

Financial Markets Review

U.S. equity markets looked poised to finally break out of several months of consolidation. Within the first two weeks of May, the VIX fell nearly 20%, while the S&P 500 gapped above April's highs, the Russell 2000 got back to all-time highs and the 10-year U.S. Treasury yield remained under 3%. Through May 14th, the S&P 500 was up over 3% and technically speaking it looked as if equities had regained their mojo. On May 15th, the positive momentum came to a screeching halt when the 10-year Treasury yield broke out above 3% on the back of a pickup in inflation chatter. The spike in interest rates caused many investment professionals to proclaim the end of the 30+ year bull run in bonds officially over. And with that, the S&P 500's advance stalled out, ultimately declining nearly 1% over the final two weeks of the month.

The big question is whether the final week of May was an anomaly or foreshadowing of what's to come this summer. Europe's political issues had pretty much been put on the back burner since Brexit rattled markets nearly two years ago. That is until Italian politics shook up global bond and equity markets for a few days in May. Many people once again started to question the viability of the EU and Euro as a single currency and its peripheral effects on the global economy. Moreover, President Trump ignited renewed talk of a global trade war by recommending tariffs be slapped on Canadian, Mexican, and European steel and aluminum imports. Put all these events together and the result was a 50% surge in the VIX coupled with 1% intraday swings in the S&P 500 over six of the final seven days in May. If this is just the start, buckle up as it could be a wild summer!

Tandem Strategy Updates

For the most part, May was not an overly busy month on the transaction front until volatility picked up over the last few days. As volatility increased, we made small incremental buys in Celgene (CELG)*, CVS Health (CVS)**, Walgreens Boots Alliance (WBA)**, Dominion Energy (D)*** and JM Smucker (SJM)****. All these stocks continue to meet our fundamental criteria and look attractive in our quantitative model.

We did finish liquidating our position in Mednax (MD)*****. As we mentioned several months ago, MD failed to pass our quantitative model because of a significant fall-off in earnings growth. The liquidation process for MD took a little longer than usual due to their acknowledgement that they were being sought after by a few private equity firms. This news caused the stock to rise from the low \$40s last fall to the mid \$50s this past spring, where we began the liquidation process. Once news broke that the interested private equity firm was most likely walking away from the deal, our stops were triggered and the remaining shares in MD were liquidated.

Through the end of May, all but two of our core holdings have reported 1st quarter earnings. And just like the S&P 500, our core holdings in aggregate reported very solid numbers. Overall, revenues grew 10.3%, EBIT grew 12.3% and EPS grew 23.0%. Because of the strong numbers and recent tax reform, we've seen many of our core holdings report significant dividend increases over the past several months. Factset (FDS)***** and Tractor Supply (TSCO)***** continued this trend by announcing a 14% and 14.8% increase to their quarterly dividend, respectively.

Events on Tap

The second week of June has the potential to provide some fireworks. On June 12th, President Trump's scheduled meeting with Kim Jong Un of North Korea is back on. If there is anything we know about this meeting, it's that we know absolutely nothing. The simple fact that there is so little detail regarding this meeting could be what reignites volatility in the stock market.

June 12th is also the first day of the Federal Reserve's two-day FOMC meeting. The expectation is for another quarter point rate hike, which would take the Fed Funds Rate to 2%. The real question is not whether they raise rates in a couple of weeks, but rather what the FOMC signals going forward. Consensus is for the Fed to raise rates just one more time this year. However, due to inflation and wage growth creeping higher, one would think there is a strong chance for Chairman Powell to deliver a hawkish statement without really committing to a 4th rate hike for 2018. Don't be surprised, however, if in typical Fed fashion, the post-meeting statement will be just dovish enough to satisfy the stock market and offset any hawkish undertones.

-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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** Purchased in Tandem Equity.*

*** Purchased in Tandem Equity and Large Cap Core.*

**** Purchased in Tandem Large Cap Core.*

***** Purchased in Tandem Large Cap Core and Mid Cap Core.*

****** Sold in Tandem Equity and Mid Cap Core.*

****** Owned in Tandem Equity, Large Cap Core and Mid Cap Core.*