Notes from the Trading Desk

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U.S. equities were lower last week with both the Nasdaq and the Russell 2000 bearing the brunt of the damage. The Dow was essentially flat, as it closed down 0.04%. The S&P 500 was off 0.97%. The Nasdaq and the Russell 2000 were down 3.21% and 3.80%, respectively. The swoon in both the Nasdaq and the Russell 2000 were the indices' worst week since late March. Crude was up 1.5% as it hit 4-year highs. However, the headline garnering the most attention last week was the action in treasuries. Yields shot higher, as the 10-year jumped to 3.23% — its highest yield since 2011. The 18 basis point move in the 10-year was its sharpest move since early February. The 30-year also climbed to its highest level in over four years.

In case anyone was unsure, the U.S. economy once again confirmed that it is red-hot. On Friday, the market digested jobs data as the unemployment rate dropped to 3.7% — its lowest level in nearly 50 years. ISM's Non-Manufacturing Index printed a record reading as well, meaning that the non-manufacturing sector of the economy is currently firing on all cylinders. The Atlanta Fed's GDPNow is currently forecasting Q3 GDP to be 4.1%. With the economy humming along, it appears that interest rates are set to continue to rise higher. Fed Chairman Jerome Powell stated this past week that the U.S. Economy is currently experiencing a "remarkably positive set of economic circumstances." Atlanta Fed President Raphael Bostic recently said that the incoming data was forcing him to rethink his trajectory for future rate hikes, stating, "the potential for overheating would require a higher path for rates than what I had been thinking." However, it is a very fine line the Fed must walk. If they do not hike fast enough, inflation could creep into the economy at an ever-increasing pace. Yet, if they hike too quickly, they could very easily choke off the economic growth.

The remarkable economic growth of late would be enough to drive rates higher in and of itself. However, on top of a fiery economy, we have experienced a sharp increase in the issuances of debt by the Department of the Treasury. Per Reuters, Blackrock recently estimated that "net supply of Treasury securities will more than double this year, to over $900 billion, and rise to nearly $1.2 trillion in 2019." The Treasury department forecasted a net expected issuance of nearly $770 billion in the second half of 2018 — this is the most since 2008. However, there is one striking difference between today and 2008. In 2008, we were in the worst recession since the 1930s — today we are in an extraordinarily strong economy.

Enough about the bond market. The selloff in the S&P 500 on Friday left the index sitting in a key pivotal technical position. On Friday we retested the January 26th high, as well as the September low. A further breakdown below the September low could potentially flip this support into resistance. The Index also retested its 50 day moving average — a retest we have not seen since the start of the third quarter. The fact that the market held at these key levels is certainly encouraging from a technical standpoint. However, there has been a slight rotation out of riskier assets the past few weeks. The Russell Mid Cap is down 3.55% from its September 21st all-time high. Even AMD, which we recently spotlighted, is now down 19.9% from its September 13th high. The struggle in tech stocks has been evident in QQQ, as the Nasdaq 100 tracking ETF was off nearly 4% this week with a little more than $2.4b in redemptions according to FactSet ETF Fund Flow data. Despite the recent slump in riskier names, there has clearly not been a rotation into fixed income as yields have surged higher. In fact, TLT — the 20+ year Treasury ETF — is now down more than 12% from its 52 week high and more than 21% from its 2016 all-time high. Despite the slight rotation out of riskier assets, the spread between corporate bonds and U.S. treasuries remains near cycle lows. However, the BofAML US High Yield Option Adjusted Spread, which measures the spread between junk rated debt and a treasury spot curve, did jump 15 bps at the end of the week — the largest spike since the end of May. What's more, investors seem to be pulling money out of High Yield ETFs. *The Wall Street Journal* reported that one of the biggest junk bond ETFs experienced its largest monthly outflows in over 2 1/2 years in September. If credit spreads do begin to blow out, it would be very worthwhile to monitor this trend.

Upgrades/Downgrades & Dividends

ACN — Initiated buy with a price target of $200 at MoffettNathanson (10/4).

CTSH — Initiated neutral with a price target of $85 at MoffettNathanson (10/4).

EEFT — Upgraded to outperform from market perform at William Blair (10/2).

EEFT — Target increased from $111 to $141, rating remains overweight at Piper Jaffray (10/1).

FDS — Initiated hold with a price target of $231 at Deutsche Bank (10/2).

NKE — Downgraded to hold from buy at HSBC, target remains $92 (10/3).

SJM — Reinstated neutral at Bank of America, price target of $106 (10/3).

VRSK — Initiated hold with a price target of $128 at Deutsche Bank (10/2).

YUM — initiated sector weight at KeyBanc (10/3).

Earnings Calendar

Date	Time	Ticker
10/11	Pre-Market	WBA

Portfolio News

The start of the quarter began with a flurry of activity here at Tandem. We continued to add to Dollar Tree and established an initial position in JM Smucker in our Equity strategy. Both DLTR and SJM have been long-time holdings here at Tandem, though they are both new names in Equity. We also took the opportunity on Friday to trim our position in Becton, Dickinson and Company.

Big news hit the tape for a holding in our Mid Cap Core strategy this past Monday. Euronet Worldwide acknowledged previously reported news that Visa International will allow dynamic currency conversion (DCC) on international ATM transactions globally beginning in 2019. Euronet will now be able to offer their DCC services to all Visa-issued cards on ATMs around the world. EEFT expects this to increase its 2019 adjusted EPS by $0.60 to $0.65. A slew of upgrades followed for the stock, as Piper Jaffray increased their target from $111 to $141, keeping the rating at “overweight”. William Blair also upgraded Euronet to outperform from market perform.

Costco reported material weakness of its internal control over financial reporting. The company went on to say, “The weakness relates to general information technology controls in the areas of user access and program change-management over certain information technology systems that support the company’s financial reporting processes…As of the date of this release, there have been no misstatements identified in the financial statements as a result of these deficiencies, and the company expects to timely file its Form 10-K.”

All in all, activity should pick up here in the next few weeks as earnings season is set to begin. We have 18 companies set to report in the next three weeks alone, which should keep us busy. As it currently stands, and according to FactSet, our core holdings are expected to grow earnings 13.81% and sales 7.55% this quarter. Both of these numbers would mark a slight deceleration from the 19.25% earnings growth and 11.21% sales growth seen in Q2.

	WTD	MTD	QTD	YTD
Dow Jones	0.0%	0.0%	0.0%	7.0%
S&P 500	-1.0%	-1.0%	-1.0%	7.9%
Nasdaq	-3.2%	-3.2%	-3.2%	12.8%
Russell 2000	-3.8%	-3.8%	-3.8%	6.3%
Comm. Svcs	-2.2%	-2.2%	-2.2%	-5.5%
Con Disc	-4.4%	-4.4%	-4.4%	14.2%
Con Staples	-0.9%	-0.9%	-0.9%	-6.4%
Energy	1.9%	1.9%	1.9%	7.1%
Financials	1.5%	1.5%	1.5%	0.2%
Health Care	-0.8%	-0.8%	-0.8%	14.2%
Industrials	0.8%	0.8%	0.8%	4.1%
Info Tech	-2.2%	-2.2%	-2.2%	16.8%
Materials	-0.5%	-0.5%	-0.5%	-4.7%
Utilities	1.9%	1.9%	1.9%	1.8%
REITs	-2.7%	-2.7%	-2.7%	-3.7%