October 2022 - Tandem Investment Advisors, Inc.

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Financial Markets Review

The hopefulness surrounding the mid-summer rally has officially dissipated as the S&P 500 closed out September by setting a new year-to-date low and ending down six of the past seven weeks. Looking out a little bit further, the S&P 500 has now declined for the second straight month and for the third straight quarter. To make matters worse, there were few places to hide. Broadly speaking, both bonds and commodities suffered sharp declines. And home prices, as measured by the S&P Case-Shiller Index, have begun their descent from recent highs as the 30-year fixed mortgage rate closes in on 7%.

The most recent weakness is nothing new and shouldn't come as a surprise. We've been on record for a year now saying that financial market valuations needed to correct. The surge in almost all financial assets post the initial COVID lockdowns was not normal, and it certainly was not sustainable. Money was so abundant and cheap that demand was pulled way forward, and prices went through the roof. Personally, I was able to get a new car loan at 0% in 2020 and refinance my home at 2.5% in 2021. That is crazy! It is very likely I will never have that opportunity again, and so I am forced to adjust my expectations going forward. We are all adjusting to a more normal world where capital has a cost and that involves a reset in asset prices.

A valuation reset is never going to be easy. If you own an asset, you don't want it to go down in value. But there are times when it is healthy for risk assets to decline in the short-term in order to preserve long-term stability. The issue today is not necessarily the decline, but the speed of the decline in certain assets, which don't normally experience this type of volatility that has markets rattled. Historically, government bonds of developed countries have acted as a volatility buffer in times of financial stress. Today, they are not only failing to provide that buffer, but they are rather a source of the volatility. The recent issues in the U.K. government bond market and rumored trouble with a couple of large European banks have people in fear that "something is about to break."

This phrase about "something breaking" is being muttered across every financial media outlet and it is instilling flashbacks of 2008. There is a significant amount of recency bias considering it really wasn't all that long ago when global financial markets were breaking.

The fear is understandable, but probably a little misplaced. Not all financial stress or even a failing bank has to lead to a global financial crisis. It would likely lead to more volatility in financial markets, but it doesn't mean all businesses are no longer a going concern.

Last month, I wrote that we were not through with this bear market, and I still believe that. The economy is showing increasing signs of slowing down and a greater number of companies are revising down earnings guidance. Investor sentiment surveys are at some of the most depressed levels on record and many sell-side strategists have finally thrown in the towel and cut their S&P 500 year-end price targets. Fear is becoming pervasive, but it's not yet entrenched. When the equity markets start moving up and down 5+% in a day, because that is what happens amid real fear, then we are nearing an end. These are all signs you need to see before a credible bottom can be put in place. So, we are getting closer, but not quite there yet.

Tandem Strategy Update

One of the questions I receive from clients is if they should get out now, especially if the belief is that markets are likely to head lower before finding a bottom. If your time horizon is only a few months, then yes, you probably don't need to be invested in equities. But if you truly are a long-term investor and your time horizon is measured in years and not months, then this is the type of market environment you should look to be opportunistic with cash.

Sure, there will be times during a bear market where the opportunity is to trim or liquidate a position. As I've mentioned before, some of the sharpest, most violent rallies occur in bear markets. Regular readers of this column may recall us being sellers in April and August of this year. Both of those months presented opportunities to pare back in several individual companies.

However, soon after those rallies, markets retreated once more and gave us the opportunity to invest cash into new positions and add to existing positions. In some cases, we've had the opportunity to pare back and add to the same company within months of each other, because that is what the market gave us. You have to be nimble and disciplined to take advantage of those opportunities, because they tend to be fleeting. As we've seen, markets are more volatile and move faster in a bear market, but with that more opportunities are present.

Given the S&P 500 ended September down over 9%, which stands shoulder-to-shoulder with the declines witnessed during the Septembers of 2001, 2002 and 2008, there certainly were opportunities to put some cash to work. You will recall those months did not mark the bottom in their respective bear markets, but they also weren't terrible times to incrementally invest in specific individual companies if you took a longer-term view. Last month, we took the opportunity to reinvest most of the cash that was raised throughout the summer rally, as cash levels are now essentially back to where they were at the start of Q3.

Most of what we purchased were incremental additions to existing core holdings, which can be seen in the table below. However, we did add one new company across all three strategies – STERIS (STE). STERIS is a leading global provider of products and services that support patient care with an emphasis on infection prevention. The next time you are in your doctor's office or at the dentist, look around and you will see something with STERIS on it. STE is one of those companies that has been on our "watchlist" for quite some time, and we finally got the opportunity to begin the process of building a position. The company has consistently grown revenues, earnings, and cash flow. As a result of this consistent growth, STE announced a 9% increase to their dividend, which marked the 17th consecutive year of dividend growth.

As financial markets continue down the path of volatility and uncertainty, we will continue to be very active within the strategies. There will be times we are selling and there will be times we are buying. However, at all times we will be opportunistic in setting up the strategy to be in a position for long-term success.

Large Cap Core	Equity	Mid Cap Core
Church & Dwight (CHD)	Ansys (ANSS)	Akamai Technologies (AKAM)
Comcast (CMCSA)	Intuitive Surgical (ISRG)	Ansys (ANSS)
Essential Utilities (WTRG)	Laboratory Corp Holdings (LH)	Church & Dwight (CHD)
Mastercard (MA)	SEI Investment Co (SEIC)	Essential Utilities (WTRG)
McCormick & Co (MKC)	STERIS (STE)	Laboratory Corp Holdings (LH)
Nike (NKE)		McCormick & Co (MKC)
SEI Investment Co (SEIC)		SEI Investment Co (SEIC)
STERIS (STE)		STERIS (STE)
Visa (V)		

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Billy Little is a shareholder, Senior 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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