OBSERVATIONS

Tandem Investment Advisors | William "Billy" Little, Jr., CFA

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Financial Markets Review

After five straight months of gains across all major U.S. indices, the streak finally came to an end. U.S. equities were mostly lower with the S&P 500 declining 3.92%. Much of the weakness came from the previous red-hot large cap technology space, as the Nasdaq fell 5.16% in September. A lot of records have been set so far this year with regards to the speed of declines and advances and the Nasdaq was able to set another one this past month. It took just three days for the Nasdaq to enter correction territory (decline of 10%) after closing at an all-time high. The previous record was six days, which was set in February.

The inflation trade also cooled off in September, as the widely expected fifth coronavirus relief bill failed to gain any traction in Congress. The U.S. Dollar Index reversed course early in the month and ended up closing higher by 1.90% while the Bloomberg Commodity Index fell 3.37% on the back of WTI Crude oil and gold falling 5.6% and 4.2%, respectively. The past decade of Federal Reserve policy has proven that monetary policy will inflate financial asset prices, but not everyday goods, as measured by CPI. Whereas fiscal stimulus and putting money directly in individuals' pockets has the potential to stoke non-financial asset inflation. If Congress is unable to pass another fiscal stimulus bill, the threat of sustained inflation greatly diminishes.

Aside from the inability to pass additional stimulus, the slowing of the economic recovery is another reason one can blame for September's equity weakness. One of the risks we highlighted last month has begun to rear its ugly head – temporary job losses are now turning into permanent losses. The most recent jobs report showed an increase of 661,000 jobs in September; however, it also showcased the disturbing trend of slower job growth. The unemployment rate dropped to 7.9% from 8.4% in August, but the declining unemployment rate was more indicative of individuals leaving the labor force and job losses turning from temporary to permanent. The non-farm payrolls report revealed that nearly 3.8 million people had lost their jobs permanently in September, which is twice as many permanent job losses reported at the height of the pandemic in April. The layoff announcements have seemed to really gather steam over the past couple of weeks with the following job cuts:

Company	Job cuts
•Disney	28,000 jobs
•Ralph Lauren	15% of workforce
•Royal Dutch Shell	9,000 jobs
•Allstate	3,800 jobs
•Brookfield Properties	20% of workforce
•American and United Airlines	32,000 jobs

And these are just the announcements you hear of in the media. This does not count the hundreds of small businesses that are closing around the country daily. The initial bounce back in the economy and subsequently the stock market is now being tested, and the next few months of economic reports will tell us a lot about the structural nature of this recovery.

The Election

I might as well address the elephant in the room – the Presidential Election. Understandably, we have been receiving a fair amount of questions regarding our thoughts on how clients should prepare for the election and/or how we might go about positioning the strategy ahead of the Presidential election.

Not to be flippant, but our response to this question is to do nothing different. Our answer likely does not shock those individuals who follow us very closely, because we have never adjusted the portfolio based on a perceived outcome to a major event. This type of portfolio management does not have a place within our investment discipline, as we have built processes that rely on math and not our individual biases.

In the world we live in today, elections are becoming increasingly tense and emotional. We have always viewed political or economic events to ultimately be just a lot of noise. Any changes that might affect a company you own is typically on the margin and not felt immediately. A company that has a history of consistently growing revenues, earnings and cash flow through any economic cycle will likely continue to do so, regardless of who is in the White House. Rather, the process of the election itself tends to fuel an enor-

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mous amount of emotion in individuals, which ultimately leads to confusion and the feeling to make big life/financial decisions to combat a perceived outcome. Emotions tend to cloud sound decision making, which is in the same vein as when you hear us say, "volatility is the enemy of the individual investor." And it is for this reason that we have built a quantitative investment process that strips out the human emotion. This process allows us to manage the strategy objectively and not succumb to the day-to-day noise.

It is safe to say that there will likely be an uptick in volatility in the weeks leading up to and after Election Day. And it is this volatility that should be embraced rather than feared. We are not staring down the path of a liquidity event or financial crisis. If a company needs to be sold, then it should be sold based on its own merits and not for a reason that none of us can predict. On the flip side, if a company presents an opportunity to be bought, then it too should be bought based on its own merits. Over the next couple of months, you will likely see us add to existing positions or buy new companies and liquidate or pare back in positions. Our quantitative model will guide our actions and not our personal beliefs, which is no different than any other day for us.

Tandem Strategy Update

As volatility picked up a bit in September, our quantitative model signaled the opportunity to add to a couple of existing positions and to trim back a core holding. We added to our position in Automatic Data Processing (ADP), Becton Dickinson (BDX), CBOE Global Market (CBOE), LabCorp (LH), and Essential Utilities (WTRG). The purchase of WTRG was just in our Equity strategy, as it was already a full position in Large Cap Core and Mid Cap Core. (ADP was just in LCC/Equity and LH was just in Equity).

After a very strong recovery off the March lows, our quantitative model signaled us to sell 25% of our holding in Expeditors International (EXPD). The sell signal was a valuation sale, as opposed to the full liquidation we made in Dominion Energy (D). D made headlines earlier this year when they sold some of their assets to Warren Buffet's Berkshire Hathaway. Following the sale, D effectively cut their dividend when they reset it to a lower rate. The dividend reset was greater than the profits that they would lose from the business unit being sold to Berkshire and management made the decision to prioritize a share buyback when the company had the ability to maintain their dividend at the current rate. We do not find fault with management's decision, as it is probably smart to reset future expectations for the entire business. However, their decision to cut their dividend to shareholders is a clear breach of our fundamental criteria and called for a full liquidation from our strategy.

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