Notes from the Trading Desk

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U.S. equities cooled off a bit last week. The S&P 500 was down a little more than one percent, while the Nasdaq was down more than 2.5%. The 1.03% drop in the S&P 500 was the worst week since the end of June. Meanwhile, the sharper drop in the Nasdaq was the tech-heavy index's worst week since late March. The Russell 2000 was down 1.58%, while the action in the Dow was much more subdued — down only 0.19%. Treasuries were mostly weaker as yields have continued to creep higher. On the commodity side of the world, Crude was down nearly 3% and gold was down 0.5%. Silver continued its recent slump. The precious metal is down more than 17% since its mid-June peak. Copper is still in a bear market, down more than 20% from its June peak as well.

The U.S. 10-year has moved back into the top end of its recent range (as evident in the chart below) and appears poised to finally break out in one direction or another. The chart of the U.S. 10-year shows the wedge pattern set up over the past few months. A break of the upper trendline would likely indicate a breakout to higher yields, while any movement below its bottom trendline would most likely signify the 10-year rolling over. If the 10-year yield does indeed trade lower from its current position, it seems more likely that an inversion in the yield curve would occur sooner rather than later. According to FactSet, the Fed's 9/26/2018 meeting has a 99.8% probability of a 25 bps increase. The 12/19/2018 meeting currently has a 77.6% probability of another 25 bps increase. Of course, much could change between now and year end. However, as it currently stands, the short end of the curve is expected to increase another 50 basis points by the end of the year. Thus, a lower 10-year yield would almost certainly lead to a yield curve inversion.

The weakness in last week's tape stemmed largely from the tech sector. The media was fixated on the showdown on Capital Hill. Twitter and Facebook both testified before Congress, while Alphabet was noticeably absent. Twitter fell 13.3%, while GOOGL was down 4.4%. Facebook continued its recent slide. It was down 7.8% for the week and remains more than 25% off its July all-time high. However, the breakdown in tech was much more widespread than the few firms testifying in D.C.. Amazon was down 3.01% and Netflix dropped 5.17%. The PHLX Semiconductor Index was down 2.9% — led lower by Micron, who closed down 14.58%. Even the market's golden child, Apple, fell 2.78%.

Defensive sectors largely outperformed their more cyclical counterparts last week. Utilities, Staples, and Industrials were all the best performers. While Tech, Energy, and Discretionary stocks all led the way lower. The rotation into defensive sectors is a notable divergence from the YTD price performance of each sector. With the VIX steadily rising for the last month or so, coupled with the defensive rotation, it appears that the marketplace is becoming a little less optimistic than it was throughout much of July and August.

Upgrades/Downgrades & Dividends

BF.B — Initiated hold at Jeffries, price target of $49 (9/8).

CTSH — Downgraded to underperform from buy at Bank of America Merrill Lynch, price target decreased to $81 from $91 (9/4).

DLTR — Downgraded to outperform from top pick at RBC Capital Market, target remains $96 (9/3).

DLTR — named a Best Idea Long at Hedgeye, firm sees 75% upside (9/4).

EXPD — Initiated hold with a price target of $71 at Deutsche Bank (9/3).

ICE — Initiated buy with a $88 price target at Rosenblatt Securities (9/5).

ROST — Initiated neutral at Goldman Sachs, price target of $103 (9/3).

TJX — Initiated buy at Goldman Sachs, price target of $126 (9/3).

TROW — Downgraded to hold from buy at Deutsche Bank (9/7).

Portfolio News

No sense in beating around the bush. The largest headline in the Tandem portfolio this past week was Nike's Kaepernick ad. Nike's new ad initially sent the stock lower. However, analyst's have initially seemed optimistic. Oppenheimer stated that they believe the ad to be an effective way to make some noise. They went on to say that they believed the "power of the messaging" over time will overpower any short-term backlash. Buckingham Research seemed to be largely in agreement with Oppenheimer. Buckingham noted that they believe there may be short-term headline risk, but that they did not believe there will be any meaningful negative impact. Both of those analyst reports came out on Tuesday afternoon. On Wednesday, the *Wall Street Journal*'s Heard on the Street wrote that they were cautiously positive on Nike, stating that Nike's risk was limited. The Journal went on to say, "If, in the worst-case scenario, the shares slide further, investors can buy the stock on the selloff and wait for the controversy to subside. As the news cycle produces something new to fume about, it inevitably will." On Friday evening, the NY Post reported that according to Edison Trends, a research firm, Nike saw sales increase 31% from Sunday through Tuesday.

News also broke this week that the DoJ was nearing antitrust approval of CVS-Aetna following the divestiture of Medicare drug coverage assets. CVS popped nicely on the news. Trading at $73 right before the news was released, it ultimately closed the week at $77.29.

	WTD	MTD	QTD	YTD
Dow Jones	-0.2%	-0.2%	6.8%	4.8%
S&P 500	-1.0%	-1.0%	5.6%	7.4%
Nasdaq	-2.6%	-2.6%	5.2%	14.5%
Russell 2000	-1.6%	-1.6%	4.3%	11.6%
Con Disc	-1.2%	-1.2%	5.5%	16.9%
Con Staples	1.0%	1.0%	5.3%	-5.2%
Energy	-2.3%	-2.3%	-4.7%	0.3%
Financials	-0.1%	-0.1%	6.2%	1.0%
Health Care	-0.3%	-0.3%	10.6%	11.7%
Industrials	0.6%	0.6%	7.9%	1.9%
Info Tech	-2.9%	-2.9%	5.7%	16.5%
Materials	-0.6%	-0.6%	1.6%	-2.5%
Utilities	1.0%	1.0%	3.4%	1.9%
REITs	-1.1%	-1.1%	2.1%	0.9%