

THE TANDEM REPORT

Volume XII, Issue 3 July, 2011



"It requires a great deal of boldness and a great deal of caution to make a great fortune, and when you have it, it requires ten times as much skill to keep it."

~ Ralph Waldo Emerson

Dear Clients,

Tandem is committed to the preservation of your wealth by minimizing risk while adding value through superior investment performance. 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 or upon request. We hope you find this report informative.

Respectfully,

John B. Carew
President,
Chief Investment Officer

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All performance figures, charts and graphs contained in this report are derived from publicly available sources believed to be reliable. Tandem makes no representation as to the accuracy of these numbers, nor should they be construed as any representation of past or future performance.

MARKET COMMENTARY: MACRO VS. MICRO BULLS AND BEARS BATTLE TO A DRAW, CREATING OPPORTUNITY FOR INDIVIDUAL STOCKS

Two competing big-picture investment theses continued their struggle for supremacy during the second quarter. The tug-of-war between the school of global growth (bullish) and that of global financial turmoil (bearish) resulted in a draw, with the U.S. stock market finishing essentially flat for the quarter.

With an early run by the bulls, the market added to its first quarter gains in April. The tide turned in May and the first three weeks of June to the clear advantage of the bears. Over the last five trading days of the quarter, the bulls once again gained the upper hand and the S&P 500 rallied 5% to erase the quarter's losses. The tug-of-war produced no winner. Or did it?

Generally speaking, the debate between bulls and bears is nothing new. In fact, the conflict is as old as investing itself. What makes the present environment somewhat different from those past is the focus on the macro (big-picture economics) rather than the micro (fundamentals of companies) that typically drives or undermines

stock markets. Corporate profits and balance sheets are impressively healthy, yet the debate centers on global economics.

The bullish thesis asserts that the expanding middle class of developing economies will demand ever-increasing amounts of food, services and infrastructure. In addition, government and central bank policies will continue to flood financial markets with liquidity, causing asset prices to rise and inflation to become problematic. The popular way to invest for this strategy is to invest broadly in things like commodities and precious metals, energy, transportation, infrastructure and emerging markets like Brazil, Russia, India and China (dubbed the BRIC countries).

Bears worry that European and U.S. debt concerns will bring about another financial crisis. With Greece likely to default, the survival of the Euro as a currency in question and the sterling credit rating of the U.S. in danger, large banks may once again be in peril because they hold the debt of

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COMMENTARY:

WITH NO END IN SIGHT TO THE UNCERTAINTY THAT GRIPS MARKETS, WE TURN OUR ATTENTION ELSEWHERE

As we go to press for this issue of *The TANDEM Report*, the European debt crisis has moved beyond Greece, Ireland and Portugal and Italy is now at bat with Spain on deck. The political parties of the U.S. have thus far failed to reach agreements about how best to address our debt ceiling and unbridled spending, much less how to put unemployed and underemployed Americans back to work. State and local governments face tough choices as they attempt to over-

come budget shortfalls. The problems seem limitless while the solutions are as yet unclear.

Our clients are rightly troubled by the unpleasant economic news of the day. Having lived through two major bear markets in the last ten years and now faced with the prospect of government defaults, reasonable people wonder what, if anything, constitutes a safe haven these days. The coffee

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COMMENTARY (CONTINUED)

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can and mattress hold appeal not seen in many generations.

We understand these concerns. Times are indeed uncertain. Yet try as we might, we can think of no financial crisis in history that was as widely anticipated as the one many suspect is about to unfold. The Crash of '29, Black Monday 1987, the Tech Bubble/9-11 and the Great Recession of 2008 only garnered this much public attention *after* the fact. Few foresaw the looming disasters. If history is to be our guide, the crisis to fear is the one we don't see coming.

Investors must act with confidence and clarity of purpose. Today's economic issues make this challenging, but not impossible. Our methodology has worked for more than twenty years regardless of the economic backdrop. We continue to invest today as we always have - identifying reasonably priced stocks of companies that consistently grow earnings and dividends (if they are paid).

Sometimes bad news attaches itself to investor psyches and blocks their recall of what they would otherwise know to be true. So permit us to recount the experiences of our clients through the worst financial crisis since the Great Depression. The table below is provided by the independent in-

vestment manager research firm Zephyr and is designed to demonstrate the size of the decline in portfolio value (drawdown), the duration of the decline, the time required to return to previous levels and the date at which an all-time high was established. Tandem's clients experienced declines far less severe (1st column) than the stock market (S&P 500), with recovery coming for Tandem clients by year-end 2010. The S&P has yet to reclaim its July, 2007 high water mark. According to Zephyr, Tandem's clients reached a new high water mark in January of 2011. As this data only goes through March, we must note that Tandem's new high water mark is June, 2011 while the S&P's remains July, 2007.

that our investment methodology has historically produced results quite different from the broader stock market in troubled times. The reason is simple. The companies we invested in for our clients continued to earn money, grow earnings, remain financially healthy and increase dividend payouts where dividends were paid. Stock prices of such companies are certainly influenced in the short term by the movements of the broader market (like the baby being thrown out with the bath water). But given time, the soundness of these companies limits the severity of the decline and reduces the recovery time required. This has supported our portfolios through many downturns and we expect it will do so again in the future.

One other important aspect to consider in Tandem's demonstrated ability to negotiate past downturns is our sell discipline. We do not make market forecasts. In fact, we are market agnostic. However, we place what are known as stops (potential sell prices should stock prices decline) below the market price of many of our stocks. If prices rise, our stops rise too. But if prices fall, as they did in 2007 and 2008, our stops trigger sales of 25% of any given stock. Thus, it is no coincidence that most of our clients' stock portfolios held in excess of 20% cash in the summer of 2008. Stock prices hit our stops *before* the crisis magnified and our clients were protected from the extent of the down-

Drawdown (Decline) July 2007 – March 2011

	Max Drawdown	Max Drawdown Begin Date	Max Drawdown End Date	Max Drawdown Recovery Date	High Water Mark
Tandem Large Cap Core	-24.75%	Oct 2007	Mar 2009	Mar 2010	Jan 2011
Tandem Equity	-32.28%	Oct 2007	Mar 2009	Dec 2010	Jan 2011
S&P 500	-45.80%	Oct 2007	Mar 2009	N/A	Jul 2007

Created with Zephyr StyleADVISOR. Manager returns supplied by: Zephyr. Returns are gross of fees, or "Pure" Gross and represent the performance of Tandem's Large Cap Core and Equity Composites. Tandem maintains many composites representing the various styles of portfolio management Tandem offers clients. These are but two and may not reflect actual client experiences. Performance will be reduced by management fees and past performance is no guarantee of future results. For complete composite and performance information, including compliance with GIPS, please contact Billy Little, CFA at wbittle@tandemadvisors.com or (843) 720-3413.

vestment manager research firm Zephyr and is designed to demonstrate the size of the decline in portfolio value (drawdown), the duration of the decline, the time required to return to previous levels and the date at which an all-time high was established. Tandem's clients experienced declines far less severe (1st column) than the stock market (S&P 500), with recovery coming for Tandem clients by year-end 2010. The S&P has yet to reclaim its July, 2007 high water mark. According to Zephyr, Tandem's clients reached a new high water mark in January of 2011. As this data only goes through March, we must note that Tandem's new high water mark is June, 2011 while the S&P's remains July, 2007.

This data is relevant because it is important to understand

side that resulted from the failure of Lehman Brothers in September, 2008. And we did this without anyone at Tandem making a "market call". We allowed our discipline to work, much as we did in 1999 and 2000. We believe the process is repeatable because it is not based on the luck or skill of any individual to foresee what lies ahead. Rather, it is a strict discipline, tested by time, that allows our individual stocks to dictate the appropriate course of action.

So what is a safe haven today? Is it a CD? Maybe. For investors concerned enough to earn such a paltry rate in exchange for the likelihood of at least preserving their principal, perhaps CDs do provide a safe haven. The same can be said of Treasury Bills, Notes and Bonds, as well as Corpo-

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MARKET COMMENTARY (CONTINUED)

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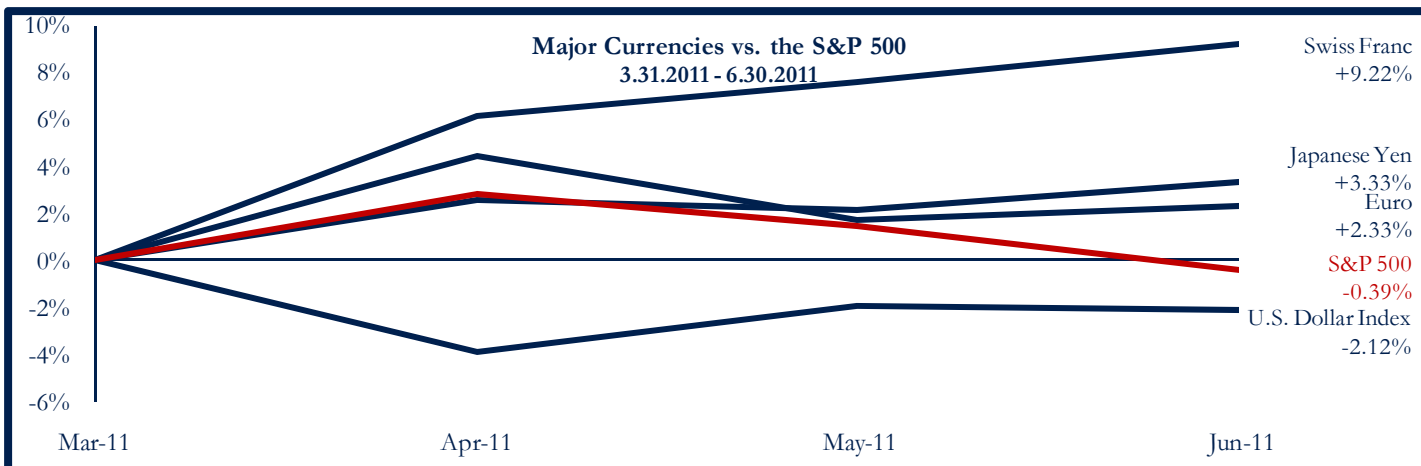
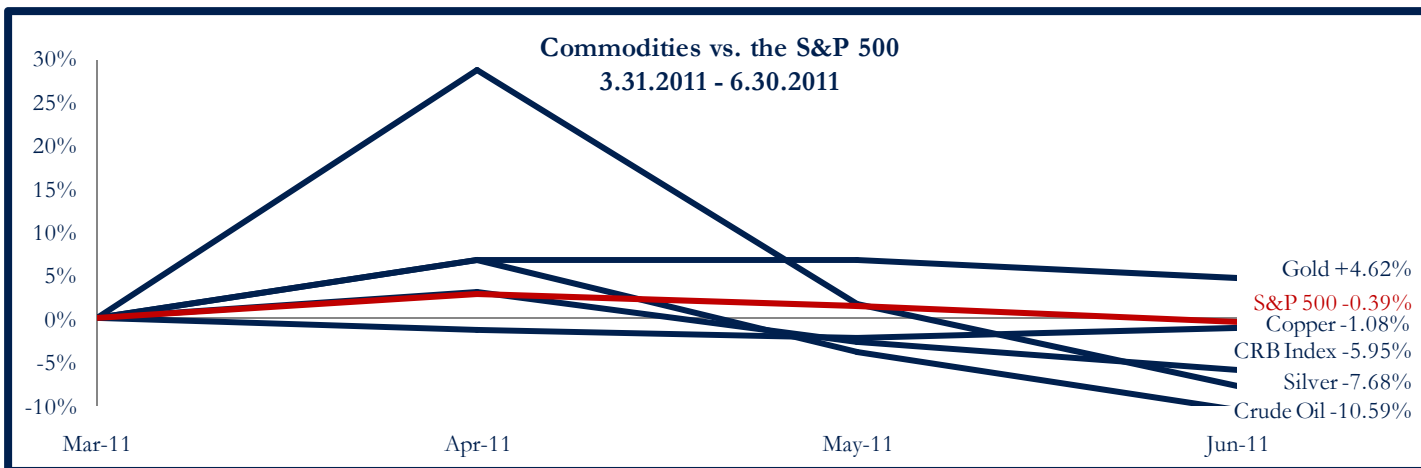
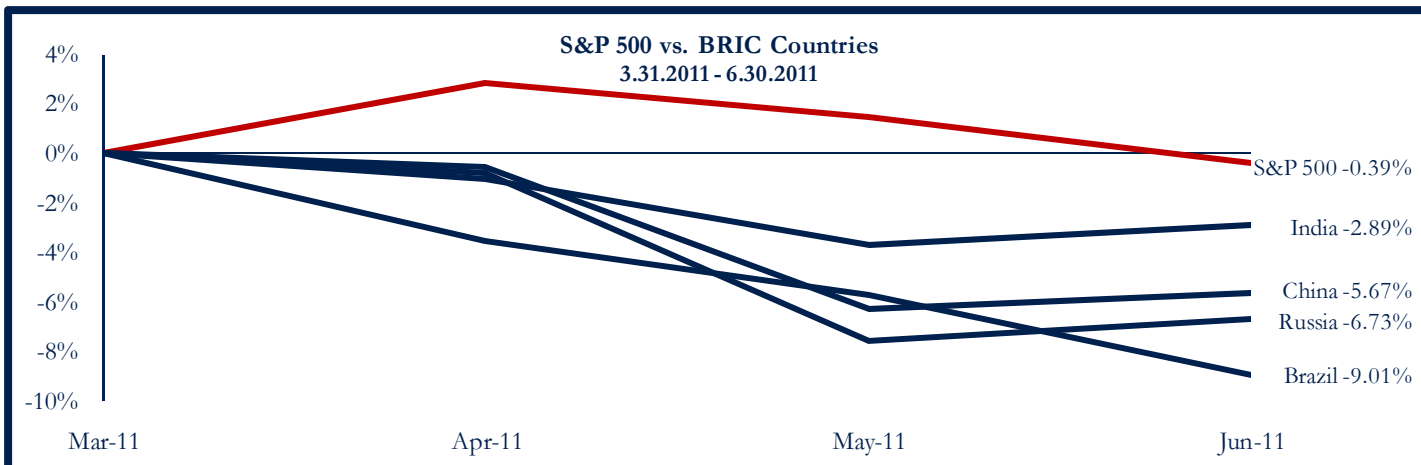
these nations on their books. The investment strategy for those concerned about a looming financial crisis is tricky because it is hard to know which currencies and assets are “safe”. Gold, short-term U.S. Treasuries and the Swiss Franc have been favored safe havens.

The three charts below illustrate that, for the second quarter at least, the bullish thesis took it on the chin. The S&P 500 bested the BRICs and most commodities other than Gold.

The bears like gold too, but major currencies also outperformed the S&P and the U.S. Dollar Index. Although not illustrated, short-term U.S. Treasuries posted modest gains. So for the second quarter, it would appear that bears held the upper hand on the strategy front, if not in the S&P action.

We follow a third school of thought. Overlooked by these lofty theories about possible economic outcomes is the performance of individual stocks that are not influenced by

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MARKET COMMENTARY (CONTINUED)

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Greece, government policies or anything other than their own ability to grow their business. And for companies such as these, the second quarter was quite good.

Tandem bases its investment philosophy on the premise that companies that demonstrate the ability to consistently grow their earnings and dividends regardless of economic climate will ultimately reward their shareholders. The table to the right illustrates this point. The stocks in this table are core holdings in our clients' portfolios. Of the 46 companies, 34 of them, or 74%, outperformed the S&P 500 for the quarter. The average appreciation of all 46 stocks was 3.63%, well ahead of the S&P's -0.39%.

We do not believe in touting quarterly performance. The vagaries of the market can make today's winners tomorrow's losers. However, in this case, quarterly performance can serve to illustrate an important point.

The success of individual companies is being overshadowed by macro thought. Investors are focused on the big picture, often neglecting the smaller success stories taking place. The companies in the table on the right represent a cross-section of industries. There are health care companies like Thermo Fisher, Novartis and Becton Dickinson. There are retailers like O'Reilly Automotive, TJX and Tractor Supply. And there are Consumer Products companies like Brown Forman, Colgate and Smucker. Greek debt is of little con-

cern to their respective managements. They operate in their own space and control their own destiny. Some of these companies have little or no international exposure, while others conduct the majority of their business overseas. The only common thread among them all? They consistently grow their earnings and dividends (for those that pay them), and as a result, reward their shareholders.

Companies are successful for a variety of reasons, but the best companies succeed in any environment. While macro investment theses are dominating the debate and the daily movement of the broad stock market (while scaring away the individual investor), a focus on the micro strategy of identifying great companies never goes out of style, just out of the headlines.

The point we wish to leave the reader with is that it will likely take time to determine if the world will resume economic growth or succumb to financial demons and slip back into recession. There is no clear answer. What is clear is that the average investor has given up on individual stocks and instead invests according to some broader theme. This is unfortunate. There may or may not be good value in a "stock market", but there is plenty of value in good companies. The macro-focused themes of the day have left plenty of room for individual stocks to behave differently from the broader group.

Perhaps more than any other time in Tandem's existence, the stock market is not an efficient pricing mechanism.

COMMENTARY (CONTINUED)

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rate and Municipal obligations. But what if we experience inflation in the future? What if defaults make bond investors nervous? In either case, interest rates will rise. And for those trapped in fixed income investments such as these, they may indeed get their principal returned, but that principal's purchasing power will be eroded.

Some say gold and other precious metals provide a safe haven. Maybe. Unless we return to the Stone Age, your grocer isn't likely to accept gold as payment. What we know about gold and other precious metals is that their value as an inflation hedge is overstated and that when they decline in price, the decline is typically rapid and painful. Gold may provide market timers and other traders the opportunity to *make* money, but rarely has it proven to be a good store of value over time.

Others forecast a collapse of the dollar. Gold is perhaps one way to avoid this, with the cautions noted above. Another is to exchange your dollars for other currencies like the Swiss Franc. Currencies may provide some sort of hedge, but cur-

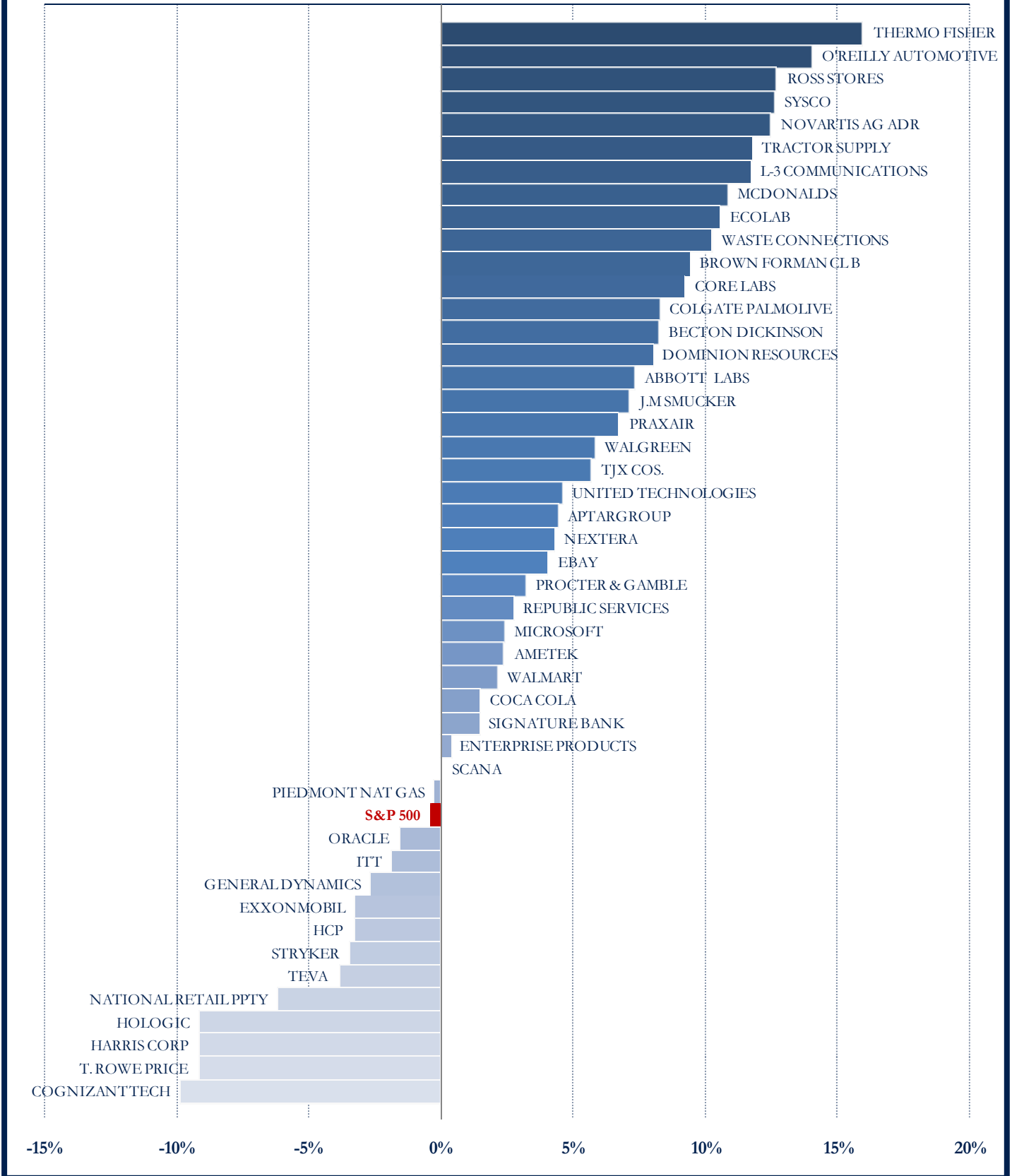
rency markets are as volatile as gold markets and we still live in a country that requires that we pay our bills in dollars.

The alternative we favor (surprise) is stocks. Not the "stock market" but stocks we know and understand. Stocks that grow their dividends every year (bonds and CDs can't do that). Stocks of companies that control their own destinies, in spite of the world around them. Companies like Piedmont Natural Gas, a utility, or AptarGroup, a manufacturer of non-aerosol plastic pumps, or Walgreen, a pharmacy. If the worst is realized, nothing will do particularly well. But these companies and most of the others listed to the right have long histories of recovering value quickly while increasing the amount of income they pay shareholders. They provide a hedge against inflation and have demonstrated stability over time.

We cannot predict what lies ahead. It may be bad, or it may be that the fear is worse than the reality. What we can predict is that we will follow our investment discipline and remain confident that we are protecting our clients' portfolios while taking advantage of whatever opportunities this inefficient, nervous market may offer.

Stock Price Performance of Core Tandem Holdings

3.31.2011 - 6.30.2011



The table above reflects only the share price appreciation of Tandem's core holdings across multiple styles of portfolio management from March 31, 2011 through June 30, 2011. Not every client portfolio holds each of the stocks listed. This table does not include dividends and should not be construed to represent actual performance experienced by Tandem clients.

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MARKET REPORT CARD

YIELD TABLE				KEY MARKET DATA				
	Current	3 months ago	1 year ago		6/30/11 Close	% Change 1 Year	% Change 5 Years	% Change 10 Years
3-month Treasury Bill	0.02%	0.05%	0.18%	S&P 500	1,320.64	28.13%	3.97%	7.86%
5-year Treasury Note	1.76%	2.28%	1.78%	Dow Jones Industrial	12,414.34	27.01%	11.34%	18.20%
10-year Treasury Note	3.16%	3.47%	2.93%	NASDAQ	2,773.52	31.49%	27.69%	28.37%
30-year Treasury Bond	4.37%	4.51%	3.89%	Russell 2000	827.43	35.76%	14.18%	61.24%
Prime Rate	3.25%	3.25%	3.25%	German Xetra DAX	7,376.24	23.65%	29.79%	21.75%
Federal Funds Rate	0.04%	.09%	0.04%	London FTSE 100	5,945.71	20.92%	1.93%	5.37%
Discount Rate	0.75%	0.75%	0.75%	Shanghai Composite	2,762.08	15.16%	65.18%	24.53%
3-Month LIBOR	0.25%	0.30%	0.53%	Crude Oil	\$95.42	26.17%	29.09%	263.35%
				Gold	\$1,505.50	21.02%	145.40%	525.73%
				CRB Index	338.05	30.76%	-2.41%	64.45%
				U.S. Dollar Index	74.39	-8.77%	-12.65%	-37.71%
				Dollar/Euro*	145.01	18.67%	13.49%	71.29%

The data used to compile the above tables come from publicly available sources. Tandem believes it to be reliable, but makes no such assertions. Such data is not meant to imply past or future performance for Tandem or any securities market.

* Negative return represents dollar strength, positive return represents dollar weakness. Returns are cumulative, not annualized.