January 2024 - Tandem Investment Advisors, Inc.

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Financial Markets Review

After an agonizing three-month stretch, from August to October, where U.S. equity markets corrected over 10% and bond yields surged, everything was made right again over the final two months of the year. All major U.S. indices closed higher in December with small cap stocks stealing the show, as the Russell 2000 soared 12%. On the heels of a nine-week winning streak, which was the longest since 2004, the S&P 500 ended the month higher by 4.4%. As had been the case for the better part of the year, the Nasdaq continued its move upward, advancing to the tune of 5.5%. However, more importantly, the S&P 500 Equal-Weight Index finally showed some strength over its market-cap weighted counterpart with an advance of 6.7%.

Just maybe the relative strength of the S&P 500 Equal-Weight Index is a harbinger of what's to come in 2024. As it has been well documented for most of the year, the positive performance in the S&P 500 (market-cap weighted) was driven by a handful of large technology-centric names, which came to be known as the Magnificent 7 – Apple (AAPL), Alphabet (GOOG), Microsoft (MSFT), Amazon (AMZN), Meta (META), Tesla (TSLA) and Nvidia (NVDA). With the year drawing to a close that tide started to change as the equal-weight S&P 500 outpaced the market-cap weighted S&P 500 by over 2%, which is the most since April 2022. Given that much of the recovery off the 2022 lows has been driven by so few stocks, it is imperative that the rally broadens out to include more companies. The S&P 500 is now within spitting distance of its all-time high set nearly two years ago to the day. And if it has any shot at breaking through and sustaining new all-time highs, it must be done on the backs of many companies and not the continued strength of just a few.

Over the past couple of months, it hasn't been expectations of a stronger economy that have driven the equity market. The economic landscape has been quite mixed, as witnessed just last week in the two economic reports that came out on January 6th. The December nonfarm payrolls report came in strong showing 216,000 jobs were created vs. 170,000 that were expected, while the unemployment rate held steady at 3.7%. As of 8:30AM on that Friday, the labor market appeared to remain robust with few signs pointing to any weakness in the economy. Roughly an hour later, the ISM non-manufacturing PMI report hit the tape showing a meaningful slowdown in the services sector of the U.S. economy. And the most head

scratching part of the ISM report was the employment index hitting a 3 ½ year low and revealing a sharp contraction in the number of jobs. Within minutes of each other, two significantly sought-after economic reports gave conflicting views of the economy. So, it is certainly not conviction of a strong economy causing equity prices to move higher. Rather, it has all been about Fed policy expectations and the path of interest rates. The predominant expectation for the economy is for it to continue growing and avert a recession while inflation dissipates. This goldilocks scenario would allow the Fed to begin cutting interest rates at some point in 2024, which would ease financial conditions and theoretically soften any weakness in the economy. At any rate, this was the market's expectation going into the December FOMC meeting and the Fed delivered. The Fed brought their own 2024 interest rate projection down to a range of 4.5%-4.75%, which implies 75 basis points of interest rate cuts next year. The market went even further, pricing in a little more than 150 basis points of interest rate cuts by next December. The narrative of "higher for longer" to easing policy "sooner than later" has caused long-term interest rates to drop precipitously, as the 10-year Treasury bond yield has fallen from 5% in late October to under 4% most recently. This downward path in interest rates has been a major boon in supporting and extending already lofty equity valuations. Given how laser-focused the market is on interest rates and future Fed policy, the path of interest rates will continue to have a major affect on the direction of the equity market.

Tandem Strategy Update

As we roll into 2024, it is ever more important to remain disciplined and focused. Last month, we touched on the concept of blocking out the noise and staying focused on the task at hand – own growing companies and pay reasonable prices for them. It is becoming clear that the noise and the potential distractions will be significant as we progress through the upcoming year.

Just as we mentioned earlier on in this column, recent economic reports have been mixed and often send conflicting signals. These signals can then change the market's expectation of future Fed action, which leads to increased volatility in interest rates. Given how much equities are correlated to the day-to-day changes in interest rates, the increase in rate volatility feeds into greater equity volatility. And it's not just economic reports that can be the source of financial asset volatility but throw in geopolitical tensions and an upcoming U.S. Presidential election and there are any number of reasons for the market to swing one way or another on any given day.

It is certainly easier said than done, but staying grounded and not letting the noise shake you from a strategy or plan increases the probability of reaching your goals. Part of our discipline is to make investment decisions independent of what is going on in the market. Our process relies on math and is done on a company-by-company level regardless of the market's

direction and sentiment. Sometimes we buy or sell a stock when the market is going up and other times when the market is going down, but at no time is the market dictating our action. The company's fundamentals, growth and valuation ultimately dictate our next move.

Even as U.S. equities continued to rise in stunning fashion throughout December, we were still able to find a couple of attractive opportunities to add to existing core holdings. Across all three of our strategies, we added to our positions in Becton Dickinson (BDX) and Steris (STE). Both companies have continued to meet our criteria of consistent growth in revenues, earnings and cash flows. And while doing so, they have maintained a long history of growing their dividends to shareholders. Although the market was already up significantly, our models were able to find value in adding to these existing positions. Our decision was not predicated on the Fed forecasting a cut in rates next year or the most recent Presidential race polls, but rather these companies individually presented an opportunity in that moment and so we acted.

It is impossible to predict where the market will end up next month, quarter or even a year from now. With the market's moves out of your control, it is best to focus your time and effort on what you can control, which is your process and discipline. By redirecting your focus on the things that you can control, you will ultimately be better positioned and prepared to deal with the daily whims of the broader market.

Source: *Source of all data is FactSet, unless otherwise noted.*

William "Billy" Little, Jr., CFA

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.

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