# *Notes from the Trading Desk*

Ben Carew
Tandem Investment Advisors

*November 10, 2017*

## Market Movers & Shakers

For the first time in eight weeks, the Dow and the S&P closed lower. The two indices were down 50 bps and 21 bps respectively. The Nasdaq let off the gas ever so slightly as well, closing down 20 bps. Lastly, the Russell was down 131 bps. Two weeks ago we discussed the potential cracks forming in the junk bond market. Well this past week those cracks widened a little more. Junk bond ETFs traded down to levels they have not seen since early March. A flight to quality can often signal more tumultuous times ahead. However, after a rather rough week, junk bonds did seem to show a little life in the form of a Friday bounce which helped dampen their losses for the week. Finally, treasuries were mostly weaker this past week as the yield curve continued to flatten.

On Thursday, the market closed down 0.38% — the 15th worst trading session of the year. That bears repeating, a day in which the market closed lower by 1/3 of a percent is the 15th worst trading day (out of 218 sessions) of 2017. Volatility has been completely absent from this marketplace. YTD we have had a ±1% day only 8 times. The average daily move this year has been a measly 0.07%. If the S&P 500 were to close lower by 1.21% one day, it would be a 3 standard deviation move. Using daily data going back to January 4, 1928, a 3 standard deviation move would be a down day of roughly -3.5%. The current market environment is more or less an anomaly. The only time we have seen less volatility was in the mid-60s. A return of volatility does not mean a bear market. It merely means that we shouldn't expect this current market of ours that slowly but surely inches ever so higher to continue. It may continue to move higher, but statistics say that we should expect that ride to start being quite bumpier.

YTD, the Dow Jones is up 18.5%, the S&P 500 is up 15.3%, and the Nasdaq is up 25.4%. The tech sector alone is up 37.1% in the past 11 months! The rally in the equity market has been a sight to see! What is truly remarkable is that the rally has been global — not just here in the US. The Hang Seng in Hong Kong is up 32.3% YTD, the Japanese Nikkei is up 18.7%, the German DAX is up 14.3% — even the Brazilian Bovespa is participating as it is up 19.8% YTD! So what has driven this global move higher? The answer is simply growth. The world has finally been growing again. All 35 OECD countries have positive GDP for consecutive quarters for the first time since 2007. This global growth story is one explanation for what has *driven* the market . However, that does not mean it will be the driver going forward. The OECD has data on all 35 OECD countries going back to 1960. Since 1960, the average 1 year return on the S&P 500 has been 8.1%. But, the average 1 year return following a quarter in which all countries are growing is 3.7% — substantially lower. There is a quote that we have all used at one point or another here at Tandem and I think it is relevant here. Seth Klarman, CEO of Baupost Group, said "When share prices are low, as they were in the fall of 2008 into early 2009, actual risk is usually quite muted while perception of risk is very high. By contrast, when securities prices are high, as they are today, the perception of risk is muted, but the risks to investors are quite elevated." In other words, when the going gets really, really good, one must be most cautious. It doesn't mean the good can't get better, just that we must not let our guard down.

## Portfolio News

It was a rather good week for the average Tandem stock. The S&P 500 was down 21 bps, while the average holding here at Tandem was up 82 bps. The leaders were a nice mix of stocks for us as well. Tractor Supply, Walgreens, and Scana — which have all been quite beat up over the last year — all were found at the top of the weekly leaders. However, it was not just the downtrodden that performed well. AbbVie, Brown Forman, Costco, and FactSet — all of which have performed better than the S&P YTD — were also at the top of the weekly leaderboard.

News wise it was and activity wise it was again, rather quiet. Earnings last week were rather muted as well. 91.5% of the S&P 500 has now reported their Q3 numbers. Reported earnings growth in the S&P, according to FactSet, sits at 6.5%, versus analyst estimates of 7.3% . The reported growth marks a continued slowdown since peak earnings growth in Q1 of 13.8%. Here at Tandem, 84% of our names have reported with growth of 5.8% compared to estimates of 2.6%.

| | WTD | MTD | QTD | YTD |
|---|---|---|---|---|
| Dow Jones | -0.5% | 0.2% | 4.5% | 18.5% |
| S&P 500 | -0.2% | 0.3% | 2.5% | 15.3% |
| Nasdaq | -0.2% | 0.3% | 3.9% | 25.4% |
| Russ 2000 | -1.3% | -1.8% | -1.0% | 8.7% |
| | | | | |
| C.D. | 0.7% | 0.4% | 2.4% | 13.4% |
| C.S. | 2.1% | 2.2% | 0.6% | 5.0% |
| Energy | 1.1% | 2.1% | 1.4% | -7.4% |
| Fins | -2.7% | -2.0% | 0.7% | 11.8% |
| H.C. | -0.5% | 0.0% | -0.8% | 17.8% |
| Ind. | -1.1% | -0.7% | -0.6% | 11.7% |
| I.T. | 0.0% | 1.0% | 8.8% | 37.1% |
| Mats | -1.2% | -1.5% | 2.2% | 16.6% |
| Utes | 0.4% | 0.7% | 4.5% | 13.9% |
| REITs | 3.2% | 3.9% | 4.6% | 9.2% |

### *Upgrades & Downgrades*

**ACN** — initiated buy at Pivotal Research with a price target of $165 (11/8).

**BRO** — downgraded to sell from neutral at Citi (11/8).

**CTSH** — initiated buy at Pivotal research with a price target of $93 (11/8).

**CVS** — upgraded to buy from hold at Needham with a price target of $79 (11/10).

**FDS** — initiated neutral at Goldman Sachs with a price target of $194 (11/8).

**MSFT** — initiated buy at UBS with a price target of $105 (11/8).

**NNN** — upgraded to neutral from sell at UBS, price target increased to $42 from $36 (11/8).

**VRSK** — initiated neutral at Goldman Sachs with a price target of $89 (11/8).

### Earnings Calendar

| Date | Time | Ticker |
|---|---|---|
| 11/14 | Pre-Market | TJX |
| 11/16 | Pre-Market | SJM |
| 11/16 | Post-Market | ROST |