Notes from the Trading Desk

Tandem Investment Advisors

September 15, 2017

Market Movers & Shakers

Equities were up across the board this week. In fact, the Dow, the S&P and the Nasdaq all hit all-time highs Friday afternoon — the S&P actually closed at all-time highs as it finally cleared 2,500. Irma failed to do as much damage as originally predicted and North Korea refrained from launching a missile over the past weekend (though they did early Friday morning, not that the market seemed to care). This was enough to get the markets off to the races for the week. The S&P gapped up on the Monday open, and then actually stayed more or less flat the last 4 days of action. We also had a headline CPI that beat, which raised the December rate-hike probability to 50%, up from 31% last Friday. All in all, it was a fairly active week, albeit a rather quiet one. Metals all headed lower off their recent rallies as the dollar attempted to put on its rally cap. The 10Y moved higher this week, closing at 2.20, after hitting a post-election low of 2.01 last Friday.

While we are certainly equity managers, it can always help to try and gain a little insight from the bond markets (though I'm not sure how much my insights are worth... hence the free weekly letter). First, the yield curve appears to be flattening once again after steepening for the last week or two. Short-term rates have been heading higher. The 2-year is yielding 136 bps and has been in a sustained uptrend since its triple-bottom in August of 2013. The 30 year's (or the ten year's, take your pick) 30 year downtrend remains very much intact. These differing trends have been the case for 4 years. What makes it more interesting now is that central banks are beginning to ramp up their tightening. The Fed is supposed to begin shrinking its ginormous balance sheet next week and the market views December as a coin flip as to whether or not the Fed hikes. That means short-term rates should continue to go higher, however the market is clearly not buying the growth story as long-dated maturities continue to be bid lower. Basically, the Fed is saying we don't want to overheat this economy lets pump the brakes a little, while the market is shaking its head saying "What Economy? There is no growth!". 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. Second, we have previously discussed the spread between the US 10-year and the 10-year Bund. Typically the spread peaks about 18 months prior to a recession. The spread peaked in December of 2016 and continued to move lower the past month or so. The German 10-year should head higher if/when the ECB begins to tighten — which they are expected to begin doing next month. Our 10-year looks poised to continue to head lower, and I agree with the Rickster that we ultimately fill the post-election gap down to the 180s. If we head lower, and the Bund heads higher, then the spread continues to flatten. Finally, keep an eye on the Dollar. For all of 2017, the DXY and the 2018 implied rate hikes have been trading in lockstep. Further rate hikes will only serve to further flatten our curve.

Finally, I came across an intriguing article this past week that I thought I'd share here. If you want to read it, its rather short, google "The Mystery of the Missing Inflation", its written by Nouriel Roubini and can be found on the Financial News website. Roubini, though a Larry Summers fanboy, raises an interesting conundrum facing the Central Banks right now. CB's are basically stuck in no-man's land as their ultra-easy monetary policies have driven asset inflation in countless asset classes — bonds, equities, cryptocurrencies, and real estate. However, major CB's have been unable to drum up any inflation through their core measures. Thus, the problem they face is this, do they attempt to tighten and try to avoid the popping of bubbles, or do they continue to try and achieve their inflationary mandates and run the risk of overheating the economy? I think the actions of the Central Banks are incredibly interesting right now as I believe much of this bull market can be attributed to them. If I had to guess, I would say that the CBs will somehow flub this tightening, by tightening when they shouldn't, which will lead to heightened volatility. Again, only time will tell — but the next few weeks of Central Bank policy could certainly shape the future landscape in the marketplace.

Upgrades & Downgrades

- **EBAY** — initiated buy at DA Davidson with a price target of $45
- **KO** — initiated neutral with a price target of $47 at Macquarie
- **NKE** — initiated outperform at Bernstein with a price target of $69
- **NNN** — upgraded to buy from neutral at Ladenburg Thalmann, target of $47
- **PYPL** — reinstated buy with a price target of $71 at BAML
- **ROST** — initiated outperform at Bernstein with a price target of $74
- **SBNY** upgraded to market perform from underperform at Hovde Group, target of $132 (decreased from $139)
- **TJX** — initiated outperform at Bernstein with a price target of $88

Portfolio News

This week we finalized our liquidation of the Bank of Ozarks. On the composite level, we bought our initial position in Ozarks at $39.40 in May of 2016. We sold half of the position this past August at $42.40 and the other half on Thursday at $43.16 (for those keeping score, that is a 7.6% and 9.5% return). Other than that, composite activity is rather slow. We currently do not have one stock ranked to buy — the first time that this has occurred in a few months.

Similarly to the quiet activity level, our core holdings had a rather muted week in terms of headlines. Most notably, AbbVie is up 16% in the last 8 trading sessions off a couple of key items. First, the US patent office denied four petitions to review Humira's patents. AbbVie also moved higher on the back of a successful phase III study. The only other thing to note, according to Bespoke Investment Group, short interest in the retail sector hit a post-recession peak. In contrarian terms, this seems to be a positive for a few of our stocks and it shows this past week. All of our "Amazon" impacted holdings had a very solid showing this week. O'Reilly was up 540 bps, CVS was up 430, ROST up 370, and COST up 320. Only TJX (up 190 bps) and Walgreens (up 140 bps) did not outperform Amazon this week.

		WTD	MTD	QTD	YTD
DJI-DJX	Dow Jones	2.2%	1.5%	4.3%	12.7%
SPX-SPX	S&P 500	1.6%	1.2%	3.2%	11.7%
COMP-USA	Nasdaq	1.4%	0.3%	5.0%	19.8%
RUT-RUX	Russell 2000	2.3%	1.9%	1.2%	5.5%

Buy	Accumulate	Sell	Liquidate
	CTSH	ABT	ITT
	CVS	D**	KO
	DG	MSFT	SNI
	DLTR**	NEE**	
	FDS**	WCN	
	SJM		

**Denotes a position that is either +3% in the case of a buy/accumulate, or less than 1.5% in the case of a sell

Earnings Calendar		
Date	Time	Ticker
None	None	None

Core Holding Performance

Performance					
Ticker	**WTD**	**MTD**	**QTD**	**YTD**	**1 Yr.**
ABBV	2.4%	16.0%	20.5%	39.5%	37.9%
ABT	-0.5%	1.6%	6.5%	34.8%	25.9%
ACN	1.2%	3.5%	9.4%	15.6%	22.2%
BDX	-4.1%	-2.1%	0.1%	18.0%	11.0%
BF.B	-0.8%	1.6%	10.9%	20.0%	18.2%
BRO	-3.6%	3.2%	7.8%	3.5%	24.6%
CERN	3.1%	5.5%	7.5%	50.9%	13.9%
COST	3.2%	3.5%	1.5%	1.4%	6.3%
CTSH	1.0%	1.5%	8.2%	28.2%	32.8%
CVS	4.3%	7.5%	3.4%	5.4%	-7.7%
D	0.3%	0.9%	3.7%	3.8%	6.8%
DLTR	0.8%	4.8%	19.4%	8.2%	1.8%
EBAY	1.6%	6.3%	10.0%	29.3%	20.1%
ECL	-0.1%	-1.7%	-1.3%	11.8%	11.0%
EXPD	-0.1%	1.4%	0.7%	7.4%	12.9%
FDS	1.7%	3.0%	-2.6%	-1.0%	-9.1%
FISV	1.1%	0.3%	1.4%	16.7%	24.1%
HRL	-0.7%	2.1%	-8.0%	-9.9%	-14.4%
ICE	0.1%	1.1%	-0.8%	15.9%	16.0%
ITT	5.3%	4.5%	5.0%	9.4%	20.5%
KO	-0.3%	1.4%	3.0%	11.4%	9.0%
MD	2.2%	-4.3%	-28.9%	-35.6%	-34.3%
MSFT	1.8%	0.7%	9.3%	21.2%	31.7%
NEE	1.2%	-0.3%	7.1%	25.6%	22.3%
NKE	3.2%	2.0%	-8.7%	6.0%	-2.9%
NNN	1.2%	3.2%	10.4%	-2.3%	-11.0%
ORLY	5.4%	7.0%	-4.1%	-24.6%	-24.0%
OZRK	6.1%	1.1%	-7.3%	-17.4%	12.2%
PYPL	2.2%	1.3%	16.5%	58.3%	53.1%
RMD	-0.8%	2.1%	1.7%	27.7%	22.0%
ROST	3.7%	3.9%	5.2%	-7.5%	-2.0%
RSG	2.2%	2.5%	5.0%	17.2%	33.1%
SBNY	-3.9%	-7.3%	-17.1%	-20.8%	2.8%
SCG	1.0%	-0.9%	-10.7%	-18.3%	-15.6%
SJM	2.9%	5.2%	-6.9%	-13.9%	-19.9%
SNI	0.6%	0.4%	25.9%	20.5%	38.4%
SYK	1.0%	1.8%	3.7%	20.1%	26.8%
TJX	1.9%	2.0%	2.2%	-1.9%	-1.7%
TROW	3.2%	0.4%	14.2%	12.6%	25.0%
TSCO	4.7%	6.1%	16.5%	-16.7%	-8.5%
UTX	3.2%	-5.5%	-7.4%	3.2%	10.1%
VRSK	-1.8%	0.0%	-4.0%	-0.2%	-0.6%
WAB	2.9%	2.5%	-20.9%	-12.9%	-3.9%
WBA	1.4%	1.2%	5.4%	-0.3%	1.4%
WCN	3.5%	4.3%	8.0%	32.8%	36.1%
YUM	-1.6%	-2.0%	2.0%	18.8%	19.2%
YUMC	4.9%	5.7%	-5.2%	43.1%	
Avg.	1.5%	2.1%	2.5%	9.7%	10.7%
SPX-SPX	1.6%	1.2%	3.2%	11.7%	16.4%