OBSERVATIONS 4.1.2019

TANDEM
Investment Advisors

Financial Markets Review

The S&P 500 ended the quarter on a high note to lock in its third straight positive month and post a 14% return for Q1. U.S. equities are essentially back to where they were before December's meltdown and remain 3.5% from its all-time high set in September of last year. However, I would be remiss to not touch on the elephant in the room – the inverted yield curve.

In previous editions of ***Observations*** and ***Notes from the Trading Desk***, we've written extensively about the flattening of the yield curve. For several years now, much of the flattening occurred in the 2-year and 10-year Treasury spread. However, many prominent economists and Federal Reserve officials noted that the flattening in the 10s to 2s should be taken with a grain of salt. In fact, the San Francisco Fed published a paper stating the following:

> *"The yield curve has been a reliable predictor of recessions, and the best summary measure is the spread between the ten-year and three-month yields. Although this particular spread has narrowed recently like most other measures, it is still a comfortable distance from a yield curve inversion."*

This statement was published seven months ago when the spread was 80 basis points. Last week, this spread finally inverted. To be honest, it really shouldn't have taken people by surprise. Many economic indicators have been decelerating since the end of last summer – home sales, consumer sentiment, continuing jobless claims, GDP, ISM manufacturing, retail sales, industrial production and the Leading Economic Index – to just name a few. During this entire time, the data dependent Fed stuck to their guns and marched on raising the Fed Funds rate 25 bps at a time until just a couple of weeks ago. Rightfully so, the Fed has officially pivoted and announced an end to QT in September and no additional rate hikes this year. Market participants see it a little differently and are getting out ahead of the Fed. Currently, there is a 25% probability of a rate cut by the June meeting, a 55% probability of a rate cut by the September meeting and a 66% probability of a rate cut by the December meeting.

So, you are probably wondering by now whether all of this means a recession is imminent and what should be done about it. Unfortunately, I'm not going to be of much help. I, like the rest of the world, have no idea. The warnings are there, and the probabilities have been slowly rising through the past year. Financial pundits have been paraded out in front of the cameras to all declare that once an inversion takes place, time is on your side as a recession typically won't occur for another 9 to 18 months. So, with that knowledge, these market experts suggest nothing but rainbows and butterflies in the equity market for several months or even year to come. My take on it is that it's one of the more ridiculous assertions one could make. You will not be able to set a calendar reminder nine months from now letting you know that a recession has officially arrived. As I mentioned, financial markets other than the U.S. equity market are warning us, so there is no reason to play with fire. The thought of going all-in because historically the market went up between the time the yield curve inverted and a recession is just mind blowing to me. On the flip-side, it's equally mind blowing to dump everything because we might go into a recession. Being all-in or all-out is not a way to manage a portfolio, which leads me to the next section of this column…

A Big Thank You

To all the financial professionals who've hired us, their clients and our direct clients – thank you for believing in and supporting our investment strategy. And above all else, thank you for entrusting us with your hard-earned money.

The Informa Investment Solutions' PSN manager database is North America's longest running database of investment managers and they recently named us as one of the top managers within the following universes*:

- Managed Account Large Cap Equity
- Managed Account U.S. Core
- Managed Account U.S. Equity
- Managed Account Mid Cap Equity
- Large Cap
- Large Core Equity
- U.S. Core Equity

We take great pride in our investment strategy and discipline. And without your support and money to manage, we wouldn't be able to do what we do. So, thank you!

The past 15 months have been and continue to be one of the more confusing times for an individual investor. Coming into 2018, the future couldn't have looked brighter. Global growth was accelerating and virtually all financial assets were rising in lock-step. Just as shouts for an equity melt-up and the mocking of cash hit a fever pitch, the first warning struck - the S&P 500 proceeded to crater nearly 12% over the course of eight trading days. Calm eventually returned to domestic equities as spring turned to summer. Unfortunately, the same couldn't be said for international equities, international bonds and commodities, which ended up being warning number two. As we entered the autumnal equinox, U.S. equities peaked and began their convergence to their underperforming international counterparts. From the start of fall to Christmas Eve, the S&P 500 fell 20%. All the while, corporate earnings growth remained robust and for the most part U.S. economic activity remained stable. This strength kept the Fed on track to continue raising rates, but the declining equity market clearly had them shaken. Fast forward three months, expectations for corporate earnings are now for a decline in year-over-year growth, the economy is showing signs of weakness and the S&P 500 is up over 20% since that Christmas Eve low.

It all makes total sense, right? Not even close! And, therefore individual investors throw up their hands and let their emotions take over. Without a strict investment discipline, you are simply a rudderless boat getting tossed around by the waves. It's not any fun and you're unlikely to make it to your destination.

It is our job to help you navigate the storms and sort through the confusion to make sure you stay on track. We often talk about the "market", but the reality is it makes no difference to us if the "market" is up, down or sideways. Our goal is to pay attractive prices for businesses with growing revenues, earnings and cash flows. And, then we look to sell when those prices overvalue those fundamentals. We have our proprietary way of identifying these companies and our discipline guides us. It's really that simple and done the same way every day of the week.

** For more information on the Informa Investment Solutions PSN rankings, please visit our website at www.tandemadvisors.com.*

Tandem Strategy Update

As equities marched higher, broadly speaking due to multiple expansion and not earnings growth, there have been fewer opportunities for us to put cash to work. However, there have been a few individual opportunities over the past month to add to existing positions.

At the end of February, we were able to take advantage of a good-looking technical set up going into Dollar Tree's (DLTR) earnings announcement on March 5th by adding incrementally to our holding. DLTR beat earnings and same-store sales expectations. In addition, they announced a further re-branding of their Family Dollar stores, which received positive reviews from analysts. In mid-March, we were also able to take advantage of a strong technical setup in Tyler Technologies (TYL) and add to our existing position. TYL reported a strong quarter in early February and subsequently ran up 10% over the course of two weeks. Over the ensuing couple of weeks, TYL pulled back to support and consolidated where we felt confident in increasing our position size. Lastly, after initiating a position in Comcast (CMCSA) in December of last year, we were able to take the position to a full size over the course of this past quarter.

In addition to the incremental buying of existing positions, we have taken the opportunity to sell half our position in Celgene (CELG) before the April 12th vote by Bristol-Myers (BMY) shareholders on the proposed BMY – CELG merger. There are several large investors in both BMY and CELG that have been leaking their intention to vote for or against the deal. Much of this uncertainty is still in the stock, as it continues to trade at a significant discount to the merger price. Lastly, we have completed our liquidation of Cognizant Technology Solutions (CTSH) due to the previously announced hiring of an outside CEO, which is a fundamental violation of our investment strategy.

Every year, a significant number of corporations will announce dividend increases in the November to March timeframe. A lot of this has to do with the timing around their fiscal year, which often coincides with the calendar year. Among our three main strategies, 17 companies announced an increase to their quarterly dividend payment and one company initiated a quarterly dividend.

- Abbott Labs (ABT) – 14%
- AbbVie (ABBV) – 12%
- Brown Forman (BF.B) – 5%
- Comcast (CMCSA) – 10%
- Dominion Energy (D) – 10%
- Dollar General (DG) – 10%
- Ecolab (ECL) – 12%
- Hormel Foods (HRL) – 12%
- Intercontinental Exchange (ICE) – 15%
- NextEra Energy (NEE) – 13%
- Nike (NKE) – 10%
- Ross Stores (ROST) – 13%
- Stryker (SYK) – 11%

- TJX Companies (TJX) – 18%
- T. Rowe Price (TROW) – 9%
- Verisk Analytics (VRSK) – initiated a quarterly dividend
- Waste Connections (WCN) – 14%
- YUM Brands (YUM) – 17%

-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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