September 2021 - Tandem Investment Advisors, Inc.

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Observations
- September 2021
by William “Billy” L. Little, Jr., CFA

Financial Markets Review

All U.S. equity indices closed higher in August, as the S&P 500 notched its seventh straight monthly gain. Equities experienced a minor speed bump in the middle of the month when geopolitical tensions rose and chatter regarding the Delta variant’s effects on economic growth gained some steam. However, the 3-day, 2.5% correction in the S&P 500 was all investors could take before storming back into equities and pushing indices to record highs.

The stock market is in full honey badger mode. According to Wikipedia, “The honey badger is notorious for its strength, ferocity and toughness. It is known to savagely and fearlessly attack almost any other species when escape is impossible, reportedly even repelling much larger predators such as a lion. Bee stings, porcupine quills, and animal bites rarely penetrate their skin.” Basically, the honey badger is one of the most resilient animals on the planet and any hope to contain it has proven to be a fruitless exercise. I am not sure there is a better way to describe U.S. equity indices.

The proverbial “wall of worry” is being scaled with ease by this honey badger. Each day the bricks continue to stack, and the wall gets higher and higher.

- Delta variant’s spread and its impact on the economy
- Inflation not abating as global supply chains remain broken and input costs continue to rise
- Federal government’s pandemic unemployment benefits set to expire

- Economic data continues to moderate with the Citi Economic Surprise Index falling into negative territory
- Conference Board's consumer confidence index drop to a six-month low and the University of Michigan sentiment index recorded its lowest level in nearly a decade

The tenacity and relentlessness of the honey badger is likely under-appreciated as it consistently defies the impossible. And the equity market has proven to be no different this year. No matter what is thrown at it, the path of least resistance remains higher. Strong corporate earnings growth, stock buybacks and TINA (there-is-no-alternative) continue to support the equity market. Most importantly though, financial conditions are ultra-easy with accommodative monetary and fiscal policies.

It is getting increasingly more difficult to justify and rationalize the moves in financial assets, as each month goes by. Recently, we have touched on U.S. equity valuations trading at or very close to Tech Bubble levels. The S&P CoreLogic Case-Shiller national home price index rose 18.6% annually in June, which is now 41% higher than the last peak during the housing boom in the mid-2000s. The CMC Crypto 200 Index (comprised of the 200 largest cryptocurrencies by market cap) is up more than 475% and 565% over the past one and two years, respectively. Real yields on European junk bonds have just fallen below zero for the first time. And to top it off, two weeks ago, someone paid $1.3 million for an EtherRock. An EtherRock is a JPEG of a cartoon rock or more simply, a picture of a rock.

Last week, Elon Musk's tweet hit the nail on the head, "I thought 1999 was peak insanity, but 2021 is 1000% more insane!" Although Musk's tweet was directed toward the valuation of a competitor electric truck maker, it encapsulates a lot more of what's going on. However, crazy can get crazier. As long as the world remains awash in liquidity and TINA is calling the shots, rationality and valuations will not matter. As much as you might want to bet against the honey badger, the honey badger will keep doing honey badger things.

Tandem Strategy Update

Valuations may not matter in the short-run, but they do in the long-run. The price you pay for something today matters greatly, as it is the basis for future returns. There is nothing wrong with purchasing an asset regardless of its valuation because the trend is higher, and momentum is on your side. That is commonly referred to as speculation and a lot of money can be made doing it. However, one must understand the risks associated with speculative trading.

At Tandem, we are the antithesis of speculation. Valuations do matter to us, as it is a big part of our process. The discipline that prevents us from buying our clients EtherRocks is the same discipline that had us selling T. Rowe Price (TROW) and Blackrock (BLK) last month. We created an investment process deeply rooted in adhering to our math-based disciplines. When the math signals to sell, we sell. And when the math signals to buy, we buy. Anything outside of that would be speculation on our part, which is not part of our DNA. There are times we are early to sell, and the price continues higher. And there are times we are early to buy, and the price continues lower. It happens, but we are confident enough in our process to not get caught up in the short-term. Ultimately, what our processes and disciplines do is manage risk, which is a concept oft-forgotten in a one-directional market. The resolve to buy during times of panic and to sell during periods of hubris can be quite daunting if there are no guideposts in place. Those guideposts are in place, and it is our job to stay within them.

Written By: William "Billy" L. 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 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.