Tandem Investment Advisors

Observations - July 2021 - Tandem Investment Advisors, Inc.

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by William “Billy” L. Little, Jr., CFA

Financial Markets Review

After the S&P 500 spent the past couple of months vacillating between 4,050 and 4,250, the index managed to finally break through and close above this range on June 24th. Since that day, the S&P 500 has not looked back and has closed at a record high for the past seven consecutive days. The last time the market accomplished this feat was back in 1997.

As the broader equity market continues to set records, there have been some notable changes among other financial assets. Yields on the long end of the Treasury curve took a leg lower this past month with 10-year and 30-year Treasury bonds falling roughly 20 and 30 basis points, respectively, over the past few weeks. Treasury bond yields peaked back in March; however, most of the decline in yields has been a more recent event. Meanwhile, the yields on 30-day Treasury bills to 5-year Treasury notes, which make up the shorter end of the curve, have all risen over the past month. And lastly, King Dollar has reasserted itself as an asset worth owning again. The U.S. Dollar Index has appreciated 3.3% since the end of May after declining roughly 11% over the preceding 12 months.

The flattening of the yield curve and strength in the U.S. Dollar Index, at least for the time being, are pointing to a bit of change in the most recent inflation narrative. As demand came back online amidst broken supply chains and freak weather events, prices for just about everything have shot up. But does that mean inflation or hyper-inflation, as some are calling for, is here to stay? The Federal Reserve is adamant that the current bout of inflation will be transitory, and I am inclined to believe them. After all, transitory just means “not permanent” and every inflationary period in the history of this country has turned out to be transitory. Unless this time is different (famous last words), I would be willing to bet we have not entered a permanent state of hyperinflation.

Financial markets can change rapidly, but currently the U.S. Treasury and U.S. Dollar markets are indicating inflationary pressures persisting in the near future with the Federal Reserve being able to contain it. If this were not the case, the U.S. Dollar Index would not be appreciating. Inflation and lack of confidence in policy erode the value of one’s currency. Again, this could be a dead cat bounce in the U.S. Dollar, but the recent strength in this index is not pointing to an uncontrollable inflationary spiral. Additionally, the long end of the Treasury curve would not see yields come down if persistent inflation was truly a threat. The yield curve steepens, and rates rise on the back end if inflation were truly a long-term threat to the economy.

The U.S. Treasury and U.S. Dollar markets are predicting that in the intermediate to long-term, the U.S. economy will look very similar to what we have experienced since the Financial Crisis, ex-Covid. That would be an environment where real-GDP runs around 2% to 2.5%, bond yields remain low and any equity that exhibits “growth” maintains an underlying bid. The market action in June and into the first week of July supports this view. In June, the Nasdaq Composite logged its best month of 2021 with a 5.49% advance and long-dated Treasuries, as measured by TLT (iShares 20+ Year Treasury Bond ETF), climbed 4.27%. In comparison, the S&P 500 moved higher by 2.22% and the DJIA declined by 0.08%. Welcome to 2019, again!

Tandem Strategy Update

As we gear up for Q2 corporate earnings announcements, expectations for Tandem’s core holdings are for 15% sales growth and 29% earnings growth. Although valuations remain elevated, many of our core holdings and companies on our watch list are “growing” into their valuations. Waiting for a company’s fundamentals to catch up to their valuations can be arduous at times, but it is part of the discipline and process that make us who we are. We will only act when opportunities are present. Each and every day that goes by, those opportunities appear to be getting closer.

Consensus and investor sentiment is getting a bit stretched, which makes a lot of sense considering record highs are being set on a regular basis, the rebound in earnings growth is robust and central banks continue to be accommodative. However, as we have mentioned numerous times in past columns, when sentiment gets a bit too stretched in either direction, the likelihood of prices moving in the opposite direction increases substantially. An increasing risk of a near-term price correction, while fundamentals continue to improve, gets us closer to the path of “opportunity.”

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Billy Little is a shareholder, 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 where he directs Tandem’s quantitative 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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