Notes from the Trading Desk

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Market Movers & Shakers

The stock market continued its move higher this week — marking the sixth straight up week. Fins largely led the way, closing up nearly 2%, with healthcare not far behind, up over 180 basis points. Utes and Industrials closed up 140 and 130 bps, respectively. Tech also had a positive week, continuing its good run so far this year. The sector was up nearly 1%, and reportedly experienced its largest inflow in 38 weeks. Staples were the real laggard, falling nearly 1 and 1/4 percent. The fall in staples was mostly triggered by the selloff in home and personal care products — Unilever, Procter & Gamble, and a few others all had a rough end to the week. We currently find ourselves in the middle of earnings season and earnings have been, and will continue to be, the driving force for this marketplace. With over 180 companies in the S&P 500 set to report this week, it will be important to see a continuation of the past few quarters' excellent growth to keep this market on track.

The bond market hit an interesting milestone this week. The spread between the US 10s and 2s is knocking on the door of cycle lows based on their closing print. On an intraday basis, 10s minus 2s broke the previous cycle low set in July 2016. The yield curve has been flattening for a variety of reasons and all of them are able to impact our stock market. First, the Fed has been steadily hiking rates and, at least according to the market's probabilities, appears set to hike again in December. The Fed hiked rates into the Dot Com Bubble and again heading into the housing crisis. These rate hikes are bringing the short end of the curve higher. The rate hikes in theory should trickle through the different maturities as interest rates broadly increase across the curve. However, the short end and the long end of the curve are behaving very differently. The 2-year is currently resting at 9 year highs, and believe it or not is actually above yields seen at one point or another in 2003 and early 2008. The 2-year made a triple bottom in yield between 2011 and 2013 and has been in a steady uptrend since then. The 10-year, or the 30-year (take your pick), both remain very much in their 30 year down trends. This brings me to my second important takeaway from the current environment in yields. The Fed is supposedly raising rates so as to not overheat our economy. The market meanwhile, is already signaling slowing growth as long-dated maturities continue to be bid lower. We are currently in one of the longest expansions in US history, the probabilities of this cycle continuing uninterrupted diminish as time passes. This late in the cycle, sustained economic expansion becomes increasingly less likely. The long-end of the curve is more forward thinking, seemingly saying that a slowdown is coming. The short-end meanwhile is focused on the immediate, trying to not overheat our economy. The two seem to be directly contradicting each other — hence the flattening curve. Will this curve eventually invert — an age old signal for a recession? Possibly. If the trends continue, then the curve will continue to flatten, and it can only flatten so much before it inverts. Only time will tell though.

Finally, another important thing to keep in mind with rising short-term rates is the effect it might have on outstanding debt. Whether it be the Fed Funds Rate or the 3 month LIBOR, short-term rates are heading higher which makes it more costly for companies to roll over their debt and/or pay off their current floating debt. The short-term moves have been gradual to be sure. However, it is worth keeping an eye on. Nonfinancial corporate debt is up more than 60% since the end of the recession. According to FactSet, long-term debt to total capital for the S&P 500 is currently 42.87%. For comparison, this number has never been in the 40s until 2015. The appetite for debt has been insatiable. Earlier this year, Argentina issued a 100-year bond that got snapped right up. Argentina! The country that has defaulted on its debt twice *this* century. The BofA Merrill Lynch European Junk Yield index is currently yielding 2.17, below the 2.38 our safe haven 10 year is yielding. Anything and everything is getting gobbled up in the debt market. Credit spreads are essentially the tightest they have been this market cycle. Spreads tighten when the economy is humming along. However, if this trend reverses and begins to widen, it could signal some frothiness coming our way. Spreads began widening in 1998 and again in 2007. They also widened into the selloff in 2011 and again served as a precursor to the start of the year selloff in 2016.

Portfolio News

After a rather muted start to the quarter, news and action within the portfolio seems to have really picked up. We had a few names report this past week, with an abundance set to report this coming week as well. This past week we finalized our liquidation of Coca-Cola (KO). Coke had been a holding of ours for quite some time now. However, Coke has now seen declining earnings in the last two calendar years, with that trend expected to continue for the rest of this year. According to FactSet, Coke earned $1.92 in 2011, this year, they are set to earn $1.91. Some of the most important traits a Tandem holding can have is sustained growth of earnings, cash flow and revenue — traits that Coke has unfortunately not possessed most recently. That is not to say Coke will not ever grow again, merely that they no longer fit within the rules of our discipline.

Our notable outperformers this week were Signature Bank, AbbVie, Mednax and Becton Dickinson. All closed up over 5%. AbbVie continued its tremendous run this year — YTD it is up nearly 58%. Nike was able to shake off a downgrade at Goldman and actually closed higher that day and for the week. Generally speaking, being able to easily shake off a downgrade like that is positive for the stock going forward. However, we did see some downward price action as well last week. Intercontinental Exchange (ICE) was lower by almost 5% this week. It took a breather, up 24% YTD, on the back of Saudi Aramco possibly shelving their IPO plans for now.

Brown & Brown (BRO), Abbott Labs (ABT), and PayPal (PYPL) all reported fine numbers. BRO beat on their bottom-line expectations and was flat for the week. Abbott also beat and raised the midpoint of their FY guidance. They were subsequently rewarded by the market, closing up a little more than 3% this quarter. PYPL also beat and then raised this week, they promptly closed higher by 3.4% this week (for reference, PayPal is up nearly 80% YTD). eBay was the lone reporting laggard this past week. They beat on their topline and were in-line on their earnings numbers. However, they lowered the mid-point of their guidance ever so slightly. eBay was down 1.9% for the week.

With 14 companies set to report this week, it will certainly be a busy one here at Tandem. A few items to key in on this week will be Scana's call on Thursday, whether or not Tractor Supply can continue to see some acceleration this quarter (their numbers showed signs of life last quarter), and lastly we will get our first GDP numbers on Friday. All in all, it should be an exciting week.

	WTD	MTD	QTD	YTD
Dow Jones	2.0%	4.1%	4.1%	18.0%
S&P 500	0.9%	2.2%	2.2%	15.0%
Nasdaq	0.4%	2.0%	2.0%	23.1%
Russ. 2000	0.4%	1.2%	1.2%	11.2%
C.D.	0.2%	1.3%	1.3%	12.2%
C.S.	-1.2%	0.0%	0.0%	4.4%
Energy	-0.4%	-0.9%	-0.9%	-9.4%
Fins	2.0%	3.0%	3.0%	14.4%
H.C.	1.8%	2.5%	2.5%	21.8%
Ind.	1.3%	2.6%	2.6%	15.2%
I.T.	1.0%	3.8%	3.8%	30.9%
Mats	0.6%	3.3%	3.3%	17.9%
Utes	1.4%	3.5%	3.5%	12.8%
REITs	-0.8%	1.4%	1.4%	5.9%

Upgrades & Downgrades

ABBV — Remains a buy at Goldman. The firm suggested that investors should rotate out of Celgene and into AbbVie (10/18).

EBAY — Initiated neutral at Guggenheim Securities (10/20).

MD — Initiated market perform at BMO Capital Markets, price target of $46 (10/17).

NEE — added to Goldman's Conviction Buy list, target of $159 (10/15).

NKE — downgraded to neutral from buy at Goldman. Target remains $54 (10/19).

ROST — Assumed neutral at Buckingham, price target is $71 (10/19).

SBNY — Upgraded to outperform from market perform at BMO Capital Markets, target of $145 (10/20).

TJX — Assumed a buy at Buckingham, price target of $85 (10/20).

TROW—remains a hold at Deutsche Bank, price target increased to $94 from $87 (10/17).

Earnings Calendar

Date	Time	Ticker
10/24/17	Pre-Market	WAB
10/24/17	Pre-Market	UTX
10/25/17	Pre-Market	WBA
10/25/17	Post-Market	TSCO
10/25/17	Post-Market	WCN
10/25/17	Post-Market	ORLY
10/26/17	Pre-Market	NEE
10/26/17	Pre-Market	SCG
10/26/17	Pre-Market	TROW
10/26/17	Post-Market	CERN
10/26/17	Post-Market	RMD
10/26/17	Post-Market	SYK
10/26/17	Post-Market	MSFT
10/27/17	Pre-Market	ABBV