 — roughly one year into the bursting of the tech bubble. Spreads widened dramatically multiple times throughout the Financial Crisis. More recently, spreads widened during the flash crash in 2010, the U.S. Federal Government debt downgrade in August of 2011, and following the wild slide in Crude Oil in 2016. For the most part, these quick and dramatic widenings of credit spreads have occurred during notable moments in recent market history. Only a few episodes are less significant in the grander scheme of things. Surely this most

S&P 500 and Junk Bond Credit Spread Widenings

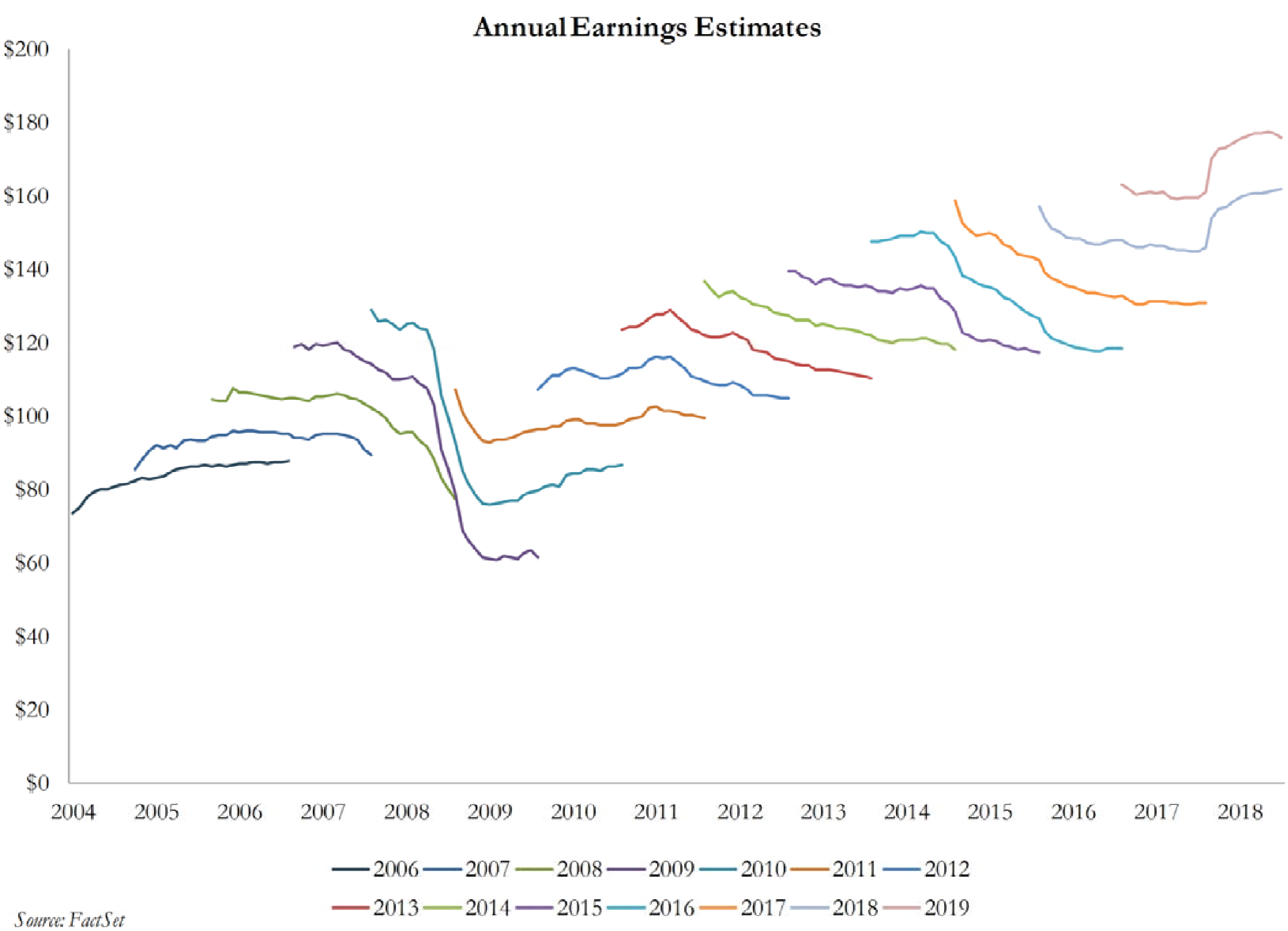


recent selloff could be one of the “less notable” episodes. However, a rapid rise in credit spreads is clearly atypical, and a trend worth noting. Spreads are still much tighter than they were even two years ago. But, it is the rate of change and the speed of the change that can shock markets.

With earnings season largely behind us, it is time to turn our attention to 2019. According to FactSet, Analyst estimates for the S&P 500 2019 EPS are hovering right around $176 — which means the market is trading at a forward multiple of 15.5x — a reasonably valued P/E, though still slightly above the 15 year average. However, per the chart below, the typical yearly trend shows estimates decreasing — with the recent jump in 2018 and 2019 earnings being attributable to the tax cut. In fact, the average yearly decline in estimates, from peak estimate to final estimate, is 17.9%. If current estimates were to come down 17.9%, the S&P 500 would be trading at a forward multiple of 18.4x — which would be near the cycle high in P/E multiples that we witnessed back in January.

Last week we saw a lot of chatter surrounding a potential slowdown in 2019. Apple suppliers Lumentum and Qorvo both negatively pre-announced earnings and were punished dearly for doing so. However, despite the negative pre-announcement surrounding Apple’s supply chain, Apple’s earnings estimates barely budged, falling 5 cents last week to $13.41 for FY19. Nvidia fell 18.76% on Friday alone following weak forward guidance. Even retail is starting to feel some pain. Nordstrom was down more than 22% last week following their multimillion dollar charge stemming from delinquent credit-card debt. Companies in many different sectors seem to be pointing towards a slowdown in 2019. However, analyst estimates have yet to come down.

It’s not just companies pointing towards a slowdown in 2019 economic activity. t’s evident in other metrics as well. Copper, though off its August lows, is still down 15% from its June highs. The Baltic Dry Index — another good gauge for global economic activity — is down 41.85% since early August. Europe appears to be on the brink of a recession, as Germany reported negative GDP growth for the first time since 2015. All eyes should be on the G-20 meeting at the end of the month. If a deal with China is not reached, we are looking at 25% tariffs going into effect. This would certainly further exacerbate the global slowdown.



Upgrades/Downgrades & Dividends

BF.B — Increased their dividend, payable January 2nd, by 5.1% to $0.166 from $0.158 (11/15).

FISV — Initiated overweight with a price target of $95 at Barclays (11/15).

NKE — Increased their dividend, payable January 2nd, by 10% to $0.22 from $0.20 (11/15).

PYPL — Initiated overweight with a price target of $110 at Barclays (11/15).

Earnings Calendar

Date	Time	Ticker
11/20	Pre-Market	HRL
11/20	Pre-Market	ROST
11/20	Pre-Market	TJX

Portfolio News

With no Tandem core holdings having reported earnings last week, the news cycle was a tad on the light side. That should change slightly this week, as TJX, Ross Stores, and Hormel Foods, are all set to report earnings on the 20th. Despite the lack of earnings being reported, we saw a spike in M&A activity. Accenture announced the acquisition of a Swedish customer relationship management firm. Brown & Brown acquired not one, but two firms, as they bought assets from Rodman Insurance Agency and completed their previously announced acquisition of Hays Companies. PayPal closed on their deal with Hyperwallet for $400m, which was announced this past summer. Even Microsoft got in on the action as they acquired XOXCO — a company known for its conversational AI and bot development capabilities.

Outside of the M&A world, O'Reilly Auto announced an additional $1b share repurchase authorization. This raises their aggregate authorization to $11.75b. Within the same announcement, ORLY also announced that they too were getting in on the M&A frenzy as they purchased nearly all of the assets of Bennett Auto Supply — a private auto supplier in southern Florida.

	WTD	MTD	QTD	YTD
Dow Jones	-2.2%	1.2%	-3.9%	2.8%
S&P 500	-1.6%	0.9%	-6.1%	2.3%
Nasdaq	-2.1%	-0.8%	-9.9%	5.0%
Russell 2000	-1.4%	1.1%	-10.0%	-0.5%
Comm. Svcs	-1.1%	-1.9%	-7.8%	-10.9%
Con Disc	-3.8%	0.7%	-10.7%	6.7%
Con Staples	-1.7%	1.3%	3.4%	-2.3%
Energy	-2.1%	-0.5%	-11.7%	-7.2%
Financials	-1.3%	1.8%	-3.2%	-4.4%
Health Care	-1.0%	3.6%	-3.4%	11.2%
Industrials	-0.7%	2.8%	-8.4%	-5.3%
Info Tech	-2.5%	-1.8%	-9.7%	7.9%
Materials	0.4%	5.0%	-5.0%	-8.9%
Utilities	-0.3%	1.7%	3.7%	3.6%
REITs	0.8%	3.9%	2.3%	1.2%