June 2022 - Tandem Investment Advisors, Inc.

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Financial Markets Update

The monthly returns for May do not quite paint an accurate picture of the real ride investors endured over the past several weeks. All major U.S. indices ended the month flat, except for the Nasdaq, which declined 2%. For the majority of the month, the path of least resistance was lower. At one point, the S&P 500 notched its seventh straight weekly decline and had officially crossed the psychological bear market threshold down 20%+ from its high.

For much of the month, the narrative centered around the expectation of an impending bear market rally. I would be lying if I said I wasn't one of those expecting some sort of recovery in equity prices. Investor sentiment got to be so depressed that many sentiment surveys were triggering contrarian buy signals, where historically equities managed to stage meaningful rallies. The much anticipated pop in equity markets finally came late in the month, as the S&P 500, Nasdaq and Russell 2000 each soared roughly 10% off their May intra-day lows.

The most recent rally in equity prices was not sparked by negative sentiment, but rather the negative sentiment gave fuel to power stocks sharply higher. The rally was sparked by comments from Raphael Bostic, who is the CEO of the Federal Reserve Bank of Atlanta. He is a non-voting member of the Federal Reserve Board, but his comments were exactly what the market was craving when he gave a speech to the Rotary Club of Atlanta.

"I have got a baseline view where for me I think a pause in September might make sense." –

Raphael Bostic, CEO of the Federal Reserve Bank of Atlanta

Over the past several months, we have been consistent in our view that we entered a new market regime with the bear market we find ourselves entrenched in today having commenced in November of last year. It all started when the Federal Reserve announced plans to begin tapering their purchase of Treasuries and mortgage-backed securities. It wasn't more than a couple of weeks after the initial announcement that Fed Chair Powell remarked that the Fed would accelerate their tapering schedule. Soon enough, the market was expecting multiple interest rate hikes and QT to combat rising inflation and inflation expectations. The subsequent rise in volatility and the bear market began with the Fed and it's my belief that it will all end with the Fed.

After a few weeks of softer economic data and uninspiring earnings announcements by several retailers, specifically Walmart (WMT) and Target (TGT), a growth scare began to gain traction. Inflation expectations and bond yields started to come down and the narrative immediately switched to a legitimate fear of an impending recession. Atlanta Fed Bostic's comment regarding a "pause" was perfectly timed. It was the first hint from a Fed official that a dovish pivot just might be in the cards. And, just like that a recovery in equity prices was born.

Unfortunately, Mr. Bostic's comment was not supported by other members of the Fed and even he had to walk it back a bit. Fed Vice Chair Brainard, Cleveland Fed President Mester and Fed Governor Waller each downplayed the comments regarding a potential pause in September. It is clear that most of the Federal Reserve and, even more so, the voting members of the FOMC are not ready to back down from their inflation fight. The S&P 500 falling 20% is not going to stop Fed Chair Powell's mission to bring inflation down. Inflation might not be in the Fed's control, but they will do whatever is needed to try and break it. In the meantime, we now have the playbook for a sustained market recovery. Short of inflation coming down closer to their target level of 2%, there is no telling how much downside in equities the Fed is willing to stomach. In the past, it wasn't much, but this Fed appears to be in a different mindset. Once multiple voting members of the FOMC begin to ease up on their tightening rhetoric and start to make the dovish pivot, then it's at that point, the equity markets could truly find a sustainable bottom.

Tandem Strategy Update

Last month, we concluded Observations by stating that you would likely see us remain very active within our strategies as we traverse the current bear market. The volatility in markets would be used opportunistically to set the portfolios up to be in a position of strength going into the future. As the market sold off during the first three weeks of May, we were able to put some of the cash to work.

Last month, we highlighted a new position that we took in all of our strategies. The company is SEI Investments Company (SEIC), and they are a leading provider of technology and investment solutions to the financial services industry. In addition to continuing to build our position in SEIC throughout May, we established another new position in Large Cap Core, two new positions in Equity and one new position in Mid Cap Core.

In our Large Cap Core strategy, we established a new position in Nike (NKE). NKE continues to grow their revenue and earnings at a healthy clip. The company has also managed significant growth in operating and free cash flow, which has allowed NKE to consistently grow their annual dividend by greater than 10% every year. In addition to establishing a new position in NKE, we continued to add to our core holdings in Visa (V), Waste Connections (WCN), ResMed (RMD) and Brown & Brown (BRO).

In our Equity strategy, we established new positions in Ansys (ANSS) and Intuitive Surgical (ISRG). ANSS is a market leader in the development of engineering simulation and 3D design software for product design, testing, and operation. ISRG develops, manufactures, and markets robotic systems to improve patient outcomes through minimally invasive surgery. Both companies are innovative in their respective industries and on the forefront of future technological advancements. In addition, both companies have a proven track record of consistently growing their revenues, earnings, and cash flows.

Lastly, we were the most active in our Mid Cap Core strategy. We opportunistically added to our positions in Qualys (QLYS), Waste Connections (WCN), ResMed (RMD), Brown & Brown (BRO) Verisk Analytics (VRSK), Tyler Technologies (TYL) and Five Below (FIVE). We also established a new position in Akamai Technologies (AKAM). AKAM is a leading content delivery network and a cybersecurity and cloud service provider. Similar to the other new positions discussed earlier, AKAM has a consistent track record of delivering consistent revenue, earnings, and cash flow growth.

As we continue to mull through this bear market, it is fair to say you can expect more of the same. In periods of sharp declines in stock prices, you will likely see us continue to add to our core holdings and even establish new positions. On the flip side, some of the most extreme stock market rallies occur in the midst of bear markets. When we are presented with a bear market rally, there is a good chance you will see us pare back in companies that our quantitative model ranks a sell or even begin to liquidate companies that no longer meet our basic fundamental criteria. Either way, bear markets provide a lot of opportunity to buy and sell in order to position the portfolio for long-term success.

Written By: William "Billy" Little, Jr., CFA

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. 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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