

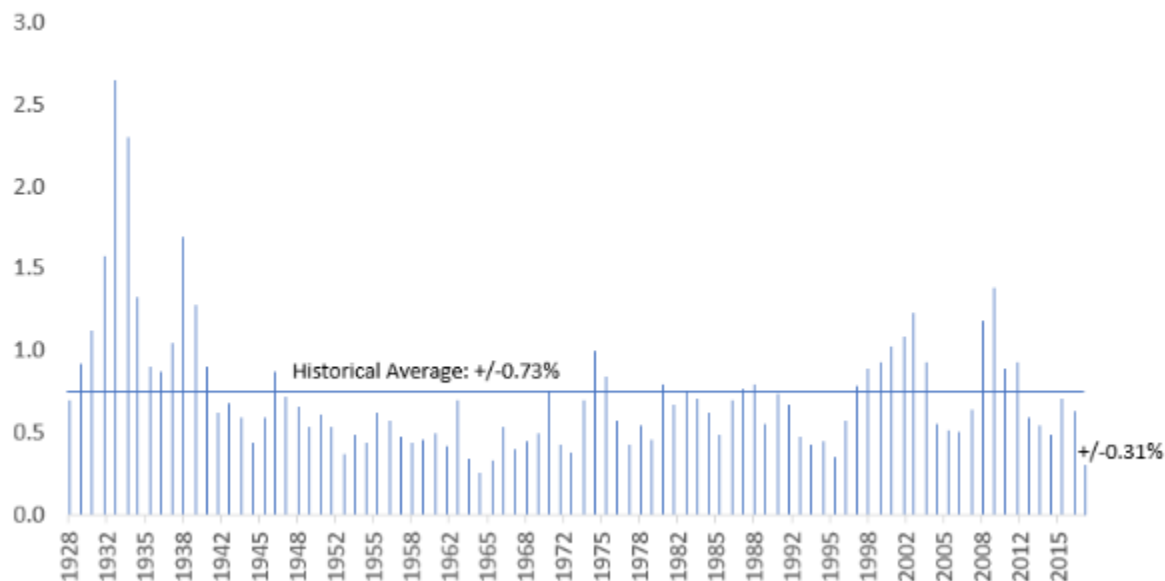
**Financial Markets Review**

And, the snoozefest rolls on through September and into what is historically the most volatile time of the year. The U.S. equity markets are on a one-way mission – higher amidst a lack of volatility. The S&P 500 broke through 2,500 to close the month up another 1.93%, while the VIX set a record for the lowest monthly close over the past 30 years. Surprisingly, there wasn't a shortage of newsworthy events over the past month. Any one of the following could have ignited at the very least a shallow correction, but the market just seems to not care.

- North Korea launched their 14<sup>th</sup> ballistic missile of 2017 and set off a hydrogen bomb that proved to be their strongest nuclear test to date.
- Following the devastation in Texas from Hurricane Harvey, Hurricane Irma unleashed its wrath on the Southeast. These disasters were soon followed up with the decimation of Puerto Rico by Hurricane Maria.
- The credit of 145.5 million Americans was potentially affected by a data breach on Equifax – the irony is surely not lost on us!
- More of the same in Washington DC – nothing can get accomplished. The health care bill is pushed into 2018, because it doesn't have enough votes to pass. It doesn't matter if you are a Republican, Democrat or Independent, I think we can all agree that the politicians representing us appear to be inept. A party had seven years to come up with a solution to something they disagreed with at the outset and still couldn't agree amongst themselves to a fix. It is truly remarkable! The enthusiasm over tax reform getting passed this year, or ever for that matter, might be getting a little ahead of itself.
- After years of QE and an ever-expanding balance sheet by the U.S. Federal Reserve, Janet Yellen finally announced a plan for Quantitative Tightening (QT). QT is set to begin this month with a \$10 billion runoff that will increase by another \$10 billion every three months until this time next year. At that time, the runoff will be \$50 billion and will continue at that pace until 2022.

The lack of volatility to newsworthy events has become rather commonplace recently. On numerous occasions, I have pointed out the historic nature of this year's volatility. The following chart, from Bespoke, is just another way to show the lethargic daily moves in the S&P 500. According to Baird and Bespoke, 2017 now ranks as the second least volatile year through the first 188 trading days going back to 1928.

## Average Daily Absolute % Chg Through 188 Trading Days: 1928-Present



Source: Bespoke, R.W. Baird

### Tandem Strategy Updates

Not only was September a quiet month in the market as a whole, but it was a quiet month as far as transactions go at the firm level. The only trade we made was to liquidate our remaining small position in Bank of the Ozarks (OZRK)\*. For the sake of time, you can read up on the reasons behind the OZRK liquidation in last month's *Observations* column.

Even though it was quiet on the transaction front, we had a little bit of noise being made in a couple of our holdings – for both the good and bad. Let's get the bad news out of the way first. Scana (SCG)\*\* was down 19.7% in September on news they received a subpoena related to their alleged attempt to hide the fact that construction of two nuclear reactors was doomed years ago due to unforeseen cost overruns. State regulators, customers, and shareholders of SCG were outraged to hear the allegations and so the witch hunt has begun. So far, the steady drumbeat of bad press has placed constant pressure on the stock price. However, the CDS (credit default swaps) and bond prices have held up extremely well. These securities are not currently exhibiting any stress, which as of now takes any question of their solvency off the table. Obviously, current events with a company under investigation can change rather quickly, so it would be worth noting to always keep one eye on the direction of their bond prices.

Regular readers might recall in past columns having seen SCG as an example of our buy and sell discipline. In the early summer of 2015, we had owned a very small position in SCG when our quantitative models flashed a buy signal with the stock trading in the low \$50s. So, we followed our buy discipline and bought the stock up to a 3% position. Not much more than a year later, a sell signal was triggered and we took advantage of the opportunity to sell shares in the high \$60s to low \$70s. Our sales brought the position size down close to where it is today. SCG is the third smallest position in our Large Cap Core strategy at 1.07%, so the business specific risk on the portfolio as a whole is limited.

As far as we are concerned, SCG has clearly made a few mistakes and heads are likely to roll. Fundamentally, the company looks to be in position to satisfy their future obligations. And, quantitatively the stock price is quickly becoming attractive. We are not currently adding to or selling our position. Instead, we are content waiting to see the story unfold a little bit longer and how that affects our fundamental and quantitative research. (Just recently, we wrote a short research piece analyzing the fundamental side of SCG in more detail. If you are interested in this piece, please do not hesitate to call, or email us.)

Now on to the good! Abbvie (ABBV)\*\*\*, the largest holding in our Large Cap Core strategy, was up 18% in September on a patent victory and timely results from their pipeline. At the beginning of the month, the U.S. Patent Office refused a request from Coherus to review a patent on ABBV's best-selling therapy, Humira. Earlier in the year, Coherus filed several petitions to review the patents, which put a lid on any stock price appreciation. The denial to review the patent on Humira allows ABBV to continue keeping biosimilars out of the U.S. market for another five years. Later in the month, Amgen (AMGN) settled with ABBV on their push to release a Humira biosimilar. ABBV is allowing AMGN to sell their biosimilar in Europe starting next year and in the U.S. by 2023. In exchange, AMGN is dropping any further patent challenges and agreeing to pay royalties to ABBV on future sales of its Humira biosimilar. Basically, ABBV has bought itself a few more years to reap the benefits of their cash cow, also known as Humira, while developing their pipeline so they can replace lost revenues in the future.

We continue to hold ABBV in both our Large Cap Core and Equity strategies with no immediate plan to add to or sell any of our position. Fundamentally, we have been monitoring the Humira patent news for several years now, as it could affect the sustainability of future profit and cash flow growth. Quantitatively, the stock is ranked a hold, but after a sharp 18% jump over the course of a few weeks, you can imagine it is getting ever closer to producing a sell signal. However, for the time being, we will sit tight and enjoy the ride on the composite level. And, for our new accounts, we will continue to incrementally build a position on any weakness.

### **Thought of the Month**

Back in June of this year, I included a quote from Seth Klarman who is the Founder and CEO of Baupost Group. For whatever reason it really stuck to me and I have found myself citing the quote several times over the past couple of weeks. So, I thought it was pertinent to use again in light of where we find ourselves in today's environment.

*"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."* – Seth Klarman, Founder, CEO, and Portfolio Manager of Baupost Group

-Billy Little, CFA

***"It requires a great deal of boldness and a great deal of caution to make a great fortune, and when you have it, it requires ten times as much skill to keep it." ~ Ralph Waldo Emerson***

*DISCLAIMER: This writing is for informational purposes only. The information contained in this writing should not be construed as financial or investment advice on any subject matter. Tandem Investment Advisors, Inc. does not represent that the securities, products, or services discussed on, or accessible through, this site are suitable for any particular investor. You acknowledge that your requests for information are unsolicited, and the provision of any information through this site shall not constitute or be considered investment advice, or an offer to sell, or a solicitation of an offer to buy any product, service, or security. Past performance is no guarantee of future results. Indices are unmanaged and not available for direct investment. They are shown or referred to for illustrative purposes only and do not represent the performance of any specific investment. No data in this writing should be construed in any way as performance of any Tandem investment product. For complete performance information and disclosures, please contact John Carew at [jcarew@tandemadvisors.com](mailto:jcarew@tandemadvisors.com)*

*From time to time Tandem may discuss select purchases and/or sales within this report. All past portfolio purchases and sales are available upon request. Any portfolio transaction discussed here does not constitute advice or a recommendation. Please consult your financial advisor before making any investment decisions. For information regarding past purchases and sales, please contact John Carew at [jcarew@tandemadvisors.com](mailto:jcarew@tandemadvisors.com).*

*\* OZRK was sold across all strategies (Tandem Large Cap Core, Equity, and Mid Cap Core).*

*\*\* SCG is owned across Tandem Large Cap Core and Mid Cap Core.*

*\*\*\* ABBV is owned across Tandem Large Cap Core and Equity.*