

Financial Markets Review

August managed to have a few more fireworks than the previous couple of months. On two separate days, the S&P 500 declined roughly 1.5% due to tensions with North Korea and apparent dysfunction among leaders in the White House. The fact we saw the market drop this much twice within one week is a phenomenon as of late. However, true to form, the dip was quickly bought and any fear of a potential correction became a distant thought.

The S&P 500 zigged and zagged a few times over the course of the month to close higher by 1.30 points (not percentage points, but absolute points, which equates to 0.05%). Exciting stuff on the index level! Even though the S&P 500 closed within 0.78% of its all-time high, only 50.99% of stocks were trading above their 50-day moving average, which is not nearly as exciting for the stocks making up the index.

Tandem Strategy Updates

Based on volumes and the lack of volatility for much of the summer, it appears most managers closed up shop to head for the beach. Not us! Fortunately, we live at the beach here in Charleston. We don't have to lock the doors and take time off to put our feet in the sand. Therefore, regardless of the time of year, weather or stock market trading trends, we will take advantage of all opportunities to buy and sell stocks. And, August was seemingly just as busy as July when it came to transactions at the firm level.

We added a new position to our clients' portfolios – CVS Health Corporation (CVS)*. Over the past couple of weeks, we have been building a position in CVS. Many of you have noticed and have asked a very good question – why are you buying CVS when we already own Walgreens (WBA)? It's a great question as it would appear that we are doubling down on drugstores. The quick and simple explanation is we don't have a mandate to cap our exposure to any specific industry or sector. If a company shows up as exuding a rare low valuation relative to their growth and the fundamentals check out, we will be buyers of the stock. This is regardless of what we already own. Both companies appear to be the same thing, but when looking under the hood they are actually very different. For long-time clients of Tandem, you might recognize a similar situation when we bought Waste Connections (WCN) while owning Republic Services Group (RSG) for several years. In this case, CVS and WBA are both retail drugstore chains. What is typically overlooked is that CVS derives over 67% of their revenues from their pharmacy benefit management (PBM) segment. WBA doesn't own a PBM, which is the biggest difference between the two drugstores.

CVS is interesting to us on a few levels. Over the past two years, the stock has fallen over 30% and for good reason. PBMs came under fire from regulators due to skyrocketing drug prices over the past several years. The job of the PBMs is to keep drug prices to the end consumer in check. While the profits of PBMs and drug prices continue to soar, many people started to question the purpose of these companies and their business practices came under scrutiny. This put a dark cloud over the entire industry. Then in November 2016, CVS announced the loss of their contract to fill over 40 million prescriptions for the Department of

Defense. The announcement was yet another blow to the company and has served as a lead weight to CVS's stock price for nearly a year now. Expectedly, sales and earnings have slowed year-over-year; however, the company fundamentals appear to have troughed and are set to accelerate as the year over year comps roll off in a couple of quarters. It is for this reason, in conjunction with CVS trading at a P/S and P/E level only seen during the past two recessions, that our quantitative model signaled an opportunity to take a position in this consistent dividend grower.

In addition to CVS, we added to our positions in TJX Companies (TJX)* and Ross Stores (ROST)** for the first time in several years after taking profits a year ago when the stocks were 10% and 17% higher, respectively. Our clients have owned both TJX and ROST for the past seven years. The table below highlights the operational and stock price performance of both stocks.

Ticker	Initial Purchase Date	Annualized EPS Growth	Annualized Dividend Growth	Annualized Price Performance	Cumulative Price Performance
TJX	8/4/2010	12.0%	26.1%	19.36%	250.29%
ROST	2/3/2010	17.0%	23.7%	24.18%	407.38%

The final stock purchased at the firm level this past month was Dollar General (DG)*. I have touched on DG over the past few months, so I won't go into much company specific information right now. We were given an opportunity to increase our position in Dollar General after they reported a decent quarter, but nonetheless sold off due to future margin concerns. The stock declined nearly 8%, while its growth prospects remained unchanged. The price decline allowed us to continue to incrementally build our position in DG.

The sales this past month were all done for different reasons, whether it be for fundamental or valuation purposes. On the fundamental side, we have completed the liquidation of both Aptargroup (ATR)*** and Thermo Fisher Scientific (TMO)****. Both ATR and TMO have been holdings of ours for the past 10 years. As seen in the table below, our clients have experienced pleasant returns since the initial purchase.

Ticker	Initial Purchase Date	Annualized EPS Growth	Annualized Dividend Growth	Annualized Price Performance	Cumulative Price Performance
ATR	8/7/2007	6.83%	9.43%	8.57%	127.60%
TMO	6/22/2007	16.35%	N/A	12.79%	240.07%

Although both positions have provided excellent returns over the past 10 years, they have violated two of our basic fundamental criteria. ATR hired a CEO from outside the company. And, TMO stopped increasing their total dividend payment. Therefore, it was time both companies were sold from our clients' portfolios.

We also began the liquidation process in Bank of the Ozarks (OZRK)***. We have only held this position for 16 months, but a lot has changed within the company since our initial purchase. The bread and butter of OZRK is their Real Estate Specialty Group, which was founded and led by the Chief Lending Officer, Dan Thomas. Under Dan's 14-year leadership, the Real Estate Specialty Group closed over \$25 billion in loans. The most impressive stat is that over that time span, only two loans have gone bad representing 0.07% of the total loan balance. That is practically unheard of! Unfortunately, much of their success may have gone to their heads. OZRK has strayed from their conservative and thoughtful lending roots to become one of the largest lenders in

New York City. They are now offering non-recourse loans on large scale commercial and residential development projects. Basically, they are taking over loans or giving new loans that no other bank will currently touch and they are doing so by offering some of the riskiest loans out there. Not only are they taking over loans in New York City, but they also have a presence in South Florida, San Francisco and Chicago. OZRK's business has changed and is no longer the company we originally purchased. The icing on the cake came at the end of July when Dan Thomas unexpectedly resigned. There is no way to quantify the new risks they are undertaking and to believe their past successes will be sustainable going forward. For the reason, OZRK is now in the process of being liquidated.

Lastly, on the quantitative side, our model flashed a sell signal in Republic Services Group (RSG)***. RSG was a position we also took a little over 10 years ago and this past month is the first time we've ever sold any of our shares at the firm level. Since the day we purchased RSG, they have managed to consistently produce decent operating numbers, which is in line with their industry – waste services. People will always need their trash picked up and RSG is there to do the dirty work. Over the past 10 years, RSG has grown the following on an annualized basis.

Ticker	Initial Purchase Date	Annualized EPS Growth	Annualized Dividend Growth	Annualized Price Performance	Cumulative Price Performance
RSG	3/20/2007	5.70%	12.06%	8.57%	135.42%

As consistent as RSG has been over the years, the stock price has doubled over the past 3 and a half years. RSG is now trading at a record high P/E and P/S level. Our quantitative model has signaled RSG to be trading at an extreme valuation relative to its growth. For that reason, we are bound by our sell discipline to take profits in 25% of our position.

Events on Tap

- Every day – a new development coming out of North Korea
- September 5th – SEC adopts T+2 for securities transactions
- September 7th – ECB Meeting Announcement – will Mario Draghi begin to hint at tapering QE?
- September 20th – FOMC Meeting Announcement – will they raise the Fed Funds rate another 0.25% and/or begin winding down their balance sheet?

--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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** CVS, TJX and DG were purchased across Tandem Large Cap Core and Equity.*

*** ROST was purchased across Tandem Mid Cap Core.*

**** ATR, OZRK and RSG were sold across all strategies (Tandem Large Cap Core, Equity and Mid Cap Core).*

***** TMO was sold across Tandem Equity and Mid Cap Core.*