Notes from the Trading Desk

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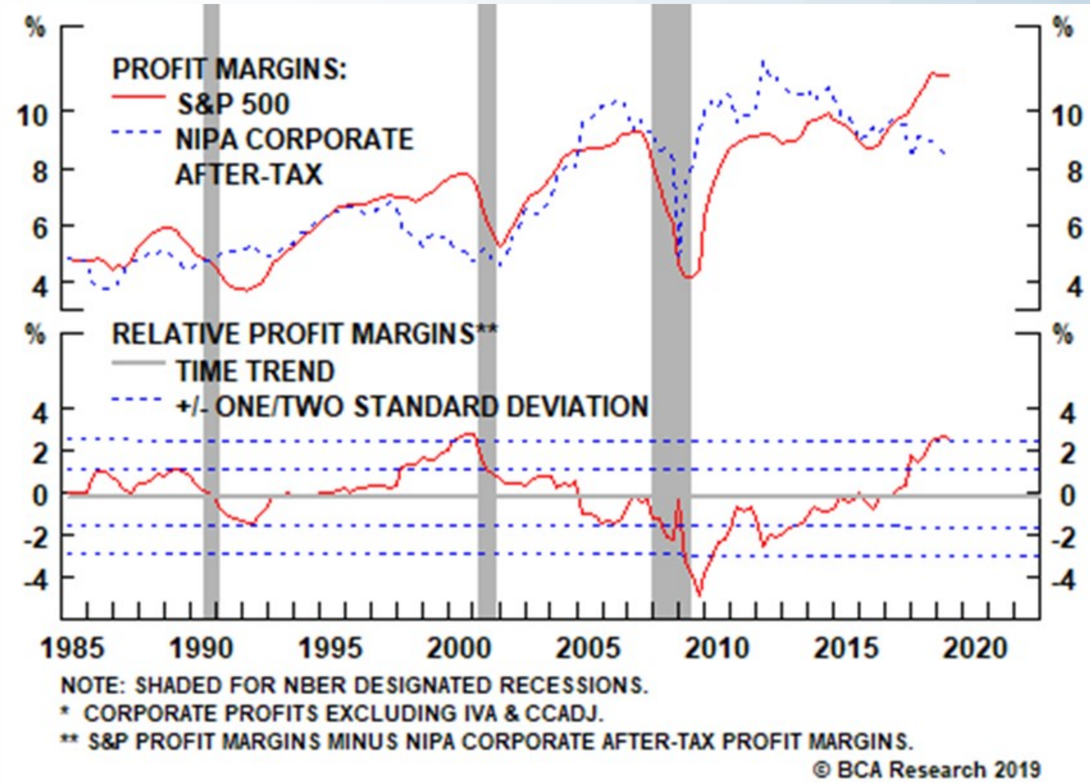
Market Mover & Shakers

The major U.S. Indices finished a choppy week in the green thanks to Friday's push higher. For the week, the S&P 500 rose 0.62%, while the Dow and the Nasdaq gained 0.91% and 0.93%, respectively. The Russell 2000 rounded out the action as it climbed 0.75%. Sector-wise, defensive stocks fared poorly as Utilities, Consumer Staples, REITs, and Healthcare were all down for the week. More cyclical areas such as Materials, Industrials and Techs were all the best performing sectors. Treasuries made quite the move, as the 10-year increased more than 20 bps, before closing the week at 1.73%. However, the quick spike in the 10-year did not lead to any curve steepening, as the 2-year and the 30-year moved in parallel fashion. Precious metals continued their struggle last week as gold fell 1.6%. They have largely stalled out since the start of September.

In hindsight, it was not totally surprising to see an up week after three consecutive weekly declines. However, sentiment remains mixed. On the one hand, according to the AAII Sentiment Survey, bullish sentiment remains near cycle lows as only 20.3% of investors are currently bullish over the next 6 months — well below the long-term average of 38%. However, the AAII Sentiment Survey indicated that cash allocations remain near the lowest levels since the end of 2017 — which was quickly followed by the blowout top into January of 2018. (Both cash levels and bullish sentiment should be viewed through a contrarian lens, thus a low reading of bullish sentiment would actually be good news for the equity markets, while low levels of cash would be viewed as a negative). Elsewhere, credit spreads also widened throughout the back half of September — highlighting negative sentiment in the credit market as well. However, spreads have tightened since the end of last month. By and large, investor's – as measured by sentiment surveys and the recent choppiness in recent price action – seem unsure of what to make of the current market backdrop.

In his most recent ***Observations***, Billy Little discussed the conflicting signals from the U.S. Economy. The labor market remains robust as unemployment continues to sit at 50-year lows. He goes on to point out that retail sales and housing both continue to be strong as well. However, cracks are beginning to show in ISM and estimated earnings growth. The negative news seems to be quickly outweighing the positive. As a result, there is now a 58.3% chance of two rate cuts by January according to FactSet. Moreover, the Federal Reserve recently announced their "Not QE" QE — my term, not theirs. The Fed is set to begin purchasing $60B of Treasuries each month — policy that sounds very similar to QE1, 2 and 3 that the Fed implemented following the Great Recession. However, Powell assured investors that, "In no sense is this QE." While the Fed is in fact once more growing their balance sheet, it does differ slightly from the Fed's Financial Crisis playbook — back then the Fed was buying longer-dated treasuries and even mortgage bonds, while they will only be purchasing treasuries with a maturity of less than a year this time around. The Wall Street Journal's James Mackintosh did a great job summarizing this recent development in his October 12th article titled, "Finding Meaning in Quantitative Easing".

Banks kick off earnings season on the 15th as JPMorgan, Goldman Sachs, Wells Fargo, and Citi are all set to report prior to the market open. Broader market earnings are set to decline for the third straight quarter. And, as Billy pointed out in ***Observations***, S&P 500 earnings are set to decline more than 4%, while sales are supposed to grow nearly 3%. If this is the case, margins will contract in the S&P 500. John Authers of Bloomberg recently noted that the divergence between the profit margins for corporations at large, as recorded by the National Income and Products Accounts of the United States (NIPA), and the S&P 500 have reached a three standard deviation divergence (see chart from BCA Research on the following page). Authers asserts that the divergence is likely the result of corporate financial engineering by companies within the S&P 500. Whatever the reason, margins have historically reverted to their longer-term means, and it is looking increasingly more likely that last year's record margins were likely peak margins for the cycle. Regardless, this quarter will be crucial to monitor the trends in both margins and future earnings guidance.



Transition Update**

October has been a fairly busy month on the transition level. The broader market selloff to start the month, and the subsequent choppiness surrounding trade news at the start of last week, presented the opportunity for us to be a bit more aggressive on the transition level than we had been throughout the back half of September.

We bought both PayPal and EXPD three times each on the transition level in the first two weeks of October. PayPal remains nearly 20% off of its all-time highs set in late July, though it appears to be in consolidation mode as it has been range bound between ~$100 and ~$110. EXPD continues to be attractively valued, according to our quantitative model, and it too seems to have a strong level of support in the high $60s.

We have also been able to add to T. Rowe Price, eBay, and Comcast on the transition level twice this month as well. Comcast seems to have found a nice level of support around $44, as the stock bounced there twice this month before rebounding higher. Comcast struggled to breakout from the $44 level for the better part of the summer as it topped out at $44 in late April and did not sustain a breakout above that level until September. Comcast remains attractively valued in our model, though their growth is beginning to start to decelerate somewhat. We have continued to add to FactSet on the transition level as the name continues to be beaten up following a disappointing earnings report towards the end of September. Finally, we were able to take advantage of the choppy markets the last two weeks as we were also able to add to Abbott, Fiserv, Intercontinental Exchange, United Technologies, Walgreens, Ecolab, Becton Dickinson, and Accenture.

***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 it is transitioned into our strategy over a longer time period that is dependent upon market conditions. This update describes that transition.*

Portfolio News & Notes

Hormel Foods made some headlines last week as they narrowed their full year guidance from $1.71-$1.85 to $1.76-$1.80 — vs. estimates of $1.74. However, despite the seemingly sufficient guidance, the company ultimately sold off. The stock dropped nearly 4% from their close on 10/9 through Friday's close.

Costco reported their September comps last week (COST provides sales comps on a monthly basis). The numbers surprised to the upside relative to analyst estimates and e-commerce grew 17.8%. Generally speaking, analysts seemed please with Costco's September numbers as they were comping against very tough numbers from 2018.

The next two weeks should really pick up in terms of news flow as we have 14 names reporting earnings in the next two weeks alone.

	WTD	MTD	QTD	YTD
Dow Jones	0.91%	-0.37%	-0.37%	14.96%
S&P 500	0.62%	-0.22%	-0.22%	18.49%
Nasdaq	0.93%	0.72%	0.72%	21.43%
Russell 2000	0.75%	-0.75%	-0.75%	12.11%
Comm. Svcs	0.77%	0.60%	0.60%	21.24%
Con Disc	0.99%	-0.08%	-0.08%	21.11%
Con Staples	-0.86%	-0.78%	-0.78%	19.66%
Energy	1.01%	-2.08%	-2.08%	0.94%
Financials	0.80%	-1.34%	-1.34%	16.02%
Health Care	-0.28%	-0.28%	-0.28%	3.93%
Industrials	1.54%	-1.09%	-1.09%	19.48%
Info Tech	1.25%	1.33%	1.33%	31.59%
Materials	1.85%	-1.43%	-1.43%	13.53%
Utilities	-1.41%	-1.24%	-1.24%	20.77%
REITs	-0.66%	-0.34%	-0.34%	26.08%

Upgrades/Downgrades & Dividends

CHKP — Downgraded to hold from buy at Jefferies, price target cut to $115 from $140 (10/8).

MSFT — Upgraded to buy from hold at Jefferies, price target increased to $160 from $93 (10/8).

NNN — Initiated buy with a price target of $75 at Jefferies (10/10).

ORLY — Initiated market perform, no price target reported to FactSet, at Raymond James (10/7).

TROW — Initiated market perform with a price target of $101 at BMO Capital Markets (10/8).

TSCO — Initiated strong buy with a price target of $115 at Raymond James (10/7).

TYL — Initiated outperform at Oppenheimer with a price target of $300 (10/7).

Earnings Calendar

Date	Time	Ticker
10/16	Pre-Market	ABT
10/17	Pre-Market	SBNY
10/22	Pre-Market	UTX
10/22	Pre-Market	NEE
10/23	Pre-Market	EEFT
10/23	Post-Market	MSFT
10/23	Post-Market	EBAY
10/23	Post-Market	PYPL
10/23	Post-Market	ORLY
10/24	Pre-Market	CMCSA
10/24	Pre-Market	LH
10/24	Pre-Market	TSCO
10/24	Pre-Market	TROW
10/24	Post-Market	RMD