

# TANDEM

INVESTMENT ADVISORS

## The Tandem *Report*

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## Letter from the Founder 01

Tandem is committed to the preservation of your wealth by minimizing risk while adding value through consistent and superior investment performance over time. This issue of *The Tandem Report* provides a summary of our views pertaining to the investment landscape and subjects that influence our decision making. More information about our firm, including our investment style and process, is available at [www.tandemadvisors.com](http://www.tandemadvisors.com) or upon request. We hope you find this report useful.



John B. Carew  
*Founder & Chief Executive Officer*

Please explore the rest of our content by visiting our website:

[www.tandemadvisors.com/commentary/](http://www.tandemadvisors.com/commentary/).

Billy Little writes the monthly Observations, Jordan Watson writes the fortnightly Notes from the Trading Desk, and each piece is available in audio format as well. We also have a podcast called Tandem Talk, so please give us a listen!

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Ben Carew joined Tandem in 2013. He manages Tandem's trading desk, overseeing day-to-day investment operations, including trading, quantitative and fundamental research, and portfolio management. Ben also oversees Tandem's equity research internship program. He is a regular member of the CFA Institute and the CFA Society South Carolina. Ben currently serves as the Vice Chair for College of Charleston's School of Business Investment Program, a student program seeking to provide the opportunity for a select group of students to distinguish themselves academically, professionally, and personally. He is a graduate of the College of Charleston's School of Business, earning a Bachelor of Arts in Economics with a minor in Finance.



Benjamin "Ben"  
Carew, CFA  
*Co-Chief Investment Officer*

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Source of all data is FactSet, unless otherwise noted.

The first six months of the year tell a tale of two halves when it comes to the market. For the first eight weeks of 2025, the market trudged higher – albeit at a much slower pace than the previous two years. The S&P 500 set an all-time high on February 19th, and then the wheels fell off. As rhetoric around potential trade wars became amplified, the S&P 500 began tumbling in earnest. From its February all-time high to its intraday low on April 7th, the S&P 500 fell more than 21%. It was a quick and dramatic fall – outpaced only by the declines in February and March of 2020 in the heart of COVID.

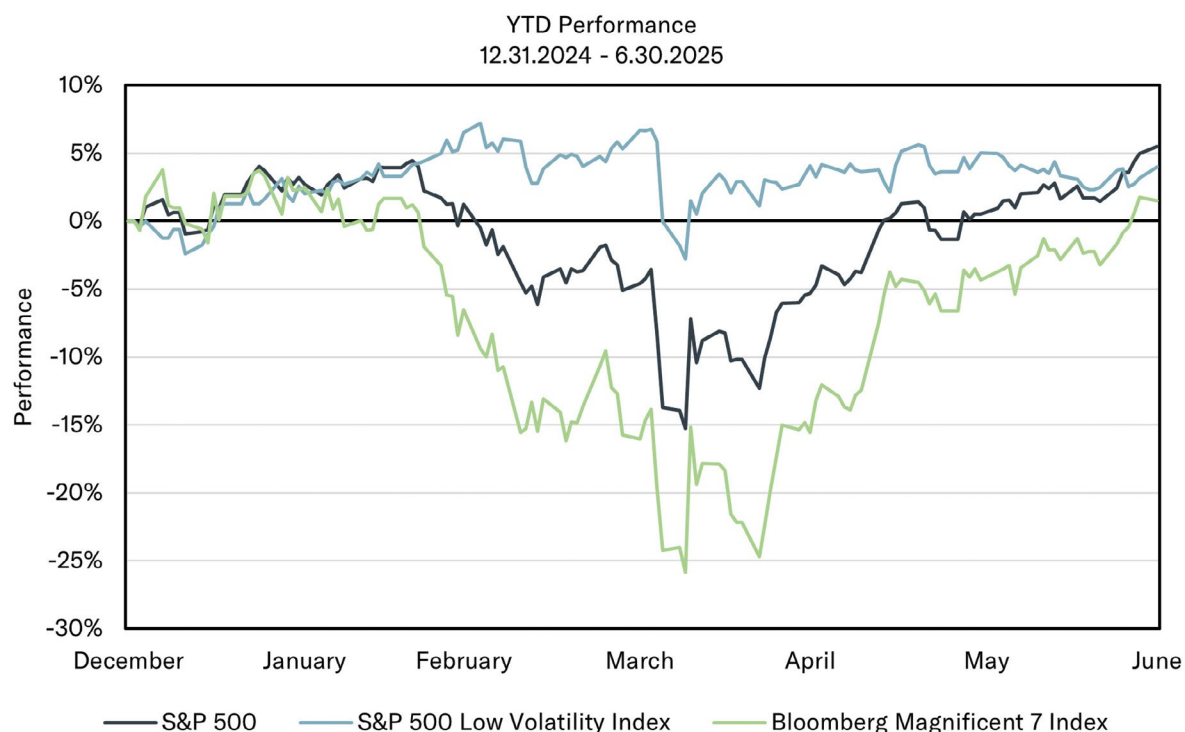
However, it was as if Newton's 3rd Law was suddenly applicable to the stock market instead of physics – for every action there is an equal and opposite reaction. From the lows, the S&P 500 soared more than 28% to reclaim its all-time high by quarter's end. This led to an S&P 500 that ended the second quarter up more than 10.5% and a Nasdaq that rose nearly 18%. Over the past 30 years, the few rallies that surpassed the strength of this current rise is a short list. It consists of the initial bounce coming off the lows during the Financial Crisis, the rally following the COVID lows, and the gains in the back half of 1998 following the Russian Ruble Crisis. Each of those periods marked fairly strong returns over the next 12 months. Twelve months after the initial COVID bounce, markets were up another 35-40%. Following the initial rally out of the Financial Crisis, markets returned an additional 15-20%. Likewise, following the bounce after the Russian Ruble Crisis in '98, the S&P 500 went on to gain another 18-19%.

So, that's good news, right? Perhaps. One positive coming out of the first quarter was the broadening of the market. Over the past few years, we have discussed in depth the outperformance of the Magnificent 7. We have also previously discussed how narrow

market leadership has become. In Q1, the average stock outperformed the S&P 500 – a feat that has been quite rare over the past few years due in part to the outsized gains from the Magnificent 7. It was generally viewed as a positive for the long-term health of the market to see it broaden out and have larger participation. That trend reversed in the 2nd quarter as the Magnificent 7 roared back to life. From the low on April 7th through the end of the quarter, the Magnificent 7 + Broadcom contributed to ½ of the S&P 500's total gain. The average stock among those 8 companies was up nearly 40%.

On the trade front, Liberation Day caused markets to enter a miniature freefall to start the quarter. The trade rhetoric coming out of the White House was much stronger than many were anticipating as President Trump's reciprocal tariffs were announced. Following the announcement, the S&P 500 fell as much as 14% in just 2 ½ trading sessions. People and markets were in panic mode. Fortunately for equity investors, President Trump quickly paused the higher reciprocal tariffs, which helped assuage many investors concerns.

President Trump impacted markets a bit more with his unrelenting criticism of the Federal Reserve Chairman Jerome Powell. Market participants were initially worried that President Trump would fire Chair Powell, which could lead to increased questions surrounding the independent nature of the Federal Reserve. It is argued by some that in a perfect world, the Federal Reserve would be insulated from political pressures so that it can make decisions with a long-term lens that will best serve the American economy and not be subject to the short-term nature of the election cycle. President Trump again gave markets the reprieve it was looking for when he announced that he would not fire Chair Powell.



These tailwinds, coupled with a stronger than expected earnings season, gave markets the needed boost to deliver an incredibly strong quarter – one that had many people nervous after the first few days. However, it is worth noting that trade concerns were not completely alleviated – just paused. This leaves the door open for a return to Liberation Day style policies that could be impactful to the global trade economy.

Recent commentary from Tandem has discussed the potential consequences of high valuations and narrowly led markets (see our January 2025 commentary in *The TANDEM Report* titled “Through the Tandem Lens”). The economic and political uncertainty also seem unlikely to abate in the short run. The optimism around AI certainly remains robust, though some are beginning to raise questions around the margin on AI implementation. For example, Goldman Sachs recently pointed out that Tech giants are set to spend over \$1 trillion on AI over the next few years. All of that spend has come with very little revenue to show for it – Microsoft earlier this year noted that it had reached \$13 billion in AI related revenue. OpenAI – which owns ChatGPT – has annual revenue of ~\$12 billion. That hardly seems worth it with \$1 trillion being spent. AI-related revenues must accelerate in a meaningful manner for the expenditures to be justifiable. Elsewhere, the unemployment rate among recent college graduates has been rising to meaningful levels. Some have placed the blame for job weakness on AI eliminating the need for more entry-level jobs, which in turn hurts those looking for a job with the least amount of experience. Finally, a recent study out of MIT’s Media Lab highlighted how ChatGPT

may actually be eroding users’ ability to think critically. How this all shakes out only time will tell. It presently looks like a lot of spending and hype, without a lot of good to show for it.

Ultimately, all of this is to say that little has changed over the past 6 months – the ride has been anything but smooth in the market. Leadership is still too narrow. Valuations are still high. Economic uncertainty remains on the trade front. Geopolitical uncertainty is still present as war erupted, then came to a swift pause, in the Middle East. The AI theme, which has been a key driver of this market, remains intact, though questions continue to arise.

Lastly, in our April commentary, we contrasted the returns between a number of different indices. We discussed how the S&P 500 Low Volatility Index was up 6.67% in Q1, while the S&P 500 was down 4.59% and the Bloomberg Magnificent 7 Index was down nearly 16%. In the second quarter, the Low Volatility index lost 2.5%, while the S&P 500 gained more than 10.5% and the Magnificent 7 gained nearly 21%. Amazingly, that leaves them all with similar year-to-date returns. The Magnificent 7 was up 1.5% through the end of June, while the S&P 500 was up 5.5% and the Low Volatility Index was up nearly 4% for the year. All of those rides delivered a fairly similar return at the end of the 1st half. However, the experiences were dramatically different. The Magnificent 7 lost more than 25% at one point. The S&P 500 fell by 20+%. The Low Volatility Index fell less than 10%. Similar returns. Much different experience. At the end of the day, that is what we try to do at Tandem – we want to deliver a more consistent, more repeatable, and less volatile investment experience.

## Commentary

### The Different Drivers of Return

Buy Low. Sell High. Profit. Rise and Repeat. Do that long enough and you will likely have a successful investment experience. But what causes something to move from low to high? In my mind, there are essentially three drivers of return. The first is the fundamental growth – the growth of important metrics like earnings growth, sales growth, or growth of cash flow. The second driver of return is dividend growth. Last, but certainly not least, is investor sentiment – a fickle thing to measure. In the short run, sentiment often holds sway. Over the long term, fundamentals like the growth of earnings, sales, cash flow, or dividends ultimately reign supreme. For the sake of this commentary piece, we are going to focus on the first two drivers and not the third. We spilled quite a bit of ink on the topic of valuation in the January edition of *The TANDEM Report* and encourage readers to visit the Commentary section of our website ([www.tandemadvisors.com](http://www.tandemadvisors.com)) to revisit our earlier analysis on valuations and what they mean for future returns.

#### THE IMPORTANCE OF FUNDAMENTALS

The ability to grow earnings, sales, and cash flow through any economic environment is a key tenet of Tandem’s investment philosophy. We believe that consistent growth of those metrics may help provide a smoother and less volatile investment experience. Imagine you buy company ABC’s stock for \$10. At time of purchase, Company ABC has \$1 of earnings (profit). Now, imagine that ABC grows its earnings by 10% this year. So, it now earns \$1.10 in Year 2. Is it still worth \$10? It should arguably be worth more now because the company is more profitable. You receive more earnings; therefore, it is more valuable to you the shareholder. That is why fundamentals matter in a nutshell.

Consulting powerhouse McKinsey and Company put out a study a few years ago analyzing the revenue growth of 3,000 companies from 2010 to 2021. McKinsey grouped companies into one of four categories.

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- 1) Large Deals – companies whose revenue grew by at least 50% in a single year
- 2) Shrink to Grow – companies that are not Large Deal and that had net divestitures in one or two years but otherwise grew
- 3) Consistent Growers – companies that did not fit into either of the previous two categories and grew in at least 7 of the years that were analyzed
- 4) Inconsistent Growers – all other companies that did not fit into one of the first three categories

The Consistent Growers had outsized total shareholder returns relative to the other three categories while the companies that fit into the Large Deal and Inconsistent Growers both had negative excess total shareholder return. Last fall, Boston Consulting Group (BCG) put out a more straightforward note on revenue growth. In it, the authors stated, “Revenue growth is imperative because, depending on the time horizon, it drives from 32% to 56% of total shareholder return”.

Jack Bogle, founder of Vanguard and arguably the father of passive investing, published a study on the importance of earnings growth in his book *Don’t Count on It*. Bogle analyzed stock market performance from 1900 to 2009. Over that time the market grew at an annualized rate of 9.1%. Earnings growth contributed to 4.5% of that 9.1% number. In other words, earnings growth attributed to nearly 50% of the market’s total return over those previous 109 years. So whether it’s Bogle’s study showing that nearly 1/2 of returns come from earnings growth, BCG suggesting that revenue growth can drive anywhere from nearly 1/3 to more than 1/2 of shareholder return, or McKinsey showing the importance of consistent revenue growth, it is clear that fundamentals are crucial to a successful investment experience.

One more thing about Bogle’s study. Nearly 50% of the market’s return was attributed to earnings growth. He attributed less than 3% to sentiment or change in multiples. So, what about the rest? Well, according to Bogle’s study, 47% of the return was explained by dividends – which brings us to our next point.

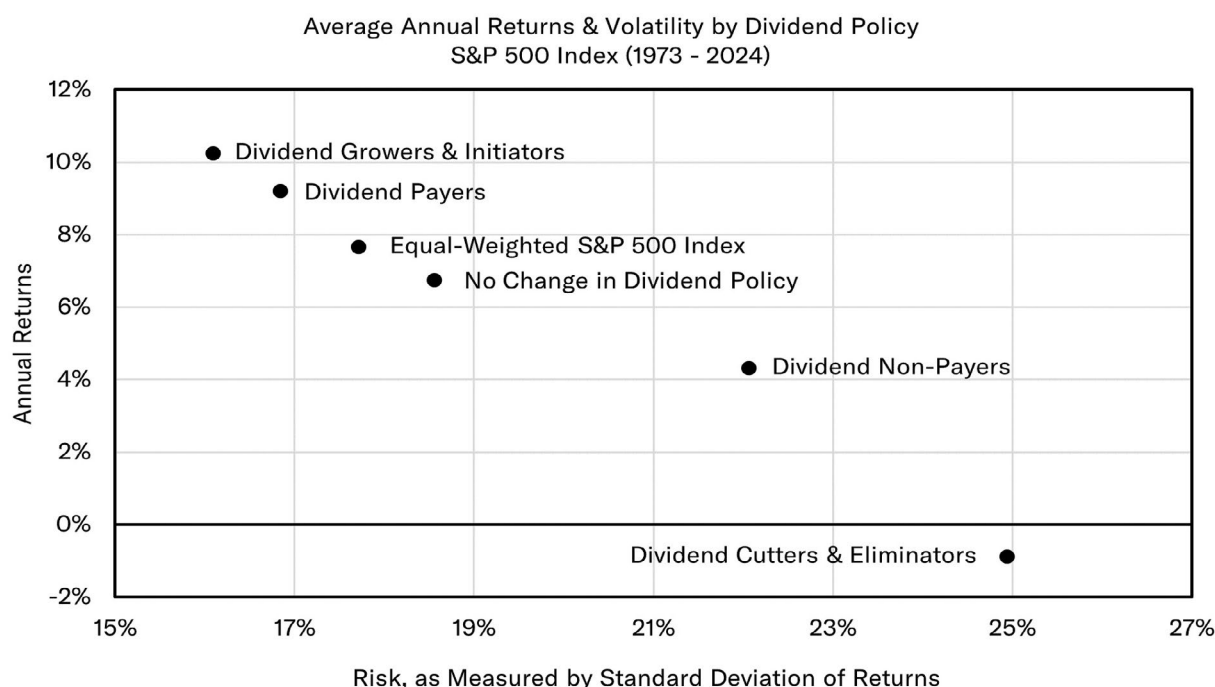
## DIVIDENDS

Imagine that you are in the market to buy a rental property. You spend time researching different parts of town and comparing one condo to the next. Eventually, after completing some rigorous due diligence, you find the perfect turnkey condo to buy. What’s even better, it is already rented out for the foreseeable future. It’s perfect.

Now imagine that this wonderful little condo can sustain a 10% price increase year after year after year without the tenants ever even batting an eye. It sounds like a wonderful investment, does it not? To have your passive income grow 10% year after year would be terrific. That condo, in time, would become more and more significant to you the investor. Why? Because it’s growing its income stream to you! Such an asset would almost certainly appreciate in value over time because it is becoming more and more valuable to the investor.

Now, imagine rather than a condo, it was instead a stock, or better yet, a portfolio of stocks. One might begin to see the benefits of a dividend that is growing. It’s not fancy. It’s not AI, quantum computing, cryptocurrencies, or even the Magnificent 7. Instead, dividend growing stocks just seem steady. Steady, but important. According to a recent article from Nuveen, dividend payment and dividend reinvestment accounts for 40% of the total annualized return of the S&P 500 from 1930 to 2024.

Research has also been pretty clear that dividend growers have typically been rewarded in terms of share-price appreciation and





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## Commentary – *Continued*

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companies that grew or initiated a dividend have had substantially better returns and much less volatility than other stocks.

Clearly, dividends can be an important part of an equity investor's total return. Dividend investors come in many different flavors though. There are those that seek dividend yield. These investors value the actual income that is produced with each dividend. Others believe dividend growth is ultimately the most important piece of the investing puzzle and in turn, these investors seek out stocks that have grown their dividends for some number of periods. In this school of thought would be something like the S&P 500 Dividend Aristocrats, a dividend growth index which measures the performance of S&P 500 companies with 25 years of consecutive dividend increases. There are some investors that are anti-dividend and believe that non-dividend payers are more growth focused and can therefore present a better growth opportunity to the investor.

Then, there is Tandem. We believe dividend growth is important. However, we do not seek it with some arbitrary threshold that must be crossed – like the 25-year mark for a Dividend Aristocrat. Instead, we seek companies that can consistently grow earnings, sales, and cash flow through any sort of economic environment. Companies that can do that, and pay a growing dividend, are showing what we

believe to be strong corporate management. We do not seek dividend growth. We simply require it to be grown if it is paid.

### TYING IT ALL TOGETHER

In October 2023's issue of *The TANDEM Report*, we discussed our two pillars when it comes to investing. Our first is our desire to deliver a more consistent, more repeatable and less volatile investment experience. Our second pillar is our desire to adhere to the discipline of buying low and selling high. To achieve the first pillar, we seek companies that have a demonstrated ability to grow the fundamental metrics that we value through different economic environments. That means that we seek the consistent revenue growers that McKinsey and BCG highlighted, and the consistent earners whose importance was emphasized by Bogle's study, and often the consistent Dividend Growers whose importance was noted by the folks at Ned Davis Research. In short, we've sought all of those things through our 34+ years of managing money. There are times where the market prefers certain trends or themes – like Dot Com stocks in the late 90s, or financials in the mid-2000s, or AI stocks today. Our strategy is not meant to be the hot investment. It is meant to be consistent. It is meant to be repeatable. It is our aim to keep you invested by delivering a less volatile experience.