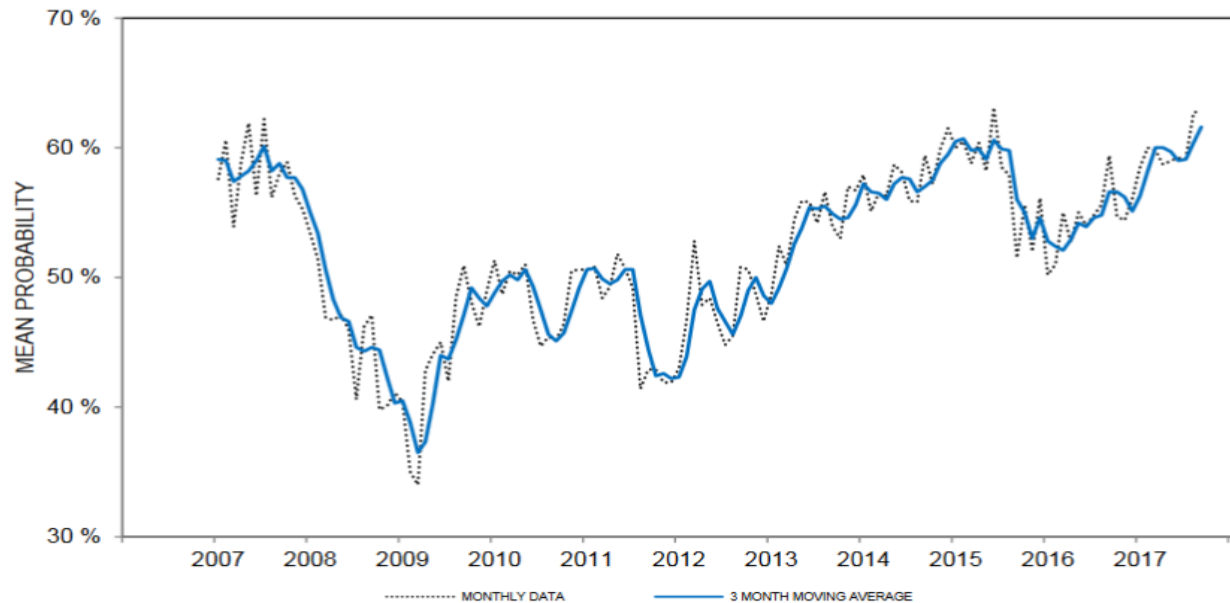


Financial Markets Review

With two months left to go, it looks as if the equity markets may have clear sailing into year-end. The S&P 500 breezed through what has been the most anxious months of trading. In the past, August and September have been the two weakest months for the stock market with October being the most volatile month. Keeping in line with the how 2017 has unfolded so far, these "scary" months have defied expectations and have done so in record breaking fashion. The CBOE Volatility Index (VIX) recorded the lowest monthly average in its history, which came on the heels of September 2017 being the least volatile September on record.

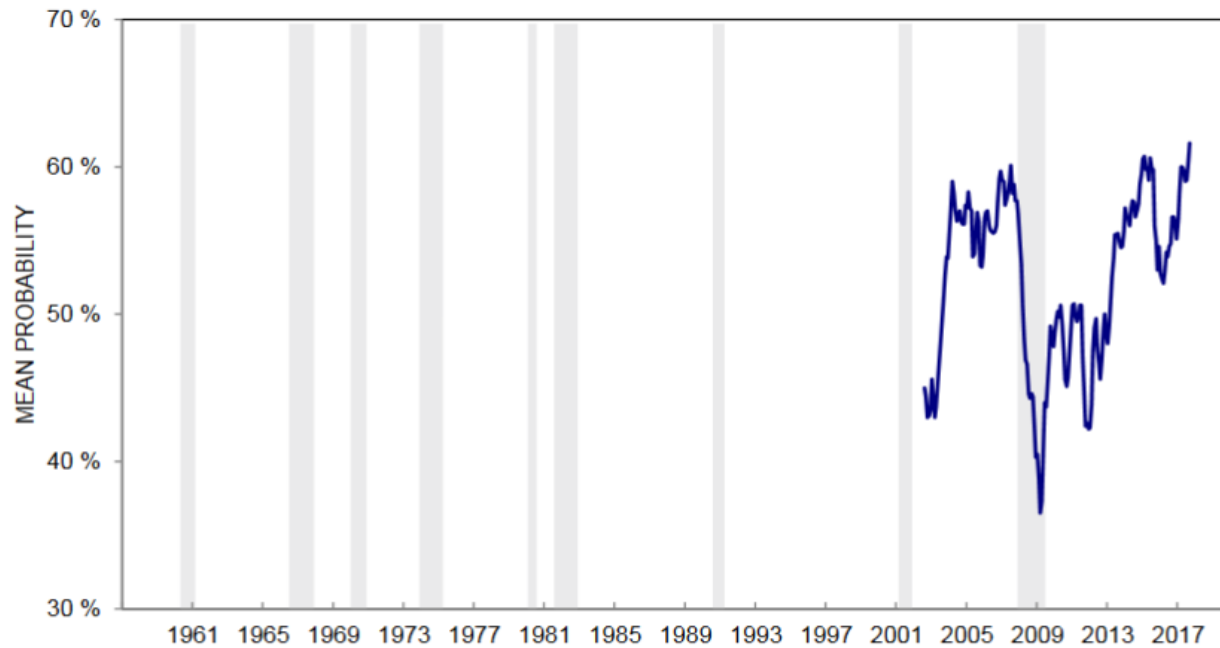
Word on the street is that stocks will never go down again! With consumer confidence soaring, GDP growing 3% for the second quarter in a row, stable inflation and virtually every economic indicator trending higher, what is there not to like!? Over the past 15 years the University of Michigan Consumer Sentiment Survey has been surveying individuals on the probability of an increase in the stock market in the next year. Currently, Americans are the most confident they've ever been in future stock market returns over the 15 years of collecting this data.

**CHART 20: PROBABILITY OF AN INCREASE IN STOCK MARKET PRICE IN THE NEXT YEAR**



Source: <https://data.sca.isr.umich.edu/>

**CHART 20: PROBABILITY OF AN INCREASE IN STOCK MARKET PRICE  
IN THE NEXT YEAR**



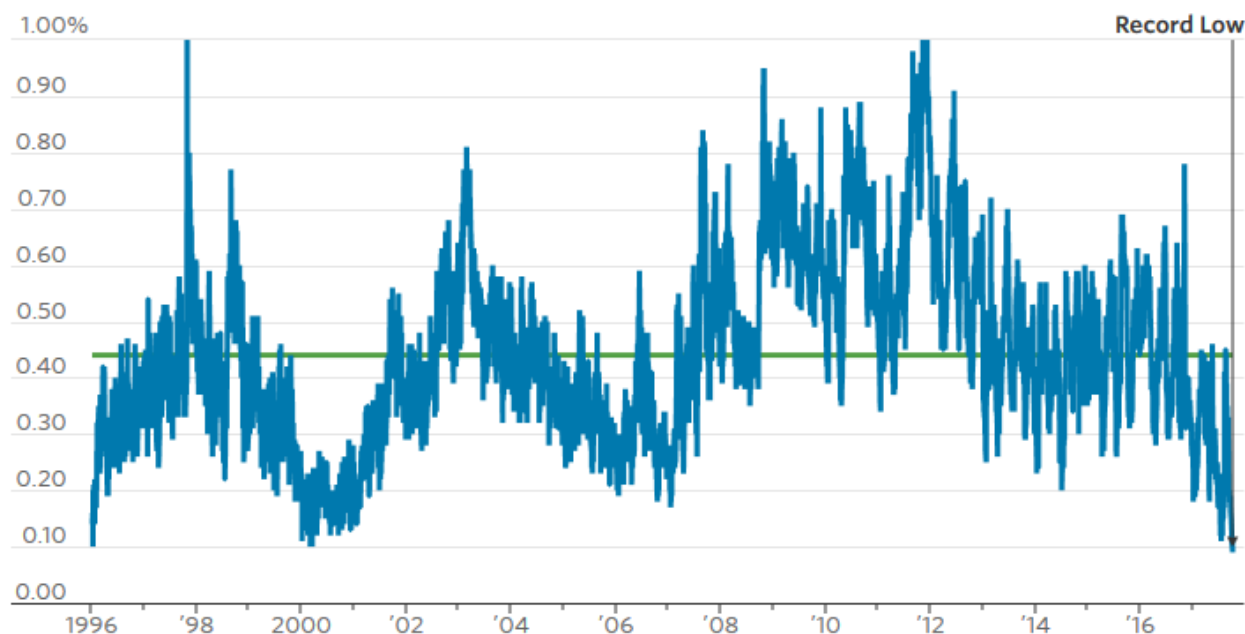
Source: <https://data.sca.isr.umich.edu/>

But with nearly every U.S. equity market setting a record high day after day and the resounding bullishness of nearly every financial pundit who comes on TV, there is one aspect of the market that is being over-looked. In today's environment of passive investing, investors are seemingly ignoring the individual stocks that make up the market. For much of the past several years, virtually every stock has risen in price regardless of whether it was justified. Over the last couple of months that dynamic has changed. According to Credit Suisse's equity derivatives strategy team, the one-month implied correlation for the 50 largest U.S. stocks has hit an all-time low. Basically, it means not all stocks are moving in the same direction even though the market as a whole may be moving in one direction – higher. The actual correlation of these stocks has been bouncing between 3% and 7% recently, which matches the all-time low set in the spring of 2000. The record low correlation is viewed by many as a stock picker's nirvana. Opportunities can be had to take profits, and future gems can be uncovered to become tomorrow's winners. This is why close followers of Tandem probably have noticed an uptick in portfolio activity this year in relation to years past.

### Race to the Bottom

A measure of implied correlation for large U.S. stocks last week plumbed an all-time low

■ One month implied correlation of the S&P 500's 50 largest stocks ■ Average



Source: Credit Suisse Equity Derivatives Strategy

### Tandem Strategy Updates

Nearly 80% of the companies comprising the S&P 500 have reported third quarter earnings and the reports from our core holdings have been positive. Here at Tandem, reported growth for sales and earnings has come in at 8.03% and 6.69%, respectively. This compares favorably with the S&P 500, which has reported sales growth of 6.36% and earnings growth of 6.75%, according to Factset.

On the transaction front, we have completed the liquidations of Coca-Cola (KO)\* and ITT Corp (ITT)\*\*. KO has been a staple in the Large Cap Core strategy for over 20 years, while ITT has been a core holding for just over 9 years. Both companies have been profitable investments; however, they have recently failed to meet our basic fundamental criteria of consistent earnings growth.

We also have some buying activity to report. Since I last reported to you we have increased our position in CVS Health Corporation (CVS)\* to a full 3% position in our clients' portfolios. We have consistently accumulated shares of CVS over the past couple of months. The majority of our purchases have come on the days the news headlines are dominated by Amazon's perceived takeover of the pharmacy industry (for our most recent views on the disruptor that is Amazon, please read the most recent edition of [\*The TANDEM Report\*](#).) However, just last week it was reported that CVS is strongly considering buying the third largest health

insurer in the country, Aetna (AET), for \$66 billion in order to better position themselves in the healthcare space. The rumored deal would allow CVS to push 22 million AET members to their pharmacies and provide CVS the opportunity to pitch a unified, seamless benefits offering to clients, including big employers. The biggest beneficiary of this deal will potentially be consumers, since CVS will have the ability to keep the negotiation of drug prices under one roof, which should lower drug prices. And, CVS's PBM (Caremark) will be incentivized to negotiate the lowest possible prices in order to lower the costs borne by the insurer (AET). The lower drug costs along with the information gathered at CVS's health clinics and home services division will allow the insurance side to better manage health care costs and in turn increase profitability. There are several questions concerning the structure and financing of the deal, but on paper it looks to make a lot of sense.

Lastly, to just update everyone on the Scana (SCG)\*\*\* saga, we have not sold or purchased additional shares of SCG over the past month. Most recently, SCG's CEO Kevin Marsh and COO Stephen Byrne have announced their decision to retire at the end of this year. SCG's current CFO Jimmy Addison will be the new CEO and current senior vice president Keller Kissam will take over as the new COO. This management shake-up does not violate our fundamental criteria of hiring from within, so for this reason in particular we continue to hold the position. As I mentioned last month, one of the most important metrics to look at when evaluating SCG's current situation is their standing within the credit markets. Over the past month, the credit markets have not signaled a reason to worry about the long-term viability of the company. Across the curve, SCG's bond yields have increased roughly 30 basis points, while their CDS spreads have actually contracted. Even though the equity in the business has declined in value, the fixed income side is not reflecting an impending demise of the business. We will continue to monitor the situation for any violation of our fundamental criteria, but in the meantime the shares are getting awfully attractive.

### **Things That Make You Go Hmmm...**

Over the past couple of months, I have been asked on several occasions to share my thoughts on Bitcoin. Here it is... I don't get it! I don't understand Bitcoin. I understand the technology behind Bitcoin and how the blockchain works, but I don't know if Bitcoin is worth buying or not. What I do know is that you can't call it a currency yet. Currencies don't fluctuate 10% in a day. There is no sane person out there who would conduct a large transaction knowing there is the potential for what is being bought or sold to fluctuate in price so dramatically between the time the decision is made buy or sell and the time it takes to execute the transaction. Bitcoin is a speculative "thing". And, for "professionals" to come on TV to put a "valuation" on Bitcoin is just ludicrous. A couple of weeks ago, someone came on CNBC to explain their rationale of putting a P/E (price to earnings) ratio on Bitcoin. The problem is there is no 'E'! It mathematically makes no sense! So, for those looking to trade Bitcoin or any cryptocurrency for that matter, I wish you good luck and that's all I've got.

-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***

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*\* KO was sold, and CVS was bought across Tandem Large Cap Core and Equity.*

*\*\* ITT 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.*