

# Manager Perspective

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**TANDEM**  
WEALTH ADVISORS

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*This fall Tandem Wealth Advisors was approached by prospective clients, a recently retired physician and his wife, who were seeking an investment management firm to assist with their retirement investment strategies and long-term financial planning. We were asked the following questions as part of their due diligence. We found the questions and our corresponding answers to be informative enough to share with others seeking a disciplined portfolio and wealth management process:*



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Managing Director

## How do you construct Tandem's portfolios?

Let's use an example: the Tandem Core Equity stock portfolio, one of five portfolio strategies we employ. We compare the portfolio to the S&P 500 Index, the industry standard benchmark for equities. We build the portfolio taking into account not only positive positions (where we own a stock at a weighting greater than that in the benchmark) but also negative positions (where we own either none or a smaller weighting of a stock than in the benchmark). Relative performance can be negatively affected not only by owning a stock that declines more than the benchmark, but also by not owning (or under-owning) a large benchmark weighting. For instance, Apple, a stock Tandem owns in client portfolios, is currently 3.25% of the S&P 500. Any investor that does not own Apple in his/her portfolio which is benchmarked against the S&P 500 has a negative bet of 3.25% versus Apple. We monitor the 25 largest holdings in the benchmark to be aware of the negative positions versus the benchmark.

## Why is ExxonMobil currently the largest position in the Tandem Core Equity stock portfolio?

- 1) It is currently the largest position by weighting in the S&P 500 (3.3% as of October 31, 2011). Owning some of the largest Index names helps dampen our total risk profile for clients. (We might miss performance if we didn't own a large benchmark weighting, as noted above.)
- 2) Exxon has one of the best combinations of upstream/downstream operations among the major integrated oils and thus can prosper best in periods of flat to rising oil prices.
- 3) The company returns significant amounts of cash to shareholders via both dividend payments and stock buybacks. Besides the 2.3% current yield, Exxon bought back approximately \$16 billion in stock during the first nine months of 2011. This strong capital discipline shows management is in tune with shareholders.

- 4) Exxon has a very strong financial position with only 7% debt/capital, one of the best balance sheets in the oil industry.
- 5) Oil prices should trade in a range of \$90-110 for the next 6-12 months.

### How do you decide if and when to sell a stock?

We sell a stock for three reasons:

- 1) **We have dynamic price targets on every stock in our portfolios along with another 150 that we monitor.** When a stock reaches our predetermined price (or valuation) target we trim the position, but understand that most times a stock will exceed fair value by 10-25% if it has a strong institutional following. When the stock reaches our “high price” target we sell the stock out of client portfolios.
- 2) **The fundamental reason that we bought the stock is no longer valid;** i.e., change in management, change in earnings estimates, change in fundamental business case.
- 3) Although the stock may still show some upside to fair price, **we have found a better use of funds** (a stock with meaningfully more upside). We will sell the stock and redeploy proceeds into positions with higher upside potential.

Reasons two and three show our commitment to “pulling weeds in the garden and allowing the more beautiful flowers to fully blossom.”

### How does Tandem use economic data points such as Fed meetings or monthly unemployment reports to help make decisions about holdings or a portfolio?

We combine top-down macroeconomic analysis with bottom-up stock selection. We look at global and regional GDP forecasts, inflation levels, employment statistics, auto sales, retail sales, and several other weekly and monthly data points to formulate our macroeconomic views. We believe market inefficiencies exist at the macro level (such as a regional, national or global economy as a whole), the sector level (an industry or area of the economy) and the individual security level. Starting with a global perspective, we look at global economies and determine how this will affect the national economy and economic sectors before moving to security selection. The term we use is “harvesting the business cycle.” Tandem professionals determine which sectors will likely outperform the market over the upcoming 12 to 18 months and which will underperform based on our economic view. Then we modify our sector weights to reflect that view. Tandem’s process for selecting stocks and managing client portfolios is highly disciplined.



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