

OBSERVATIONS

Tandem Investment Advisors | William “Billy” Little, Jr., CFA

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Financial Markets Review

“In these matters, the only certainty is nothing is certain.” – Pliny the Elder

According to FactSet, nearly two-thirds of companies in the S&P 500 who provide earnings guidance have withdrawn their fiscal 2020 guidance. On Friday, the May nonfarm payrolls report showed jobs increasing by 2.5 million with an unemployment rate of 13.3%. This came against expectations for a loss of 8.5 million jobs and the unemployment rate spiking to 19.6%. To put it plainly: estimates for the foreseeable future will be an exercise in futility.

The S&P 500’s historic decline has been well documented. It took a mere 22 days for the index to fall over 30%, the fastest drop of this magnitude in history. The subsequent ascent has been just as remarkable. In fact, the S&P 500 recently posted its largest 50-day rally on record – a 37.7% increase. Ryan Detrick, of LPL Financial, crunched the numbers and noted that the previous seven largest 50-day rallies in the S&P 500 all produced positive returns over the following 6 and 12 months. If history is any indication; equity prices are in the clear.

I will readily admit that I do hope history repeats itself. However, I have a hard time putting faith in future outcomes based on historical relationships because we seem to be making history (record equity decline, record equity rally, record monthly job loss, record monthly job gain) every day. Even investor sentiment surveys are at odds with one another, as my partner Ben Carew wrote last month:

Some gauges of sentiment, like the AAll Investor Survey, show that investors are still markedly bearish while other metrics such as Citi’s Panic/Euphoria Model suggest that investors are overly bullish. Bank of America Merrill Lynch’s Fund Manager Survey even offers conflicting views within its own survey! According to the survey, cash allocations are unusually high. However, managers cited the “most crowded trade” as being long U.S. tech and growth. – Ben Carew, CFA, Notes from the Trading Desk – 5/26/2020

Furthermore, the Investor Intelligence Survey is reporting that bulls outnumber bears by 2.26x and the CNN Fear & Greed Index just ticked into “greed” territory from a “neutral” reading earlier in the week. It is safe to say that wherever one might fall on the bull to bear spectrum, their conviction is likely to waiver.

The uncertainty surrounding our economic, social, health and political future is so extreme that it would be foolish to try and predict where we are headed. What we do know is consumption and production completely dried up as the economy was forced to shut down. However as the economy reopens, there will be an initial economic surge from almost two months of pent up demand. The million-dollar question remains: to what level of economic activity do we initially return, and will there be structural changes that prevent a return to pre-Covid-19 levels in a timely manner?

Tandem Strategy Update

The past few weeks have been quiet on the strategy front. The only transaction we made based on a quantitative signal was adding to our position in Essential Utilities (WTRG). Outside of this purchase, the other activity in our strategies were liquidations due to a fundamental violation – specifically, the suspension of dividends. The three companies we have either fully liquidated or are in the process of being liquidated consist of Walt Disney (DIS), TJX Companies (TJX) and Ross Stores (ROST).

Some could say that these circumstances are extraordinary and maybe our dividend policy should be adjusted to reflect the environment in which we find ourselves. I would agree but only to a certain extent. This time is different, and many businesses are doing the prudent thing by eliminating, cutting, or suspending their dividend until the dust settles. These actions do not make them bad businesses at all. The issue remains: how we are expected to apply our dividend discipline in the future? How are we to know when we should ignore or follow our discipline? The answer is we should not deviate because we should be following it. The reason for a dividend

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cut or suspension is usually one of the first signs of dire prospects ahead for the company. By no means do we want to be a part of that, which is why we liquidate. In this current environment, I can see a scenario where several of our holdings suspend their dividend, not because of a dire road ahead, but as an exercise of caution. The problem therefore is that we can't know if the dividend suspension is being done out of good business practice or if the business is in trouble.

Personally, I think DIS, TJX and ROST all still have a bright future. I see how much content is consumed in my house and how eager my kids are to get to the parks; I have a hard time believing the Disney brand is in danger. TJX and ROST have intriguing business models that are centered around an experience – a “treasure hunt” – that is much more appealing than going to a more structured retailer. There is no room for opinion and bias in our investment process. The foundation of our investment discipline is to remove emotion from our process and to let the numbers dictate our actions. Part of our investment discipline is to liquidate a company from our strategy if they no longer consistently grow their dividend. However, for a company to consistently grow a dividend, they must start with paying the dividend. DIS, TJX and ROST recently announced they will be foregoing their next dividend payment to conserve cash due to the lingering uncertainty from Covid-19.

A Big Thank You

Recently, Tandem was awarded a PSN Top Guns distinction by Informa Financial Intelligence's PSN manager database, North America's longest running database of investment managers.

Through a combination of Informa Financial Intelligence's proprietary performance screens, [*PSN Top Guns](#) (*free registration to view Top Guns) ranks products in six proprietary categories in over 50 universes. This is a well-respected quarterly ranking and is widely used by institutional asset managers and investors. Informa Financial Intelligence is part of Informa plc, a leading provider of critical decision-making solutions and custom services to financial institutions.

Top Gun firms are awarded a rating ranging from one to six stars, with the number of stars representing continued performance over time. The following describes the different star categories:

1-Star Category – had one of the top ten returns for the quarter in their respective universe

2-Star Category – had one of the top ten returns for the one-year period in their respective universes

3-Star Category – had one of the top ten returns for the three-year period in their respective universes

We are pleased to share that our strategies were awarded the following PSN Top Guns distinctions.

Large Cap Core

- Large Cap Core Wrap – 1, 2 & 3 Stars - MA US Core Universe
- Large Cap Core Wrap - 1 Star - MA Large Cap Equity Universe & MA US Equity Universe

Equity

- Equity Wrap – 1, 2 & 3 Stars – MA US Core Universe

Mid Cap Core

- Mid Cap Core Wrap – 1 & 2 Stars – MA Mid Cap Equity Universe
- Mid Cap Core Wrap – 1 Star – MA US Core Universe

We take great pride in our investment strategy and discipline. The most important part of our job is to make sure we stay true to our word and provide a consistent investment experience. Volatility is the enemy of the retail investor because it makes us all want to do the wrong thing at the wrong time for the wrong reason. By limiting all volatility – downside and upside – we aim to provide that consistent experience, which allows retail investors to not let their emotions dictate their investment decision making.

To all the financial professionals and clients who have hired us – thank you for believing in and supporting our investment strategy. Above all else, thank you for entrusting us with your hard-earned money during this unprecedented time.



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Billy Little is a shareholder, Vice President and the Lead 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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