OBSERVATIONS

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

November | 2020

Financial Markets Review

In September, the S&P 500 registered its first monthly decline since May and unfortunately remained unable to turn it around in October. The first half of the month brought a little hope as the S&P 500 climbed 5% on the back of renewed optimism that Congress could agree on a fifth round of fiscal stimulus. In the end, it was more of the same – a lot of talk and no action. The S&P 500 reversed and declined 7.5% in the back half of the month as the early optimism ultimately faded. Once it was all said and done, the S&P 500 booked its second straight monthly decline - falling 2.7%.

As we enter November, volatility in all financial markets has picked up in a big way and it has nothing to do with Congress’ inability to do anything, as that should surprise no one. Rather, markets hate uncertainty and the risk of a contested election and COVID resurgence loom large.

The biggest near-term risk to further downside in equities and higher volatility is a contested election with no clear-cut winner. After everything we have been through in 2020, the last thing this country needs is an extended period of uncertainty as to who will lead us for the next four years. The last time we experienced a contested election was in 2000 between George W. Bush and Al Gore. As the results were being sorted out, the S&P 500 dropped over 10%. Another unsettling parallel to the 2000 election is that the economy had been weakened and was not firing on all cylinders. However, it is apparent that this time around the country is much more divided, which presents a much greater risk to society and markets. The best outcome for equities would be a clear-cut winner, regardless of who it is. In this scenario, it is conceivable that equities would melt-up into year-end as the volatility premium embedded in the market gets eviscerated.

Outside of the election, the other risk currently threatening markets and economies around the world is a resurgence in COVID-19 cases. Global economies have clawed back from the depths of contraction seen this past spring, only to be faced with another round of potential lockdowns. Most recently, England, France, Germany, Ireland, Austria, and Belgium have announced lockdowns like those imposed in the spring. As a result, economists are now slashing European economic growth forecasts for this next quarter from a low single digit expansion to a low single digit contraction.

In the U.S., there were 1.85 million new COVID-19 cases reported in October with the worst of it coming over the past week. On October 30th, the U.S. reported nearly 100,000 cases, which is the single highest day of any country. And the number of new cases is only accelerating with the 7-day average outpacing the 14-day average. Hospitalizations are also on the rise, up roughly 65% with 47,000 individuals hospitalized with COVID-19 versus the 28,000 that were hospitalized only 6 weeks ago. It should not come as a surprise that deaths have also begun to trend higher; however, with better understanding of how to treat the virus, the mortality rates have improved significantly since the virus began spreading 8 months ago. As of now, most states are continuing down the path of slowly reopening their economies, but the fear of them reversing course is starting to build.

According to FactSet, nearly 65% of the S&P 500 has reported 3rd quarter earnings with more than 86% of these companies exceeding consensus estimates. Earnings have not merely exceeded expectations, but rather have crushed expectations. Reported earnings have come in over 19% higher than expectations, which is more than 3 times higher than the 5-year average surprise rate. However, the share price of the companies having reported a “beat” have not acted in kind, as these companies have seen an average decline of 1.7% in the period two days prior to their earnings announcement through two days after. Over the past five years, companies exceeding guidance have typically seen their share price increase 1% over the same time frame. The share price reaction is typically not indicative of “what have you done” (although it does not hurt) but rather confidence in “what are you going to do.” It is worth noting that a number of companies are still not providing future guidance or giving very limited insight into their future, so the ability for analysts to get it right becomes increasingly difficult to do with any accuracy.

Continued on Page 2

Tandem Strategy Update

One of the fundamental criteria for a company to be added to our strategies and remain as a core holding is the ability to consistently grow earnings, revenues, and cash flows through any economic cycle. The way we calculate growth is a bit more nuanced in our quantitative model, but the general idea is to avoid economically sensitive or extremely cyclical companies. One could argue that the current market cycle we are experiencing is not a natural economic or business cycle, but rather an exogenous shock to the system. Companies that are forced to shut down their businesses and the fundamental consequences of a shutdown should not be held against them, since it was completely outside of their control. We have made temporary short-term adjustments to account for this, but it is extremely comforting to know that many of our holdings were able to grow through a forced shutdown and those that did not have been able to bounce back rather quickly.

Through the end of October, 72% of our core holdings have reported third quarter earnings. And of those companies, the reported year-over-year sales and earnings growth has been +4.9% and +16.1%, respectively. This compares favorably to the 65% of the S&P 500 that have reported an aggregate sales decline of -2.5% and an earnings decline of -6.7% on a year-over-year basis. In addition to the impressive results announced by our core holdings, these companies have also been doing what is asked of them – if dividends are paid, to consistently grow their dividend. Since the end of last quarter through this writing, nearly one-third of our core holdings that pay a dividend have announced an average dividend increase of 9.1%. Granted, we are only a third of the way through the quarter and companies can announce a dividend increase at any board meeting during the year, but these are some pretty remarkable dividend hikes considering everything that has transpired this year.

William "Billy" Little, Jr., CFA

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.

Disclaimer

This writing is for informational purposes only. The information contained in this writing should not be construed as financial or investment advice on any subject matter. Tandem Investment Advisors, Inc. does not represent that the securities, products, or services discussed on, or accessible through, this site are suitable for any particular investor. You acknowledge that your requests for information are unsolicited, and the provision of any information through this site shall not constitute or be considered investment advice, or an offer to sell, or a solicitation of an offer to buy any product, service, or security.

Past performance is no guarantee of future results. Indices are unmanaged and not available for direct investment. They are shown or referred to for illustrative purposes only and do not represent the performance of any specific investment. No data in this writing should be construed in any way as performance of any Tandem investment product. For complete performance information and disclosures, please contact John Carew at jcarew@tandemadvisors.com.

From time to time Tandem may discuss select purchases and/or sales within this report. All past portfolio purchases and sales are available upon request. Any portfolio transaction discussed here does not constitute advice or a recommendation. Please consult your financial advisor before making any investment decisions. For information regarding past purchases and sales, please contact John Carew at jcarew@tandemadvisors.com.