

Forest for the Trees

All too often we get so caught up in the minute-by-minute and day-by-day gyrations of the stock market that sometimes we completely miss the bigger picture. One day the market is ripping higher and CNBC trots out every pundit who says to invest now or otherwise you'll be left in the dust. The next day the market plummets and CNBC is airing their "Markets In Turmoil" special at 7 PM. How is anyone supposed to invest in this conflicting environment? Well, here's a start. Turn off the TV! It's hard to do, but you need to tune out the daily volatility. Otherwise, I promise you, you'll fail to see the forest for the trees.

First, you need to understand that the majority of individuals interviewed on TV are "talking their books". This means if someone consistently preaches that the market is going to rip higher, they are probably invested in long only strategies in which they only get paid on invested assets. Unfortunately due to their compensation structure, it behooves them to be stay fully invested at all times. On the other hand, when a permabear repeatedly tells you the market is headed back to the 2009 lows, they are probably short the market. This just means they are only going to make money if their investments go lower. It is just as important to understand each pundit's motive and ultimately how they are compensated, rather than just blindly take what they say at face value.

Here at Tandem, we strive to be different than everyone else. We call it as we see it. Being a long only manager, our clients make money when their investments go up in value or a dividend is paid out to them. That is the only way. So, believe me when I tell you, it has not been easy writing pessimistic columns every month. It would be a lot easier to tell you everything is great and you should be fully invested. However, I would ultimately be doing you a disservice. Our job is to make you money when markets go up and protect you to the best of our ability when markets go down. We do that through a disciplined process and are not shaken by every twist and turn of the market. If we can't find anything to buy, which results in cash levels being elevated, so be it. We will not force anything to just be "invested". And, that is where we find ourselves today.

Over the past year, the economy and company fundamentals have consistently been showing signs of a disconnect between underlying growth and valuations. But, that doesn't mean everything is mispriced or overvalued. Believe it or not, we did put a little cash to work last year. However, as many of you already know, we just had a lot more to sell than to buy, which caused us to be net sellers and cash levels to rise. The table below shows what we bought in each of our strategies in 2015.

Company	Type of Purchase	Date of first purchase in 2015	Price Change of stock since purchase to 1/31/2016*	Price Change relative to the S&P 500 (purchase to 1/31/2016)*	Strategy - Large Cap Core (LCC), Equity (EQ), Mid Cap Core (MCC)
Scana (SCG)	Add to core holding	May 6th	+21.29%	+28.02%	LCC
Expeditors Intl (EXPD)	Initial position	May 28th	-1.96%	+6.55%	LCC, EQ, MCC
Becton Dickinson (BDX)	Add to core holding	August 20th	+0.85%	+5.54%	LCC, EQ
Scripps Networks (SNI)	Initial position	September 1st	+17.48%	+16.10%	LCC, EQ, MCC
Cerner (CERN)	Initial position	September 1st	-3.88%	-5.26%	EQ, MCC
Mednax (MD)	Initial position	November 5th	-5.10%	+2.50%	EQ, MCC

I've decided to show this table for a couple of reasons. First, if you've been reading this column regularly for the past year, you probably think we do nothing but sell and sit on a lot of cash. That is not the case. We are active managers and take advantage of opportunities as they arise. Unfortunately, we just have not been presented with a lot of opportunities to invest our clients' cash. Second, you will notice these companies are very different from one another. Scana feeds power to your home while you watch HGTV, which is owned and produced by Scripps. Very different businesses! However, each one has their own reason for us to accumulate shares. We own shares of companies with real revenues and earnings at attractive valuations relative to their growth rates. We don't own the stock market. This means we do not immediately put cash to work if the stock market arbitrarily falls 10%. We put cash to work when it makes sense to on a company-specific basis. Where the "market" is at that time is really of little importance. So, know that we are still hard at work behind the scenes. We simply don't listen to the daily noise of the market and feel compelled to force an investment because the stock market is down sharply on the day. Companies tend to look attractive at very different times during a market cycle and we will be ready with cash in hand to take advantage of these opportunities as we see fit.

With that being said and the fact that we still are not seeing a lot of individual stock buy signals, it is time to take a breath and look at the bigger picture. What are macro (economic) data points, company fundamentals, other asset classes (i.e. commodities and fixed income) and central banks around the world telling us right now? We are clearly in the midst of a slowdown and possibly on the verge of falling into a recession. That is a fact. We have been in the middle of an earnings recession for several quarters now. It is still yet to be seen whether we fall into an economic recession. Historically, in an earnings recession, the stock market as a whole tends to not perform so well. Over the past 30 years, every time we had at least 3 consecutive quarters of a year over year contraction in S&P 500 earnings, the stock market experienced a minimum 20% decline from its peak. On January 20th, the S&P 500 was down 15% from its peak in May of last year. Since then, we have

rebounded a little bit, but still remain roughly 10% off the high. Unless this time is different (famous last words), we have a little more left to the downside. So, if January made you uncomfortable, then you need to re-evaluate your risk tolerance.

The key to being a successful investor is to not change your strategy every time the market whipsaws up and down. It often leads to irrational decision making. You need to understand what risks you are taking on and it starts with understanding what you own. If you own something like a Triple Levered, UltraShort, Currency Hedged, North Korean Dynamic Resource ETF and you can't tell me what it's supposed to do, then you don't need to own it. I'm being a little tongue-in-cheek, but these kinds of ridiculous products really do exist. Understand what you own, ignore the daily noise and look at the bigger picture. It's the only way you'll be able to comfortably assess your risk and more than likely stick with your strategy in the most volatile time periods.

--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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* The purchase price used to calculate the price change was the average price paid by all accounts that bought the specific stock.