Notes from the Trading Desk

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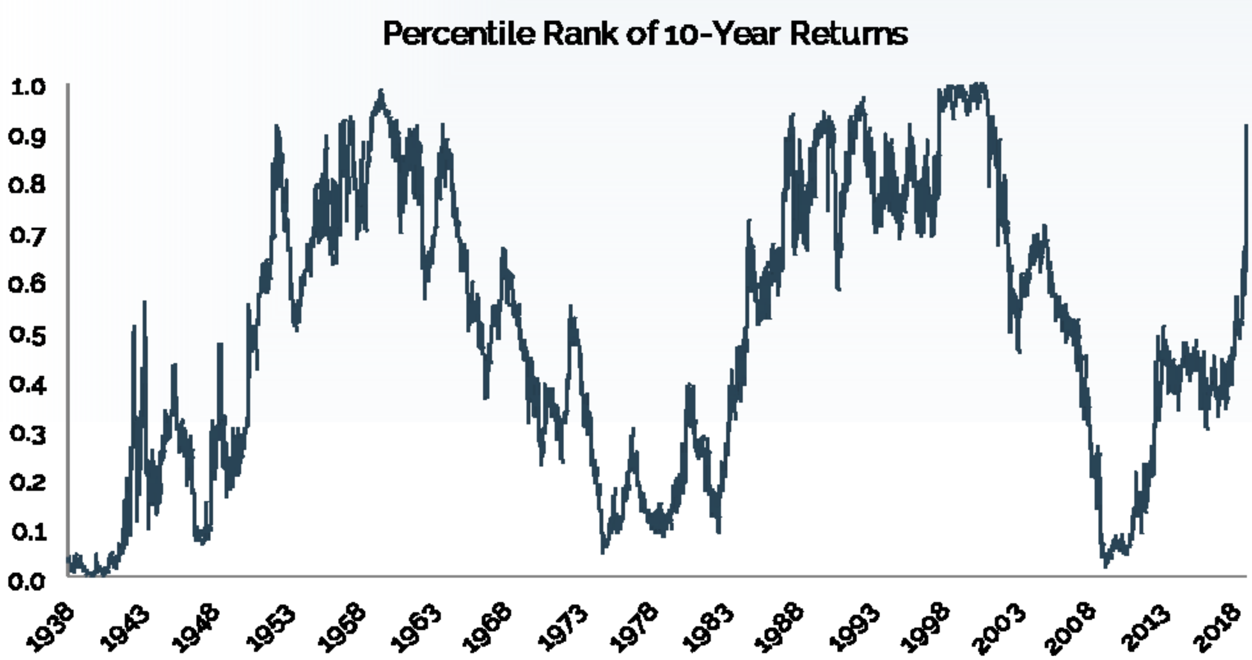
The markets have been quite tumultuous since the previous edition of *Notes from the Trading Desk*. Two weeks ago, the market witnessed a little carnage, as well as some technical damage, as the S&P 500 closed down 4.10%, the Russell 2000 was down 5.23%, the Nasdaq was down 3.74%, and the Dow Jones Industrial Average was down 3.74%. This past week fared much better for the indices. The Dow and the S&P 500 were both up, albeit rather marginally, 0.41% and 0.02%, respectively. The Russell 2000 was down 0.30%, and the Nasdaq brought up the rear as it moved another 0.64% lower. The S&P 500 appeared to have retested and failed its attempt to hold above 2,800 — a key technical level which was strong resistance for the first half of the year, as well as strong support more recently. The Russell 2000 remains in correction territory as it is still off 11.5% from its August all-time high. The Nasdaq is down 8.4% from its recent high, while the Dow and S&P 500 are down 5.6% and 5.9% from their respective highs. The S&P 500 is definitely becoming well traveled throughout this whipsaw month. The low-to-high range so far in the month of October is 229 points. That is good for the 6th largest range of the current market cycle.

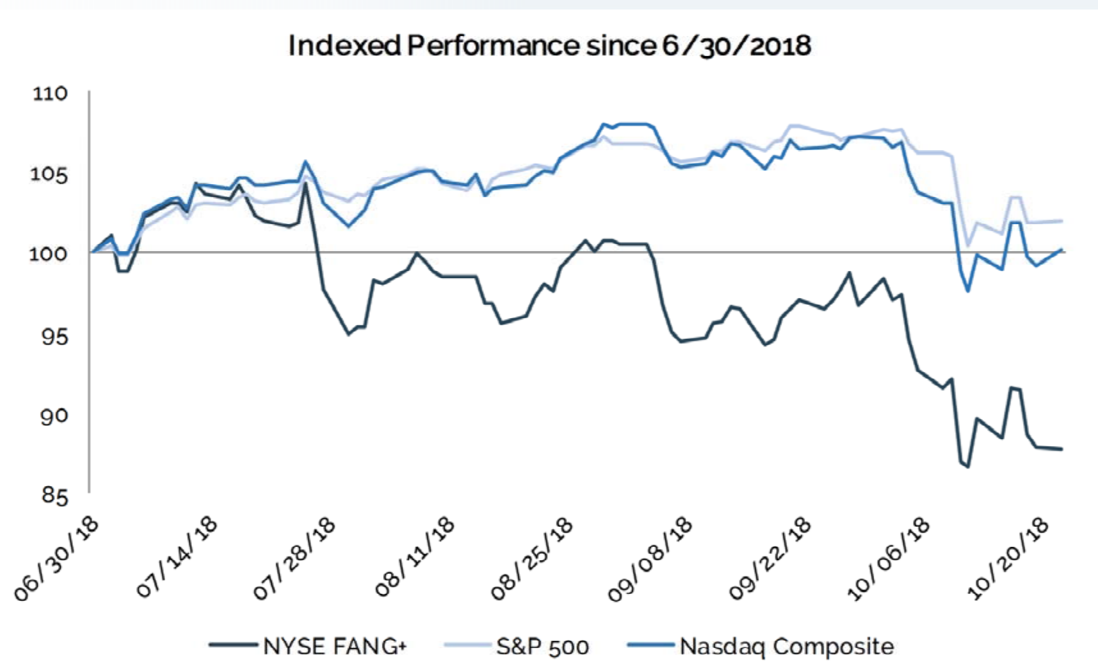
Much of the recent volatility and selloff is seemingly being attributed to the sharp rise in treasuries. However, the spike in treasuries occurred during the first week of the month. On a closing basis, the 10-year topped out on October 5th around 3.23%. Since then, yields have actually moved lower as treasuries have strengthened. The 10-year yield is now 3.19%. Most of the equity damage has occurred while the 10-year has been more or less stalled out. Market commentators have pointed towards earnings deceleration as being a key component of equity weakness. Even more recently, the cloud of uncertainty hanging around Saudi Arabia has been cited, as well as the ongoing debacle surrounding Italy's budgetary problems.

Rather than focusing on the short-term, it can be important to step back and look at longer term trends. The past 10 years have been nothing short of exceptional. The 10-year annualized return through last Friday for the S&P 500 is 11.93% — good enough to put our past 10-year period in the 89th percentile using 10-year returns starting in 1937, as seen in the chart below. It certainly does not mean the good times must come to an end. In fact, the extraordinary 10-year periods seem to have historically been clustered.



It is nearly impossible to decipher exactly why the market might trade lower or higher on any given day. More often than not, the intraday move of the market is merely noise. We have a joke around the office, when one of us asks another, “Why is the market down today?” You will often receive the sarcastic response, “There are more sellers than buyers today.” Despite the sardonic reply, there is some real truth to it. The 24-hour news cycle must come up with a reason for every bit of trading in order to hold the public’s attention. It is often best to tune out the noise of the market’s intraday whims and instead focus more largely on the backdrop.

Here at Tandem, we do not focus on valuing the market or the economy. Rather, all of what we do stems from a bottom-up quantitative and semi-quantitative process. Most recently, a little more than 82% of our 2,600+ universe of stocks appeared fairly valued, overvalued, or worse — not producing a ratio at all (which not to get too far into the weeds, indicates that the companies do not pass our fundamental criteria). On a more macro basis, the S&P 500 currently trades at a P/S ratio of 2.10. There has never been a positive return for a 2-year, 3-year, or 5-year period from a P/S ratio north of 2.10 since the turn of the century. And, there has only been one positive 1-year period during that time frame as well. Warren Buffett might have put it best in his timely *Fortune* piece in late 1999, “The fact is that markets behave in ways, sometimes for a very long stretch, that are not linked to value. Sooner or later, though, value counts.” It often seems to be the high-flying names that come crashing back down to earth. The NYSE’s Fang+ index — which tracks names such as Facebook, Amazon, Netflix, Nvidia, etc. — is down 17.4% from its all-time high and has woefully underperformed major indices of late. AMD, which at one point was up 232% this year, is now down more than 30% from its 52-week high. As we have already said, the daily gyrations of the stock market are just noise. The price one pays for a stock might not matter today. It might not matter this week, nor even this month and quarter. However, valuation always does come home to roost.



Upgrades/Downgrades & Dividends

ABT — Initiated overweight at Barclays with a price target of $80 (10/16).

BDX — Initiated equal weight at Barclays with a price target of $278 (10/16).

DLTR — Downgraded to hold from accumulate at Gordon Haskett, target decreased to $84 (10/15).

HSIC — Remains neutral at Goldman Sachs, though the target was decreased to $78 from $81 (10/19).

MSFT — Initiated outperform with $140 target at Wedbush Securities (10/18).

NKE — Re-launched at outperform vs. prior perform at Oppenheimer, target of $90 (10/18).

ORLY — upgraded to overweight from neutral at JPMorgan, target increased to $398 from $311 (10/19).

PYPL — Rating remains a buy at BoAML, though it was added to their US 1 list (10/16).

PYPL — Upgraded to buy from neutral at BTIG, target is $95 (10/19).

SYK — Initiated overweight at Barclays with a price target of $198 (10/16).

YUM — Initiated hold at Gordon Haskett with a price target of $90 (10/18).

Earnings Calendar

Date	Time	Ticker
10/22	Post-Market	BRO
10/23	Pre-Market	UTX
10/23	Pre-Market	NEE
10/24	Post-Market	MSFT
10/24	Post-Market	ORLY
10/25	Pre-Market	CELG
10/25	Pre-Market	TSCO
10/25	Pre-Market	TROW
10/25	Post-Market	RSG
10/25	Post-Market	RMD
10/25	Post-Market	SYK

Portfolio News

With earnings set to begin in earnest this week, news was fairly quiet here at Tandem. The NY Post reported on Tuesday that Carl Icahn was building a significant stake in Dollar Tree. Hedgeye, an independent investment research firm, argued that this was bullish for DLTR as the bulldog activist investor will be "likely pushing for an FDO sale and buyback/deleverage, and looking for [a] quick value creation." Hedgeye went on to say that this recent development was also likely bullish for Dollar General. DG and DLTR both popped nicely on the news.

On the management front, Abbot Labs (ABT) recently promoted Robert Ford to COO and president. Ford has been with Abbot for 22 years — most recently serving as EVP of Medical Devices, Abbott's largest business. Meanwhile, AbbVie announced that their CFO, William Chase, is set to retire in mid-2019. Robert Michael, AbbVie's Controller and VP has been promoted to SVP and CFO. Michael is a holdover from their days at ABT, where he held numerous positions in the finance department.

	WTD	MTD	QTD	YTD
Dow Jones	0.4%	-3.8%	-3.8%	2.9%
S&P 500	0.0%	-5.0%	-5.0%	3.5%
Nasdaq	-0.6%	-7.4%	-7.4%	7.9%
Russell 2000	-0.3%	-9.1%	-9.1%	0.4%
Comm. Svcs	0.7%	-4.6%	-4.6%	-7.8%
Con Disc	-2.0%	-9.6%	-9.6%	8.0%
Con Staples	4.3%	1.3%	1.3%	-4.3%
Energy	-1.9%	-5.5%	-5.5%	-0.6%
Financials	0.8%	-3.4%	-3.4%	-4.6%
Health Care	0.5%	-3.9%	-3.9%	10.7%
Industrials	-1.0%	-6.7%	-6.7%	-3.6%
Info Tech	-1.2%	-7.1%	-7.1%	11.1%
Materials	-1.3%	-8.3%	-8.3%	-12.1%
Utilities	3.0%	3.6%	3.6%	3.6%
REITs	3.2%	-2.3%	-2.3%	-3.4%