December 2022 - Tandem Investment Advisors, Inc.

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Financial Markets Review

November was a month that had a little bit for everyone. Bullish, bearish, and flat-out confused biases were all confirmed. If you wanted to spin a narrative one way or another, then this was the month for you.

The major U.S. indices were all higher in November, as the S&P 500 led the way advancing roughly 5.3%, while the Nasdaq and Russell 2000 climbed 4.3% and 2.1%, respectively. The gain in the S&P 500 marked the first time since August 2021 that the index recorded back-to-back monthly gains.

Not only have equities experienced a rather turbulent year, but owners of long-term Treasuries have also had a rough go of it. As short and long-term bond yields have surged, the prices of those respective bonds have declined rather precipitously. However, this past month, long-term rates have bucked the trend. Both the 10-year and 30-year Treasury bond yields have fallen roughly 60 and 70 basis points, respectively, since they peaked around 4.30%. The decline in bond yields and subsequent rise in bond prices has been a welcome relief to holders of these securities.

And lastly, two other trends appear to be reversing that have been major headwinds this year. First, the U.S. dollar index declined for a second straight month, falling 5.1%, which marked its weakest month since September 2010. Secondly, WTI crude fell 6.9%, as oil prices were lower for the fifth time in the past six months. Lower oil prices have led to gasoline prices falling nearly 30% from their peak in June.

There are many aspects of the market to cheer as we head into this holiday season. Equities can certainly keep rallying into year-end given the bounce off extremely poor sentiment earlier this fall and the seasonal trends currently in our favor. Given the currency headwinds cited by nearly every company doing any business overseas, a depreciating U.S. dollar is a welcome sign to nearly all corporations. And the most recent softening in inflation trends, which have been aided by declining oil prices and a thawing of supply chains, are certainly reasons to be optimistic that maybe the worst is behind us.

However, I do caution against getting too complacent. The recovery in equities, although very much a welcomed relief, is not speaking the same language as the fixed income market. For much of the year, the argument against any potential recession or even weakness in corporate earnings was that the yield curve, specifically between the 3-month and 10-year maturities, had not inverted or signaled any potential recession on the horizon. Since 1950, a negative spread between these maturities has preceded every recession, except for one false signal in 1967. During the springtime when this argument intensified, we said it was only a matter of time before this portion of the curve inverts. If the Fed were to continue hiking short-term rates, it would be inevitable that the yield curve would invert. And lo and behold, here we are with an inverted yield curve. The 3-month/10-year spread is now the most inverted it has been in over 20 years and the 2-year/10-year spread is now the most inverted in over 4 decades.

Only time will tell if the current inverted yield curve signal is a head fake or if it correctly predicts another recession. If it ends up being a head fake, then the worst of the bear market is likely behind us. However, if a recession does materialize then there is a risk to earnings and therefore a risk of further equity weakness. The weight of the evidence probably favors that of a recession in the coming quarters, but that truly is anyone's guess.

So, if you are not thoroughly confused by now, then you might not be paying enough attention, which is probably a good thing. There are signs of hopefulness and pessimism in any direction you turn. Those signs even reverse themselves from one day to another. Trying to figure out where markets go a week, month, or year from now is an impossible task. The best you can do is stick with a strategy that you understand and keeps you on track to meet your goals, while simultaneously matching your risk tolerance.

Tandem Strategy Update

As equity markets have recovered off their October lows, several of our core companies have experienced price appreciation that have outpaced their fundamental underpinnings. This often happens in a bear market. Too often bear markets are only associated with weakness in equity prices. The reality is that bear markets trend lower, but also have extremely sharp countermoves in the opposite direction (i.e., bear market rallies). It is the volatility in moves lower and higher that ultimately frustrate and grind investors down emotionally to the point where the proverbial "towel" gets thrown in. However, it is disciplined investors who can use these moves to their advantage and avoid the emotional chop.

Over the past month, our quantitative model has signaled more opportunities to trim core positions than it has signaled to initiate new positions or add to core holdings, so cash equivalents have naturally risen in each one of our strategies. We have made several partial sales in each of our strategies based on valuation and initiated the liquidation of a long-time core position. As a reminder, we will only sell a portion of our position for valuation reasons. As long as a company continues to pass through our quantitative model and meets our fundamental criteria, we will continue to hold the company. Once a company ceases to meet our fundamental criteria, whether it be through earnings no longer growing through any economic cycle or by a dividend cut, then that company will be liquidated from the portfolio. In the table at the end of this column, you can find the sales that were made in each strategy since November 1st.

Large Cap Core	Equity	Mid Cap Core
AbbVie (ABBV)	AbbVie (ABBV)	ExlSerivce Holdings (EXLS)
Automatic Data Processing (ADP)	BlackRock (BLK)	FactSet Research Systems (FDS)
BlackRock (BLK)	FactSet Research Systems (FDS)	NV5 Global (NVEE)
FactSet Research Systems (FDS)	O'Reilly Automotive (ORLY)	O'Reilly Automotive (ORLY)
T. Rowe Price (TROW)	T. Rowe Price (TROW)	T. Rowe Price (TROW)

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Billy Little is a shareholder, Senior Vice President, and Portfolio Manager for Tandem Investment Advisors, Inc. Mr. Little began his career in the investment industry in 2004, as a Financial Advisor with Ameriprise Financial in Baltimore, Maryland. Mr. Little joined Tandem in 2006. Mr. Little oversees Tandem's corporate financials, including business planning, budgeting, and vendor negotiations. Mr. Little also directs Tandem's quantitative and fundamental research. He is a regular member of the CFA Institute and past President of the CFA Society South Carolina. Mr. Little graduated from the College of Charleston with a Bachelor of Arts in Business Administration with a concentration in Finance.