Tandem Investment Advisors

October 11, 2021 - Tandem Investment Advisors, Inc.

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October 12, 2021

Notes from the Trading Desk
- October 11, 2021
by Benjamin "Ben" G. Carew, CFA

MARKET MOVERS & SHAKERS

Equities began last week with a bit of red, dropping 1.3% on Monday. The S&P 500's Monday close was its lowest since July. However, this trend was not sustained as markets righted the ship the next day. The S&P 500 gained more than 1% on Tuesday and followed that with subsequent up days of +0.41% and +0.83% before trading marginally lower on Friday. For the week, the Dow led the way higher, gaining 1.22%. That was followed by the S&P 500, up 0.79%. The Nasdaq gained only 0.09% and the Russell 2000 was actually down 0.38% for the week.

A key theme for the market continues to be yields. The 10-year closed the week north of 1.6% for the first time since early June. The continued selloff in the bond market has been suppressing the growth trade and has helped lead to underperformance of the Nasdaq relative to the S&P 500. Need evidence that duration continues to be the enemy of many fixed income investors? Look no further than the 100-year Austrian bond that was issued a few years back. The €5.8 billion bond issued at 2.1% in 2017 has dropped in price nearly 20% since early August and nearly 35% since last December. The impact of rising yields is not limited to the fixed income market and growth names though. It also affects the more yield sensitive sectors like utilities and REITs. The S&P 500's utility sector, normally a more defensive pocket, has dropped 7% since September 2nd – more than twice that of the S&P 500's 3.2% pullback through Friday's close. REITs have seen very similar drops as well. Rising yields have also historically impacted low volatility and favored high beta – a trend we have seen over the past few weeks. The mix of Fed taper talk, inflationary pressures, and even the potential for rate hikes as soon as 2022 have all contributed to the rising rate environment that we have found ourselves in for a few weeks now.

The energy complex is another vital part of today's market. WTI Crude is trading at its highest level since 2014. According to CNBC gas prices in Europe are up more than 500% this year. Natural Gas prices, which have just soared since the middle of the summer, were given a reprieve when Vladimir Putin offered to increase Russia's supply to Europe. However, the spot price of Natural Gas, according to FactSet, is still up 120% YTD. All of this has been a sort of perfect storm for the Energy sector. Energy, which is up 50% this year, is also the best performing sector for the quarter, month and even last week!

RECENTLY ASKED QUESTIONS

Recently we have been asked a bit about our transition process. We typically tell people that new money or a new account (without any sort of restrictions) will take ~3-6 months to implement our strategy. However, that period changes as market conditions change too. We think it is our job to buy low. That doesn't always happen on the first day that someone hires us. We try to pay prices for stocks that we think we should pay instead of just buying for the sake of buying. It's why we buy each position 2-4 times. The pace of our transition will occasionally accelerate – especially during a burst of volatility like March 2020, or even like what we saw towards the end of September. Towards the bottom in March 2020, it was taking us just a few weeks to implement our strategy. In less volatile markets, like much of this past summer or throughout 2017, it can take us every bit of the 6 months – and sometimes even longer – to get an account fully invested into our strategy. The pace of our transition speed is ultimately dependent upon the opportunities we see in individual names. For example, one might see us buy the same name three times in one week as our model flashes buy. It could also be months before we add a security that is currently showing up as overvalued or a sell in our model.

TRANSITION UPDATES & NEWS **

The recent market pullback has provided a lot of opportunity for us on the transition level. Yet, it has not bled into many names on our watchlist yet. So, much of our buying has been in transition accounts rather than firm wide. Towards the middle of September, it was taking us closer to 6 months to get new accounts transitioned into our strategies. However, the recent burst of volatility provided opportunities that we had not seen in some time. Now, accounts that have been with us for one month have implemented nearly 80-85% of our strategy. To be fair, being 100% invested in our strategy does not necessarily mean being 100% invested in equities. Cash is a by-product of our investment process. Buying low and selling high doesn't usually happen at the same time!

While the pullback definitely ramped up our transition activity, it also led to the introduction of a new name in our Equity and Mid Cap strategies. Qualys (QLYS) is a provider of cloud security and compliance solutions. The $4.3b company does not pay a dividend, so it was not eligible for our Large Cap strategy. However, its recent pullback allowed us to establish a position in the stock.

***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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Written By: Benjamin "Ben" G. Carew, CFA

Ben Carew is a shareholder and Portfolio Manager for Tandem Investment Advisors, Inc. Mr. Carew joined Tandem in 2013. His duties include quantitative and fundamental research and portfolio management. Mr. Carew also oversees Tandem's internship program. 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.