September 27, 2021 - Tandem Investment Advisors, Inc.

September 28, 2021

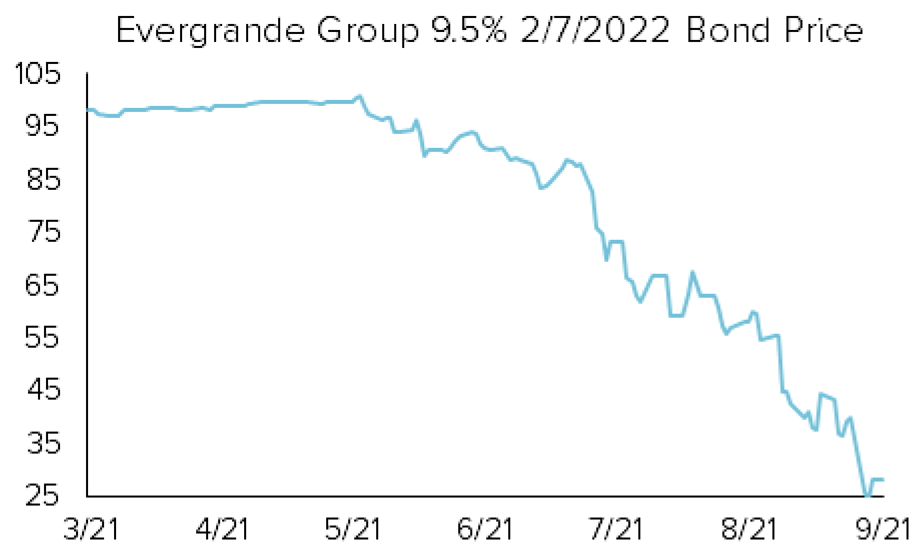
Notes from the Trading Desk
- September 27, 2021
by Benjamin "Ben" G. Carew, CFA

MARKET MOVERS & SHAKERS

In the previous *Notes from the Trading Desk*, I referred to this market as being a dull one citing the 200+ trading days that had passed us by since we last saw a 5% pullback in the S&P 500. Well, that streak was broken (like Clemson's streak of appearances in College Football's top 10 rankings, sorry Billy and Jordan). Stocks came under meaningful pressure on Monday. The S&P 500 and the Nasdaq both had their largest intraday selloff in five months. At one point during Monday's session, the S&P 500 was off more than 5.5% from its highs earlier this month. China bore the brunt of the blame for the sloppy price action as fear of potential contagion from Evergrande spooked investors globally – but more on that in a bit. Tuesday was a rather uninspiring trading session as well. However, the bull market got back on its feet as all major indices were up roughly 1% or more both Wednesday and Thursday. For the week, the S&P 500 finished 51 bps higher. The Russell 2000 and the Dow Jones traded 50 bps and 62 bps higher as well. The Nasdaq was more or less flat, finishing up 2 bps. The correlation between interest rates and the Nasdaq was in full force though as the selloff in Treasuries put a damper on large cap growth names. The 10-year, which at one point on Wednesday was below 1.3%, closed the week at 1.45% and appears poised to potentially trade higher. Energy and Financials were both stronger throughout the week while the yield sensitive sectors like REITs and Utilities struggled.

We have highlighted issues coming out of China for the past couple of months. Throughout much of August, regulatory crackdown was causing downward pressure on many Chinese stocks. More recently, the issue has not been from unfriendly business regulation, but from

Evergrande's fall from grace. Evergrande, one of the largest property developers in China, is witnessing a historical downfall stemming from leverage – like so many prior problems in financial markets. Evergrande's bonds have been trading ever lower since mid-May. In May, the February 2022 bond was trading above par with very little stress. Today, it trades at less than 30 cents on the dollar – a steep discount (see the chart below).



What's more, on Wednesday *The Wall Street Journal* reported that the company negotiated with onshore bondholders for a yuan-denominated bond to take care of a pressing interest payment. However, Evergrande missed a payment on their dollar bonds the very next day. Technically, the company has 30-days to make the payment before bondholders can call it a default. According to *The Journal*, it would be the "largest-ever dollar bond default by a company in Asia." Some referred to this epic collapse as being a "Lehman moment". Hindsight is always 20/20, but at this point those calls appear to be a little hyperbolic. At the same time, to say that the fear of contagion is overblown would also be disingenuous. In fact, the issue has already spread. The ICE BofA Asian Dollar High Yield Corporate Bond Index is off nearly 20% from its May highs and is actually below its COVID March 2020 lows. Other Chinese developers are seeing their bond prices collapse, and it's even beginning to bleed into some Chinese banks. Just because the risk and effects of leverage is infecting various Chinese assets does not mean that it needs to bring the global financial system to its knees à la Lehman Brothers in 2008.

RECENTLY ASKED QUESTIONS

We have been asked a few times lately about whether there is a cash alternative that we could invest client's cash in to hopefully garner a little bit more yield than most sweeps these days. The short answer is we do not know of an alternative money market fund with higher yields. Short-term interest rates are near zero and in some cases the yields are negative. The only way to earn a higher yield on cash is to take greater risk (i.e. lower credit quality or longer duration). Once you start to sacrifice credit quality or extend maturities, you are adding an element of risk to the principal of that cash. Since we want the cash there to take advantage of opportunities, we have no desire to risk the principal for a relatively small bump up in yield. If short-term rates were ever to go higher, we could buy short-term Treasuries or invest cash in money market mutual funds (depending on the custodian), which is what we have done in the past. Until that day, we will continue to protect the principal of the cash amount.

TRANSITION UPDATES & NEWS **

We added to our position in Ollie's Bargain Outlet (OLLI) for the Equity and Mid Cap strategies last week. As we mentioned last time, Ollie's is a closeout retailer that operates mostly on the east coast. Monday's steep selloff allowed us to put to work more money than we have in some time on the transition level. All in all, we ended up buying upwards of 20 individual names on the transition level. It felt like the busy days we saw in March of 2020. Some names, particularly some of the more expensive names we own, did not pullback enough for us to be able to purchase. Ultimately, the pullback was short lived. However, we certainly took advantage of the opportunity to put cash to work in newer accounts and for newer deposits.

On the news front, it was pretty slow. Accenture reported earnings, beat their headline EPS number, and raised their dividend more than 10%. They also guided their sales for the next quarter higher and guided full year 2022 earnings above estimates. Costco also reported their quarterly results. It beat on both the top and bottom line, despite an $84 million write-off of some technology assets. FactSet reports their numbers on Tuesday before the end of the calendar quarter. Hard to believe its almost Q4!

***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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