May 2022 - Tandem Investment Advisors, Inc.

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Financial Markets Review

Last month, we discussed equity markets finding their footing amidst the pervasive negativity roiling through financial markets in early March. Well, that toehold was not strong enough to push us higher through April. The big-cap tech companies that investors couldn't get enough of over the past several years, dubbed FAANG+, finally buckled as these companies lost a combined $1.4 trillion in market capitalization. These declines paved the way for the tech-heavy Nasdaq to post its worst month since October 2008 and the S&P 500 to log its worst month since March 2020. The Nasdaq and S&P 500 fell 13.2% and 8.8%, respectively.

For these negative monthly returns to be mentioned in the same breath as to those during the depths of the Great Financial Crisis (October 2008) and pandemic induced global economic lockdowns (March 2020) is a bit perplexing, but not totally unexpected. We are not in a crisis where we are unsure of whether our bank will be able to open its doors tomorrow or living in a world where everything is locked down. The economy is not perfect; it never is. However, employment is strong, the consumer has a healthy balance sheet and for the most part, companies and the economy in aggregate are continuing to grow, albeit at a slower pace than a year ago. There is no denying it, inflation is high and seems to only be getting worse. But, honestly, what did we expect when it cost nothing to borrow money, the Fed purchased trillions of dollars of bonds and the government distributed trillions of dollars in stimulus checks? Inflation is a serious threat that could likely derail economic growth, but it's not on the same level as global financial institutions ceasing to exist.

We have written about it before and it bears repeating, this is a correction in valuations. However you want to define normalization, this is what we are going through. As interest rates adjust to reflect the draining of liquidity from the global financial system and higher inflation expectations, so to will the valuations of financial assets. Interest rates are the backbone of valuations. Whether you are using interest rates to discount cash flows or using them to compare the relative valuation of two assets, interest rates are the crux of valuation. The level of interest rates will often determine how much house you can afford or how expensive of a car to buy. It will also alter the willingness and need to take on more risk for many investors whose living expenses can't be met by ultra-low yielding bonds. Those investors will either need to trade down in quality on their fixed income securities or move out the risk curve to equities. And that is exactly what has happened over the past several years.

Many fixed income investors were forced to become equity investors and now realize the volatility and risk that equities pose might not be worth it. Therefore, it should not be surprising that the $31.6 billion in equity outflows over the past three weeks, which is the most since March 2020, has coincided with bond yields taking another leg higher. The *TINA (**T**here **I**s **N**o **A**lternative)* trade and the speculation that came with it, is now correcting itself.

Tandem Strategy Update

Now, I am going to say something that is a bit taboo for a long-only money manager, but it is me being a realist – equity indices are in a bear market. There is no reason to sugar coat it. The trend has been down and volatility has been up. Whether you want to define it by the percentage decline is a personal preference, but this is how bear markets work. At the index level, we have been in this bear market for the past six months and many individual stocks have been in one for much longer.

The reason it is taboo in our industry to say we are in a bear market is that with most managers you are “all-in” all of the time. Regardless of the type of market, you are always fully invested. So, the only way to buy low is to sell low and the only way to sell high is to also buy high. That way of managing money is not intuitive to us. Very rarely do the best times to buy and sell coincide with one another.

Because of our different, but logical, approach to managing money, it does not pain me to say we are in a bear market. Investors hire us around these market inflection points because we are able to sell high, be patient and buy at lower prices. If you have been prudent and sold when valuations were statistically too high to be sustainable, then you have the cash available to invest opportunistically at lower prices.

There is a reason why I often use the term, opportunistically, and it is because our portfolio actions do not happen in a vacuum. We do not manage our strategies to look like the index. Rather, we own individual companies, and the price fluctuations of these individual companies will differ from the broader market. Some companies will bottom or top out well before or after the market’s respective move.

As we have written and talked about for many months now, we are in a higher volatility regime. Greater volatility in equities, both up and down, is a staple of bear markets. In fact, some of the largest single day price swings occur within bear markets. This volatility often presents opportunities and should be embraced and not feared. Just in the past couple of months, we have been able to be both opportunistic buyers and sellers. The cash in each one of our strategies is dynamic and fluctuates based on the opportunities we are given. Up until mid-March, we were net buyers after being net sellers throughout most of 2021. As equities quickly recovered in the back half of March and beginning of April, we became net sellers again. The market gave us the opportunity to sell a portion of our Costco (COST), Brown & Brown (BRO) and Automatic Data Processing (ADP) on valuation signals as each one of these companies were trading at or within a few percent of all-time highs. Fast

forward just a few weeks later and we are now net buyers again. Most recently, we have been able to add to our current positions in Essential Utilities (WTRG), Expeditors International (EXPD), MarketAxess (MKTX) and Five Below (FIVE). We are also in the process of building a new position in a leading provider of technology and investment solutions to the financial services industry who has been able to consistently grow revenues, earnings, and cash flows. In light of their consistent growth, this company has rewarded its shareholders by increasing their dividend for 31 consecutive years.

As markets remain volatile for the foreseeable future, you will see us continue to be active in your portfolios. By their very nature, bear markets are not a time to be "all-in", "all-out" or paralyzed with fear. They are meant to be taken advantage of and the volatility used to opportunistically set yourself up to be in a position of strength going into the future.

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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. 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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