Quarterly Outlook

OCTOBER 2015

Third Quarter 2015

Uncertainty, unpredictability and volatility characterized the third quarter as domestic and international events sparked rapid changes in US stock valuations. The S&P 500 ended down -6.9% in what was the worst quarter in four years amid confusion over Federal Reserve policy and turmoil in Chinese markets. The US economy, however, remains productive, with second-quarter GDP being revised upward by the US Department of Commerce to 3.9%.

Stock and bond markets remained fixated on the Fed's decision on when to normalize monetary policy after an extended period of historically low interest rates. As expected, the benchmark 10-year US Treasury Bond yield remained low throughout the quarter. Somewhat surprisingly, markets did not rally in response to the Fed's inaction in September, and investors may be fully primed if not impatient for the inevitable increase in rates to finally occur.

The Fed's decision to postpone normalization was likely due to a combination of factors including Chinese currency devaluation. If the US starts increasing rates, the US dollar will likely strengthen, making US exports more expensive and Chinese goods more competitive. The rising dollar is a continuation of an economic theme that is already affecting US multi-national companies, negatively impacting revenue.

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Going Forward: Tandem's Outlook

In early September Tandem made a conscious effort to switch to the term "interest rate normalization" as opposed to "rate hike" when communicating with clients on Fed activity. Adjusting rates is a normal function of the central bank and an indicator that officials see the economy as healthy and stable. It is not an attack on the market or its investors. We expect the Fed to raise rates no later than December.

The world is in a period of lower growth and higher levels of sovereign or public indebtedness. During past periods of public debt overhangs, countries generated lower GDP growth by over 1% on average annually. Tandem believes third-quarter US GDP data will follow this trend. Threats to the market include a greater decline in China's growth, wider spill over from China's slowdown into other emerging economies, and US fiscal concerns around the debt ceiling and possible government shutdown. Each risk should subside to allow the tepid recovery to continue in time.

Tandem has used the sell-off in the market to refocus and unwind positions. Some stocks are getting hit because of the market while others are getting hit because their story has changed.

Tandem continues to focus on proactive risk management and identifying securities that offer downside protection; that being said, markets over time revert to their mean and experience corrections. We advise patience and discipline by keeping a long-term perspective.

TANDEM
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