Financial Markets Review

If you're into symmetry, then you would find beauty in the S&P 500's chart during the month of June. The index closed 0.48% higher for the month, but it was a near perfect return to May's closing value as measured in both time and price. The S&P 500 steadily climbed higher in eight of the first ten trading days as trade war rhetoric seemed to slowly drift away. It proceeded to make a nice rounded top for a few days during the middle of the month threatening to take out the 2,800 level. However, after a few failed attempts at cracking 2,800, the stock market retreated as talk of global trade wars heated back up and the index basically ended up where it started.

Source: Factset

Much of June's advance and subsequent decline in the S&P 500 was not terribly volatile on an intraday basis. However, what is glaring in the chart above is how volatility returned over the final five trading days of the month. According to Bank of America Merrill Lynch (BAML), nearly $30 billion was pulled out of global equity funds during the final week of June, which marked the second largest weekly outflow on record. Of this $30 billion, $24 billion was pulled out of U.S. equity funds making it the third largest weekly domestic outflow.

The proposed additional tariffs led to a pickup in global trade war chatter and as a result the dollar appreciated against most other currencies. The dollar's appreciation has caused anxiety among emerging market economies as a decline in local currencies make dollar denominated debt much more difficult to pay back, which in turn causes capital to flee. Specifically, the Chinese yuan has fallen to a six-month low against the dollar, while the China Shanghai Index has declined 13.90% over that same time and 6.38% in June alone.

As long as the threat of a global trade war hangs over the global economy, I would be hard pressed to see how the S&P 500 breaks out of its five-month trading range. Trade wars have the potential to lead to currency wars, which will most certainly put the global synchronized growth story in jeopardy. And even if the proposed tariffs never materialize, the longer the threats continue the more likely business activity will slow due to uncertainty surrounding global trade. Unfortunately, it doesn't look as if the tariff talk is going to dissipate any time soon, which will likely lead to increased volatility among all financial assets in the months to come.

Tandem Strategy Update

This past month was an extremely quiet month on the transaction front as we made one incremental purchase and no sales throughout June. JM Smucker (SJM)* reported quarterly earnings on June 7th and subsequently sold off sharply on the back of an earnings miss. The company is facing several industry-wide headwinds, but we do not see these as a permanent impairment to their business. SJM was one of only a handful of packaged food companies to successfully raise prices last quarter. This pricing power led to their third consecutive quarterly increase in gross, operating and net profit margins on a rolling basis. In addition, SJM generated a record $1.1 billion in funds from operations, $1.2 billion in cash from operations and $900 million in free cash flow over the last four quarters. Their continued growth in cash has allowed them to reduce their leverage ratios over the past few years while also increasing their dividend by an annualized 7%. Aside from the fundamental nature of the business, the corporate governance side got a little interesting within the past week; SJM filed an 8-K to accelerate the expiration of its poison pill. In an industry that is currently consolidating, coupled with a company that maintains significant family control, it is intriguing to see them reduce some of their takeover/buyout prevention measures.

The impending doom of the consumer pharmacy space ratcheted up a notch when Amazon (AMZN) announced their acquisition of PillPack. The $1 billion purchase price for a company that generated $100 million in revenues last year caused Walgreens Boots Alliance (WBA)** and CVS Health (CVS)** to lose a combined $10 billion in market cap. The argument is that this acquisition is only the start of AMZN taking over the entire consumer pharmacy industry. As a reminder, almost one year ago to the day, AMZN announced their buyout of Whole Foods. At the time, it was being spoken of as a fact among most financial pundits that the Costco's (COST)** and Kroger's (KR) of the world would become extinct. COST fell 20% over the following month, which only reaffirmed what everyone believed. Today, COST is 39% higher from where it bottomed after the AMZN/Whole Foods news. And, it is 16% higher from where COST was trading when the acquisition announcement broke, which is over 4% higher than what the S&P 500 has done over the same time. The moral of the story is to be patient. WBA and CVS have had and will continue to experience short-term price pressure, but the businesses are not going away.

-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

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

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