

## MARKET COMMENTARY MONDAY, JANUARY 29, 2018

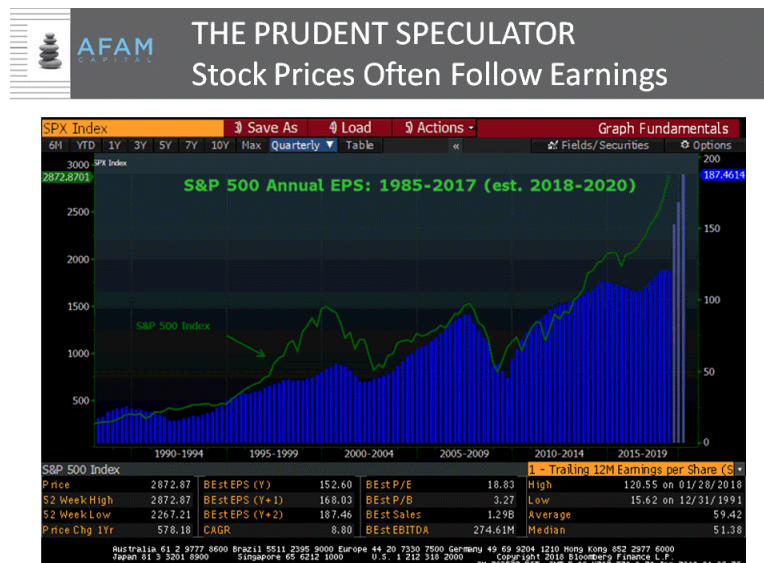
### EXECUTIVE SUMMARY

Week #4 2018 – Rally Strengthens  
GDP News – Favorable Outlook for Global and Domestic Growth  
Sentiment – AAI Bull-Bear Spread Shrinks  
Fund Flows – Investors Still Love Bonds  
Bonds vs. Stocks– Equities Still Love Bonds  
Q4 Earnings – 77.4% Beating the Street  
February Newsletter – *TPS 616* Coming Friday  
No Sale Yet – Boosted Target Prices for MSFT, NKE, PNC, STX & WMT  
Earnings News – Updates on JNJ, ABT, CE, HAL, CAT, WHR, CMCSA, RCL, NSC, AVX, INTC & ALK

### Market Review

It was another very good week for the equity markets, starting with Washington kicking the proverbial can down the road by a few weeks in quickly ending the Government Shutdown, and ending with a big rally after President Trump sounded more amenable to global trade in remarks at the World Economic Forum in Davos. For the five days, the broad-based S&P 500 and Russell 3000 returned 2.23% and 2.03%, respectively, with Growth again outperforming Value by a total return score of 2.24% to 1.80% on the Russell 3000 Growth and Value indexes.

Not surprisingly, the seemingly unrelenting advance has many folks wondering if the rally is justified. Although stock prices move up and down for numerous reasons, we would vehemently argue that the gains seen since the passage of the Tax Cuts and Jobs Act are very much reasonable, given that corporate profits for much of Corporate America are likely to increase significantly simply with the stroke of a pen,...



...while the outlook for global economic growth for both 2018 and 2019 was raised by two-tenths of a percent last week by the International Monetary Fund,...

THE PRUDENT SPECULATOR						
IMF World Economic Outlook – Jan '18						
IMF Global Growth Projections						
	2016	2017	2018	2019	Difference from 10/17	
World Output	3.2	3.7	3.9	3.9	0.2	0.2
Advanced Economies	1.7	2.3	2.3	2.2	0.3	0.4
United States	1.5	2.3	2.7	2.5	0.4	0.6
Euro Area	1.8	2.4	2.2	2.0	0.3	0.3
Germany	1.9	2.5	2.3	2.0	0.5	0.5
France	1.2	1.8	1.9	1.9	0.1	0.0
Italy	0.9	1.6	1.4	1.1	0.3	0.2
Spain	3.3	3.1	2.4	2.1	-0.1	0.1
Japan	0.9	1.8	1.2	0.9	0.5	0.1
United Kingdom	1.9	1.7	1.5	1.5	0.0	-0.1
Canada	1.4	3.0	2.3	2.0	0.2	0.3
Emerging Market/Developing Economies	4.4	4.7	4.9	5.0	0.0	0.0
Commonwealth of Independent States	0.4	2.2	2.2	2.1	0.1	0.0
Russia	-0.2	1.8	1.7	1.5	0.1	0.0
Emerging and Developing Asia	6.4	6.5	6.5	6.6	0.0	0.1
China	6.7	6.8	6.6	6.4	0.1	0.1
India	7.1	6.7	7.4	7.8	0.0	0.0
Emerging and Developing Europe	3.2	5.2	4.0	3.8	0.5	0.5
Latin America and the Caribbean	-0.7	1.3	1.9	2.6	0.0	0.2
Brazil	-3.5	1.1	1.9	2.1	0.4	0.1
Mexico	2.9	2.0	2.3	3.0	0.4	0.7

Source: International Monetary Fund, World Economic Outlook Update, January 2018

**Brighter Prospects, Optimistic Markets, Challenges Ahead**  
Global economic activity continues to firm up. Global output is estimated to have grown by 3.7% in 2017, which is 0.1 percentage point faster than projected in the fall and ½ percentage point higher than in 2016. The pickup in growth has been broad based, with notable upside surprises in Europe and Asia. Global growth forecasts for 2018 and 2019 have been revised upward by 0.2 percentage point to 3.9%. The revision reflects increased global growth momentum and the expected impact of the recently approved U.S. tax policy changes.

...which also ratcheted up its GDP estimates for the U.S. by four-tenths of a percentage point for 2018 and six-tenths of a percentage point for 2019. Of course, the new IMF U.S. growth forecasts for this year of 2.7% and for next year of 2.5%, though better than the respective 2.5% and 2.1% that the Federal Reserve was suggesting in the middle of December,...

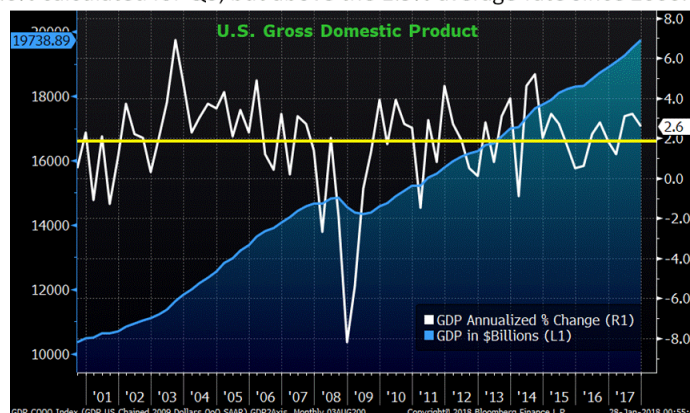
THE PRUDENT SPECULATOR						
Moderate LT Economic Growth Expected						
The Fed left its longer-run projection for GDP growth at 1.8%, though its outlook for 2018 growth increased to 2.5%, up from 2.1%. Of course, the estimates were made prior to the passage of the Tax Cuts and Jobs Act.						
Economic projections of Federal Reserve Board members and Federal Reserve Bank presidents under their individual assessments of projected appropriate monetary policy, December 2017 Advance release of table 1 of the Summary of Economic Projections to be released with the FOMC minutes						
Percent	Median <sup>1</sup>					
Variable	2017	2018	2019	2020	Longer run	
Change in real GDP	2.5	2.5	2.1	2.0	1.8	
September projection	2.4	2.1	2.0	1.8	1.8	
Unemployment rate	4.1	3.9	3.9	4.0	4.6	
September projection	4.3	4.1	4.1	4.2	4.6	
PCE inflation	1.7	1.9	2.0	2.0	2.0	
September projection	1.6	1.9	2.0	2.0	2.0	
Core PCE inflation <sup>4</sup>	1.5	1.9	2.0	2.0	2.0	
September projection	1.5	1.9	2.0	2.0	2.0	
Memo: Projected appropriate policy path						
Federal funds rate	1.4	2.1	2.7	3.1	2.8	
September projection	1.4	2.1	2.7	2.9	2.8	

Source: Federal Reserve, December 13, 2017

...might actually prove to be conservative. After all, last week we learned from Uncle Sam that its first guess for Q4 GDP growth (which had very little tax-related benefit) was 2.6%.

## THE PRUDENT SPECULATOR Solid U.S. Economic Growth

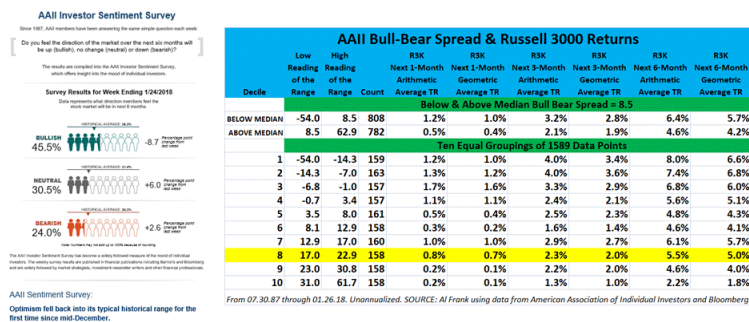
Uncle Sam estimates Q4 2017 GDP growth at a decent 2.6%, down from 3.0% calculated for Q3, but above the 1.9% average rate since 2000.



To be sure, we recognize that stocks still move in both directions, but we still are not seeing signs of irrational exuberance. Yes, many folks appear to be optimistic about equities, but the latest Investor Sentiment Survey from the American Association of Individual Investors saw a sizable pullback in the number of Bulls to 45.5% and a modest increase in the number of Bears to 24.0%.

## THE PRUDENT SPECULATOR AAII Sentiment – Contrarian Indicator

Warren Buffett states, “Be greedy when others are fearful and fearful when others are greedy,” and the weekly AAI Bull-Bear Spread and subsequent performance supports the Oracle of Omaha’s assertion...at least on the “others are fearful” argument. Of course, the latest +21.5 reading is *only* in the eight decile of nearly 1600 weekly calcs.



Those numbers are still skewed fairly strongly in favor of those looking for further market gains over the next six months, given that the historical norms are 38.3% Bulls and 30.3% Bears, but our analysis of the AAI Bull-Bear Spread and subsequent stock returns causes us to lose no sleep over the arguments that investors are somehow too enthusiastic.

## THE PRUDENT SPECULATOR AAII – Another Reason to Favor Value

Equities have enjoyed gains just about every way the historical market data is sliced and diced, but the latest +21.5 AAIL Bull-Bear Sentiment reading is on the higher end of the spectrum, though there is little difference in the solid going-forward returns of Value and Growth stocks. Happily, the R3KV has outperformed the R3KG when optimism is above the median...as is the case today.

Decile	Low Reading of the Range	High Reading of the Range	Count	R3KV Next 1-Month Arithmetic	R3KV Next 1-Month Geometric	R3KV Next 3-Month Arithmetic	R3KV Next 3-Month Geometric	R3KV Next 6-Month Arithmetic	R3KV Next 6-Month Geometric
BELOW MEDIAN	-54.0	8.5	808	0.9%	0.8%	2.7%	2.3%	5.8%	5.0%
ABOVE MEDIAN	8.5	62.9	782	0.8%	0.7%	2.6%	2.4%	5.3%	4.9%
Tail Equal Groupings of 1989 Data Points									
1	-54.0	-14.3	159	0.6%	0.4%	3.1%	2.5%	6.8%	5.4%
2	-14.3	-7.0	163	1.2%	1.1%	3.7%	3.4%	7.0%	6.4%
3	-6.8	-1.0	157	1.5%	1.4%	2.9%	2.5%	6.3%	5.5%
4	-0.7	3.4	157	0.9%	0.9%	2.2%	1.9%	5.1%	4.6%
5	3.5	8.0	161	0.4%	0.3%	2.0%	1.7%	4.0%	3.4%
6	8.1	12.9	158	0.5%	0.4%	1.6%	1.4%	4.2%	3.7%
7	12.9	17.0	160	1.2%	1.1%	3.1%	2.9%	6.0%	5.6%
8	17.0	22.9	158	0.9%	0.8%	2.4%	2.2%	5.6%	5.3%
9	23.0	30.8	158	0.7%	0.6%	2.8%	2.6%	5.4%	4.9%
10	31.0	61.7	158	0.7%	0.7%	2.6%	2.4%	4.8%	4.5%

From 07.30.87 through 01.26.18. Unannualized. SOURCE: AI Frank using data from American Association of Individual Investors and Bloomberg

Decile	Low Reading of the Range	High Reading of the Range	Count	R3KG Next 1-Month Arithmetic	R3KG Next 1-Month Geometric	R3KG Next 3-Month Arithmetic	R3KG Next 3-Month Geometric	R3KG Next 6-Month Arithmetic	R3KG Next 6-Month Geometric
BELOW MEDIAN	-54.0	8.5	808	1.1%	1.0%	1.4%	1.3%	6.9%	6.1%
ABOVE MEDIAN	8.5	62.9	782	0.5%	0.4%	1.7%	1.3%	4.0%	3.3%
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4	-0.7	3.4	157	1.2%	1.1%	2.8%	2.4%	6.2%	5.7%
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10	31.0	61.7	158	-0.1%	-0.2%	0.0%	-0.4%	-0.2%	-1.1%

From 07.30.87 through 01.26.18. Unannualized. SOURCE: AI Frank using data from American Association of Individual Investors and Bloomberg

This is especially true as data on mutual fund and exchange traded fund flows show that there is often a big difference between what people say and what they do.

## THE PRUDENT SPECULATOR Bonds Remain Stunningly Popular

While the move toward passive U.S. equity strategies has been massive over the past decade, data from the Investment Company Institute show that far more dollars have flowed out of domestic stock mutual funds/ETFs than have flowed in over the last three years. Foreign stocks and bonds have been the beneficiaries of the exodus, a trend that has continued in 2018.

Week Ended	1/17/2018	1/10/2018	1/3/2018	12/27/2017	12/20/2017
Total Equity	11,874	17,377	-21,006	4,099	-1,587
Domestic	1,720	3,637	-22,062	1,208	-9,553
World	10,155	13,739	1,056	2,892	7,966
Hybrid	-247	-149	-327	-940	-2,122
Total Bond	9,250	18,916	7,573	4,123	1,599
Taxable	6,794	15,759	7,059	4,501	1,511
Municipal	2,457	3,156	514	-378	87
Commodity	45	-2	-305	-296	-434
Total	20,922	36,141	-14,065	6,986	-2,545


Source: Investment Company Institute

Period	Total LT MF and ETF	Total	Equity Domestic	Equity World	Hybrid	Bond Total	Bond Taxable	Bond Municipal	Commodity
2015+2016+2017	736,895	207,386	-232,245	439,634	-97,258	611,742	532,119	79,621	15,020
2016+2017	621,912	105,922	-129,096	235,020	-78,936	582,021	521,142	60,877	12,903
2017	535,598	178,230	-59,613	237,845	-34,911	391,053	359,481	31,569	1,224

Note: Weekly fund flows are estimates based on reporting covering more than 98 percent of mutual fund and ETF assets, while actual monthly mutual fund net new cash flow and ETF net issuance data are collected and reported separately. Mutual fund data represent net new cash flow, which is new sales minus redemptions combined with net exchanges, while ETF data represent net issuance, which is gross issuance less gross redemptions. The primary difference is that net new cash flow excludes reinvested dividends and new issuance includes reinvested dividends. Data for mutual funds that invest primarily in other mutual funds and ETFs that invest primarily in other ETFs were excluded from the series.

True, U.S. stocks have received some modest affection so far in 2018, but the love affair with bonds has hardly missed a beat. Obviously, many investors are not able to stomach the volatility associated with the equity market, so fixed income will always merit a place in most asset allocations as a risk mitigation tool, but heretofore bond investments were also producing decent returns. The year is still very young, but that has not been the case thus far in 2018,...





# THE PRUDENT SPECULATOR

## Stock Returns Versus Bond Returns

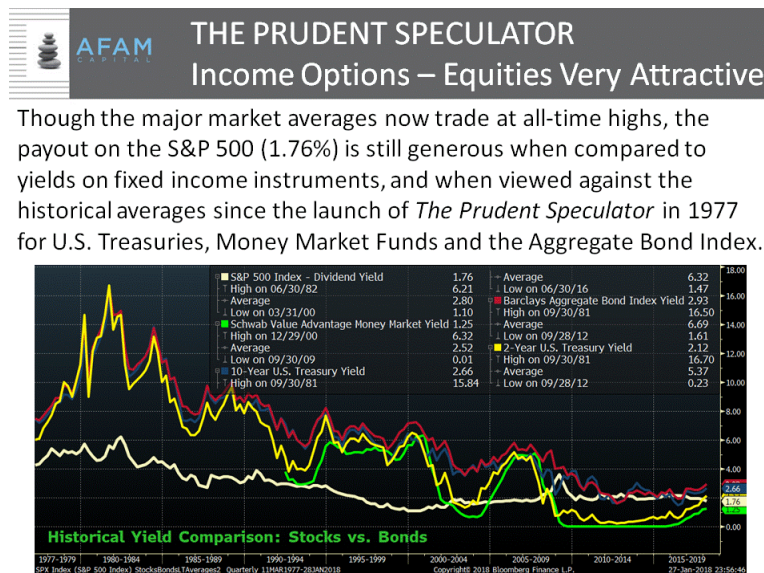
Returns Race					
2018 YTD	2017	2016	Since Fed	Bloomberg	Index
Return %	Return %	Return %	Liftoff %	Symbol	
Stock Indexes					
7.77	28.11	16.50	57.92	INDU Index	Dow Jones Industrial Average
8.76	29.73	8.97	51.89	CCMP Index	NASDAQ Composite Index
7.32	21.68	12.04	44.47	RIV Index	Russell 1000 Index
4.76	14.63	21.28	44.12	RTY Index	Russell 2000 Index
7.12	21.12	12.72	44.45	RAY Index	Russell 3000 Index
7.55	21.82	11.95	44.71	SPX Index	S&P 500 Index
8.64	30.21	7.07	49.32	RLG Index	Russell 1000 Growth Index
5.97	13.64	17.33	39.77	RLV Index	Russell 1000 Value Index
5.97	22.14	11.28	42.24	RUO Index	Russell 2000 Growth Index
3.46	7.82	31.72	45.72	RUJ Index	Russell 2000 Value Index
8.43	29.58	7.38	48.77	RAG Index	Russell 3000 Growth Index
5.79	13.17	18.38	40.23	RAV Index	Russell 3000 Value Index
8.82	27.43	6.89	45.88	SGX Index	S&P 500 Growth Index
6.21	15.35	17.39	42.26	SVX Index	S&P 500 Value Index
Largest Bond Funds					
-0.83	3.57	0.79	5.47	VBIX Equity	Vanguard Tot Bnd Mkt Idx-Inst
-0.93	3.53	0.75	5.25	VTBIX Equity	Vanguard Tot Bnd Mkt II-Inv
-0.11	8.17	0.82	17.06	PONAX Equity	Pimco Income Fund-A
-0.28	2.39	0.81	7.13	VTABX Equity	Vanguard Total Intl Bnd-Adm
-0.80	3.10	0.76	4.82	MWTRX Equity	Mitrpln Wst Trl Rtn Bnd-M
-0.81	5.13	0.73	7.05	PTTRX Equity	Pimco Total Return Fund-Inst
0.07	7.36	0.63	16.45	PIMINIA Equity	Pimco Gls-Income Fund-Ins Ac
-0.30	2.02	-0.01	4.50	VFSTX Equity	Vanguard S/T Invest Grd-Inv
-0.57	4.53	0.21	4.44	VWITX Equity	Vanguard Intm Trm T/E-Inv
-0.29	4.36	0.63	10.05	DODIX Equity	Dodge & Cox Income
-0.66	3.79	0.51	5.42	DBLTX Equity	Doubleline Ttl Rtn Bnd-I
-0.25	1.89	0.07	4.67	LDLAX Equity	Lord Abbett Shrt Dur Inc-C

Source: Bloomberg. As of 1.26.18. Fed Liftoff was December 16, 2015.

It is tough to complain about outside equity returns even as Value’s recent struggles relative to Growth have continued into 2018. Of course, the returns race is closer since the Federal Reserve initiated “Liftoff” 25 months ago. For their part, the 12 largest bond funds, with collective assets of a whopping \$1 trillion, have not exactly been grand performers, with all but one actually in the red this year!

It is tough to complain about outsize equity returns even as Value's recent struggles relative to Growth have continued into 2018. Of course, the returns race is closer since the Federal Reserve initiated "Liftoff" 25 months ago. For their part, the 12 largest bond funds, with collective assets of a whopping \$1 trillion, have not exactly been grand performers, with all but one actually in the red this year!

...so we wouldn't be surprised to see the stampede into fixed income slow as we don't think red ink is going to sit well with bond fund investors, especially given that yields are not very exciting compared to the income available on stocks,...



...while dividend payouts are likely to continue to rise over time, meaning that the 2017 payout on the S&P 500 of \$50.47 should be significantly higher in the years ahead.

## THE PRUDENT SPECULATOR Dividends Have Grown Over Time

While dividends are never guaranteed, the historical evidence suggests that Corporate America has a long history of raising quarterly payouts (**Alaska Air, Comcast, Intel, Kimberly-Clark, MDC Holdings and Norfolk Southern** did so in the past three trading days), whereas the coupons on most debt instruments are fixed.

COUNT OF S&P 500 DIVIDEND ACTIONS	INCREASES	INITIATIONS	DECREASES	CESSATIONS
2018 (YTD)	25	1	0	0
2017	351	5	9	2
2016	344	7	19	2
2015	344	7	16	3
2014	375	8	8	0
2013	366	15	12	0
2012	333	15	11	1
2011	320	22	5	0
2010	243	13	4	1
2009	151	6	68	10
2008	236	5	40	22
2007	287	11	8	4
2006	299	6	7	3
2005	306	10	9	2

Source: Standard & Poor's. As of January 25, 2018

S&P 500 DIVIDENDS PER SHARE	
2019 (Est.)	\$56.70
2018 (Est.)	\$52.80
2017	\$50.47
2016	\$46.73
2015	\$43.49
2014	\$39.44
2013	\$34.99
2012	\$31.25
2011	\$26.43
2010	\$22.73
2009	\$22.41
2008	\$28.39
2007	\$27.73
2006	\$24.88
2005	\$22.22

Source: Bloomberg. As of 1.26.18

Yes, we respect that the yield today on the S&P 500 is only 1.76%, but those who would be more comfortable if the payout were closer to the income available on longer-term Treasuries should remember that our broadly diversified portfolios of undervalued stocks offer dividend yields in the 2.3% to 2.5% range.

## THE PRUDENT SPECULATOR Newsletter Portfolio Metrics

### CURRENT PORTFOLIO AND INDEX VALUATIONS

Name	Price to Earnings Ratio	Price to Fwd. Earnings Ratio	Price to Sales Ratio	Price to Book Ratio	Dividend Yield
TPS Portfolio	17.8	14.6	1.3	2.2	2.5
Buckingham	18.4	15.0	1.3	2.2	2.3
Millennium	18.8	15.0	1.3	2.2	2.3
ProFolio	18.6	15.0	1.2	2.3	2.3
Russell 3000	25.5	19.5	2.2	3.4	1.7
Russell 3000 Growth	30.5	22.9	3.0	6.9	1.2
Russell 3000 Value	21.8	16.9	1.7	2.2	2.2
Russell 2000	59.7	26.6	1.3	2.5	1.3
Russell 2000 Growth	113.2	35.4	1.7	4.7	0.7
Russell 2000 Value	39.2	20.8	1.0	1.6	1.9
Russell 1000	24.4	19.1	2.3	3.5	1.7
Russell 1000 Growth	28.7	22.3	3.2	7.2	1.2
Russell 1000 Value	21.1	16.6	1.8	2.2	2.3
S&P 500 Index	23.8	18.8	2.4	3.5	1.8
S&P 500 Growth Index	27.6	21.7	3.9	6.2	1.2
S&P 500 Value Index	20.8	16.5	1.7	2.4	2.3
S&P 500 Pure Value Index	16.8	13.1	0.7	1.6	3.0

As of 01.27.18. Weights based on model portfolios. Harmonic mean used to calculate the portfolio price metrics. Companies with negative earnings are excluded from the P/E and Estimated P/E calculations. SOURCE: AI Frank using data from Bloomberg

We realize that we are overdue for some sort of pullback, and the equity futures are pointing to a slightly lower open when trading resumes this week, but with valuations also still reasonable for our kinds of stocks, we see no reason to alter our Bullish course for those who share our long-term time horizon. This is especially true as we like what we have been seeing thus far from fourth quarter earnings. Data provider Bloomberg calculates that 77.4% of the 133 S&P 500 companies that have announced results have topped expectations, compared to 13.5% that have trailed projections and 9.0% that have matched estimates. Those numbers compare very

favorably to the 65.7%/22.9%/11.4% Beat/Miss/Match figures for the full S&P 500 in the Q4 2016 earnings season.

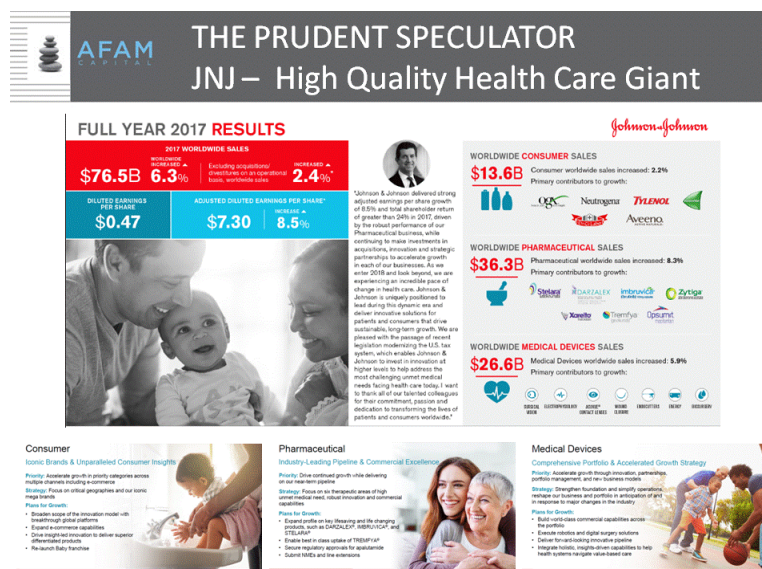
## Stock Updates

We are at work already on the February edition of *The Prudent Speculator*. If all goes according to plan, *TPS 616* will be posted to theprudent-speculator.com on Friday, February 2.

We will also be posting on Thursday updated Target Prices for all 120 or so formerly recommended stocks that have not yet been closed out. We continue to hold tight to all of our stocks, including several that have approached or even eclipsed our previously published fair value assessments. Increased earnings estimates have compelled us to raise our Target Prices for software giant **Microsoft** (MSFT - \$94.06) to \$98, athletic footwear and apparel king **Nike** (NKE - \$68.04) to \$73, regional banking powerhouse **PNC Financial** (PNC - \$158.66) to \$162, data storage leader **Seagate Tech** (STX - \$54.94) to \$58 and discount retailing behemoth **Wal-Mart Stores** (WMT - \$108.39) to \$111.

Jason Clark and Chris Quigley provide updates on a dozen of our names that were out with quarterly results last week...

**Johnson & Johnson** (JNJ – \$145.33) reported that it earned \$1.74 per share in fiscal Q4 2017 (vs. \$1.72 est.). The health care giant had sales of \$20.2 billion (vs. \$20.1 billion est.). JNJ benefitted from solid performance of its drug unit which overshadowed the flat performance of its consumer arm. Operating margins came in a bit lighter than some were expecting, as higher research-and-development spending was offset by a lower tax rate. CEO Alex Gorsky said, “Johnson & Johnson delivered strong adjusted earnings per share growth of 8.5% and total shareholder return of greater than 24% in 2017, driven by the robust performance of our Pharmaceutical business, while continuing to make investments in acquisitions, innovation and strategic partnerships to accelerate growth in each of our businesses.”



Mr. Gorsky added, “As we enter 2018 and look beyond, we are experiencing an incredible pace of change in health care. Johnson & Johnson is uniquely positioned to lead during this dynamic era and deliver innovative solutions for patients and consumers that drive sustainable, long-term growth. We are pleased with the passage of recent legislation modernizing the U.S. tax system, which enables Johnson & Johnson to invest in innovation at higher levels to help address the most challenging unmet medical needs facing health care today.” J&J announced its 2018 full-year guidance for sales of \$80.6 billion to \$81.4 billion, reflecting expected operational growth in the range of 3.5% to 4.5%. The company also projected adjusted earnings of \$8.00 to \$8.20 per share.

That all sounded pretty good to us, but JNJ shares ended the week down 2% as expected operating margins were a bit lighter than some had been expecting. Additionally, and perhaps more importantly, the stock was pressured by a patent court loss involving its top-selling arthritis drug Remicade, which came just a week after a patent defeat related to its blockbuster prostate-cancer drug Zytiga. There is no shortage of legal maneuvering still to come on both fronts.

Considering the flurry of news, we decided to trim our Target Price for JNJ by a buck to \$153. While we recognize that valuation multiples have expanded with shares returning more than 31% in the last year, we continue to like the product mix and that the majority of its pharmaceutical offerings are specialty drugs, which frequently carry stronger pricing power. We are also constructive on the firm’s recent acquisitions, which we believe add further diversifying potential. We continue to view the company as uniquely situated with unmatched depth and breadth in growing global health care markets, and with solid positions in drugs, medical devices and consumer products. We will continue to closely monitor the valuation of this high quality name and won’t be shy in reducing our position or selling it all if need be, but for the time being, we are still holding.

Shares of **Abbott Labs** (ABT – \$63.42) continued their strong performance over the last year, which has seen them soar some 58%. The latest positive catalyst for the diversified health care company was the announcement of Q4 financial results that included both top- and bottom-line beats. Abbott turned in adjusted EPS of \$0.74, versus expectations of \$0.73, and revenue of \$7.59 billion, compared to consensus forecasts of \$7.38 billion. The real story of ABT’s Q4 is the outstanding revenue growth it realized and what it suggests about the future ability to consistently grow earnings at an attractive rate. Of note, the 5.8% year-over-year revenue growth comes before investors have really seen any benefit from Abbot’s U.S. diabetes business, which recently saw the domestic launch of Libre.

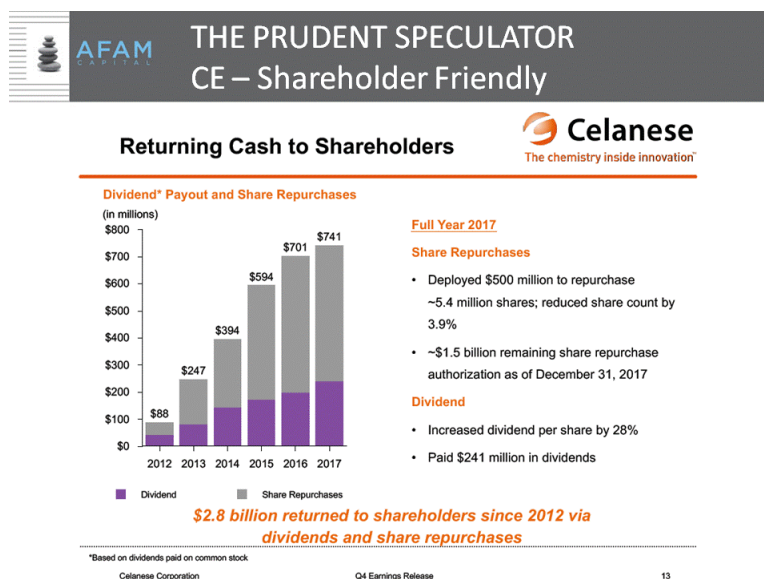
Additionally, Abbott issued full-year 2018 adjusted diluted EPS from continuing operations guidance of \$2.80 to \$2.90, reflecting 14% growth at the midpoint. Further, the company has stated its commitment to reduce its debt levels following the recent acquisitions of St. Jude Medical and Alere. For the full year 2017, Abbott generated operating cash flow in excess of \$5.0 billion and free cash flow in excess of \$4.0 billion. In January 2018, Abbott repaid \$4.0 billion of debt and anticipates additional debt repayments throughout 2018. The company also boosted its quarterly dividend last month to \$0.28 per share from \$0.265.



While financial flexibility has improved, it will continue to be somewhat challenged over the next few years as Abbott folds in Alere and St. Jude. That said, the combined firm and new product growth drivers should generate solid free cash flow which can be used to continue to improve the balance sheet, return capital to shareholders and improve the business. While we are keeping a close eye on ABT as shares have performed exceptionally well and valuation metrics have expanded, we note that investors are quite optimistic for the future, with analyst's seeing earnings topping \$4.00 per share by 2021, up from \$2.50 today. We have significantly increased our Target Price for ABT to \$68.

Shares of chemical and advanced material firm **Celanese** (CE - \$111.36) reached an all-time high intraday on Friday before pulling back and ending the week slightly lower. The initial share price bounce on Friday morning followed the company's Q4 and full-year 2017 earnings release. CE reported adjusted EPS of \$1.98, versus consensus analyst estimates of \$1.87. Revenue of \$1.59 billion for the period topped forecasts of \$1.49 billion. For the full-year, CE said its adjusted EPS was \$7.51.

Free cash flow for 2017 was \$825 million before taking into account a \$316 million voluntary contribution to fully fund qualified U.S. pension plans. \$741 million of cash was returned to shareholders, via the repurchase of 5.4 million shares for \$500 million and the distribution of \$241 million in dividends for the year. As of the end of 2017, \$1.5 billion remained under the current share repurchase authorization.



CEO Mark Rohr commented, “We set out in 2017 to further strengthen our business models in both AEM and the Acetyl Chain while addressing the headwinds in Consumer Specialties. In AEM, we made progress on integrating two high value-add acquisitions. Organic growth was further enhanced by extending the opportunity pipeline to the newly integrated polymers, creating current and future earnings uplift. In the Acetyl Chain, the business planned efficiently to address the scheduled turnaround in Clear Lake and also responded swiftly to address industry disruptions by leveraging its global supply chain. As a result, in 2017 we reported the

second highest operating profit of \$901 million and record adjusted EBIT of \$1.4 billion. In 2018, we expect the AEM pipeline model to evolve to a higher level of project volume and the Acetyl Chain to carry forward the momentum from its improved model. Tow earnings should be relatively flat. An early read on the recent tax reform indicates a 2% lower adjusted tax rate of 14% for Celanese in 2018. Taking all these drivers into consideration, current estimations for 2018 put growth of adjusted earnings per share in the 10%-14% range, with more of the growth in the first half of the year.”

Celanese shares are currently trading at 13.3 times NTM adjusted earnings projections and offer investors a 1.7% dividend yield. We continue to like the stock and believe it can move higher still via geographic expansion and new application development. CE enjoys a cost advantage in many of its markets and we see the Advanced Engineered Materials business having attractive long-term growth potential. We like CE’s free cash flow generation and see it remaining healthy, allowing the firm to continue to build a strong financial base as well as buy back shares and increase dividend payouts. We have hiked our Target Price to \$124.

Shares of **Halliburton** (HAL - \$55.61) climbed almost 5% last week, following a better-than-expected Q4 earnings report from the oilfield services giant that gave hope to investors that the industry may finally be on the mend after several difficult years. Halliburton earned \$0.53 per share for the quarter, more than 13% better than consensus analyst estimates. Revenue came in at \$5.9 billion, versus forecasts of \$5.6 billion.

“Outstanding execution resulted in an excellent fourth quarter and we are well positioned to take advantage of opportunities presented by a growing North America market and improving international outlook. I continue to believe we are on the path to normalized margins in North America in 2018,” remarked CEO Jeff Miller.

Mr. Miller continued, “2017 was a dynamic year for the oil and gas sector that marked another step on the road to recovery for our industry. I am pleased with the way our team executed on our value proposition, maintained strong service quality, and generated superior results and industry leading returns. Our Drilling and Evaluation division delivered an impressive performance over the second half of 2017, achieving nearly 50% incrementals in the fourth quarter. These results demonstrate the strength and diversity of our portfolio. Our Completion and Production division revenue grew 8% sequentially, outperforming the change in average United States land rig count. The North America completions market is tight, and demand for our completions equipment and our service quality remains strong.”

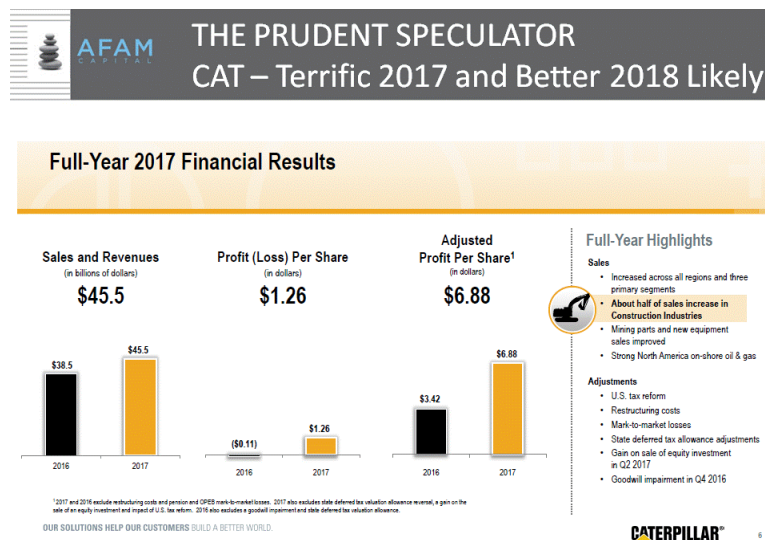
Looking ahead, Mr. Miller said, “I am optimistic about what I see in 2018. Commodity prices are supportive of increasing activity in North America and I am encouraged by the increase in tender activity and the positive discussions we are having with our international customers.”

We are pleased to see the progress that Halliburton has been able to achieve. Even though we have been experiencing a resurgence in the energy patch, and some argue that upside is limited, we still think that long-term exposure to the energy industry will prove quite profitable, especially as the global population continues to expand and many of the fastest growing economies and regions are currently the smallest users of energy per capita because of cost

and supply limitations. HAL has remained focused on reactivating rigs, expanding outside the U.S. land market and keeping up with customers as they invest to meet increased production targets. With a longer-term focus, we note that consensus analyst estimates for 2020 and 2021 currently reside at \$4.07 and \$4.99, respectively (with 2018 at \$2.54). Our Target Price for HAL has been elevated to \$64.

Construction machinery and heavy equipment manufacturer **Caterpillar** (CAT – \$167.06) posted adjusted earnings per share of \$2.16, beating consensus Q4 estimates by more than 22%. CAT had sales of \$12.9 billion (vs. \$12.0 billion est.). Despite a solid quarter, and continued operational and share price momentum, CAT shares closed down almost 2% last week, no doubt succumbing to a little profit-taking after a 73% total return over the preceding 12 months.

“After four challenging years, many key markets improved in 2017, and our global team delivered strong results. We remained focused on operational excellence and made early investments in profitable growth initiatives as we began to implement our new strategy,” said CEO Jim Umpleby. “We are in the early stages of implementing our strategy for profitable growth. In 2018, we expect to make additional investments in the expanded offerings and services important for Caterpillar's long-term success. We will use our Operating & Execution Model to bias resources to areas that represent the greatest opportunity for return on our investments...Our focus on operational excellence will not waver as we work to develop a more competitive and flexible cost structure, including implementing lean manufacturing principles. We are positioned to capitalize on continued sales momentum or quickly adjust should conditions change.”



The company also announced that the beginning of 2018 has shown strong sales momentum, resulting from favorable order rates, lean dealer inventories and an increasing backlog. Additionally, there are positive economic indicators across most of the world and in many of the company's end markets. Caterpillar is preparing its factories and suppliers to be ready for

continued growth, while remaining focused on managing with a flexible and competitive cost structure. The company now expects 2018 adjusted profit per share to be in a range of \$8.25 to \$9.25, with the outlook assuming a tax rate of 24%.

We continue to be pleased that our patience with CAT has paid off, with the stock up more than 185% since January 2016. Along with potential positives from the recent tax cuts, CAT would seemingly benefit if any type of infrastructure spending bill made it through Washington. That said, while we remain long-term fans of the company, we are keeping close watch on the shares and their increasing valuation as they have definitely attracted plenty of investor interest, illustrating that formerly out-of-favor stocks don't always remain in the Wall Street dog house. Our Target Price for CAT has been lifted to \$180.

Shares of **Whirlpool** (WHR – \$185.97) jumped more than 11% last week due in part to the posting of better-than-expected Q4 adjusted EPS of \$4.10 that beat consensus analyst estimates of \$3.99, even as the home appliance maker's revenue of \$5.7 billion trailed forecasts by a bit more than 2%. The company also announced that it expects 2018 full-year adjusted EPS to come in between \$14.50 to \$15.50, while WHR expects to generate free cash flow of approximately \$1.0 billion to \$1.1 billion.

"Our unique global strategic position, coupled with favorable macro-economic conditions, gives us strong confidence towards our long-term value creation goals," said CEO Marc Bitzer. "The solid fourth-quarter exit run rates, and faster than anticipated progress on price/mix and fixed cost reduction, are very encouraging in that respect." CFO Jim Peters added, "We are confident that our cost reduction initiatives and global price/mix will be a catalyst for significant margin improvements in the coming year. As a result, we expect to achieve our cash conversion goal and continue returning strong levels of cash to shareholders."

Of course, the larger reason for the big share price gains last week was the expectation that U.S. sales may strongly benefit from the recent decision of the Trump Administration to uphold long-standing trade rules by establishing a tariff of up to the legal maximum of 50% on imports of large residential washing machines. The administration announced this remedy to address decade long accusations that Samsung and LG have been "dumping" washers and circumventing U.S. law.

The trade news adds to our affection for Whirlpool as we still believe that the company is solidly positioned in the U.S. to capitalize on the appliance replacement cycle and continued housing recovery, while there is plenty of growth potential overseas. With analysts still looking for adjusted EPS to grow to more than \$19.50 in 2020, we think the current P/E ratio (based on trailing-12-month earnings per share of \$13.78) below 12 is cheap, especially given the 2.4% dividend yield. Our Target Price for WHR has been raised to \$232.

Cable and content firm **Comcast** (CMCSA - \$42.80) earned \$0.49 per share in fiscal Q4 2017 (vs. \$0.47 est.). CMCSA had total revenue of \$21.9 billion, versus the \$21.8 billion estimate. The company reported a video net subscriber loss of 33,000 (compared to an estimated loss of 48,000) and high speed internet subscriber net additions of 350,000 (vs. 309,000 est.). Comcast

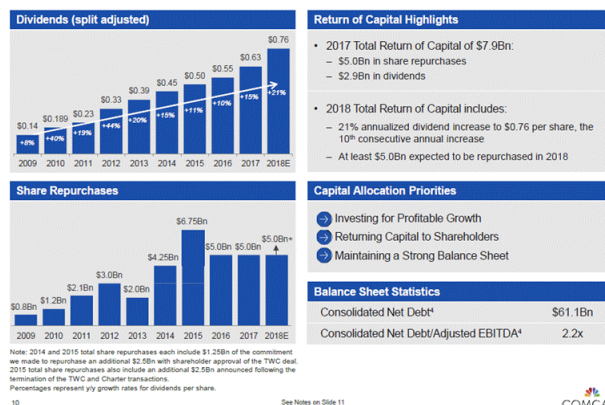


increased its quarterly dividend by 25% to \$0.19 per share and expects 2018 share buybacks to meet or exceed the \$5.0 billion level. Shares rose 1.3% following the announcement.

CEO Brian Roberts said, "In our TV businesses, with the Super Bowl and Winter Olympics as well as the World Cup on Telemundo later this year, we should further build on our ratings leadership from 2017. More broadly, our strategy will continue to center on having must-see content that drives multiple monetization streams from advertising, to content licensing, to distribution on both traditional and emerging TV platforms. In 2018, we will continue to differentiate our product by providing gigabit speeds at scale, offering one of the most powerful gateways for the home, and augmenting WiFi coverage and control with xFi and the rollout of our fabulous little pods. With connectivity increasingly at the epicenter of our relationship with customers, we have the opportunity to provide whole-home solutions that integrate and help manage all of the devices our customers rely on. In business services, we're still in the early stages of bringing our superior products to the large addressable markets in midsized and enterprise customers. And lastly in 2018, we will look to build on and accelerate our early success with Xfinity Mobile. So, our plan is to continue to invest in product innovation, while we strive to make interacting with us simpler and more consistent, and increasingly, all digital."



#### Significant Free Cash Flow Generation and Return of Capital



Shares have jumped from \$36 in November to above \$42 presently, helped by tax cuts (CMCSA has historically been a high payer) and optimism that 2018 will see strong demand for CMCSA's offerings in an increasingly robust economy. We continue to like the company's overall trajectory, which in our view is propelled by its diverse media portfolio (including NBC, Telemundo, E!, NBC Sports Network) and geographically diverse theme parks (Universal Parks & Resorts including Universal Studios Hollywood). Our Target Price has been moved higher to \$54. After the dividend hike, shares yield 1.8%.

A rising tide may not lift all boats, but the proverbial boat of cruise line operator **Royal Caribbean Cruises Ltd** (RCL - \$134.98) has been rising on an almost uninterrupted trajectory since 2009. Shares rose an additional 4.2% after the company reported that it earned \$1.34 per

share in fiscal Q4 2017 (vs. \$1.21 est.). RCL had sales of \$2.0 billion, matching the estimate. Although we are less than a month into the year, RCL shares have risen 13.2%, outpacing all of the broad market indexes.

Having completed its Double-Double program, CEO Richard D. Fain added color on the firm's 20/20 Vision program, "We believe that our Double-Double efforts have not only helped us reach these specific targets, but created a cultural vision that position us to jump ahead with our 20/20 Vision. Speaking of which, our indicators denote that we are heading into another record year. We're currently booked ahead of last year in both load factor and rate. A year ago, I said, and I'm quoting, my sense is that the booking window has stretched as far as we will ever want. And I don't expect to announce another record level of bookings a year from today. Well, I wasn't terribly accurate. Here we are a year later and we are announcing another record level of bookings. Notwithstanding my prediction, our revenue managers concluded that the market is so strong that we can eke out yet another increase, and then having this much booked would help us raise our prices as the year progresses."

Management noted that the full year adjusted EPS is expected to be in the range of \$8.55 to \$8.75 per share. "Net revenue yields are expected to be up in the range of 3% to 3.5% for the first quarter. First quarter yields benefit from additional dry dock days, the earlier timing of the Easter and the year-over-year benefit from hardware changes. Net cruise costs excluding fuel are expected to be up approximately 10% for the quarter," said CFO Jason T. Liberty. "Similar to last year, the cadence of expenses for 2018 are not linear with the first quarter weighing heavily on the overall increase in the cost metric. The increase in the quarter is mainly driven by the timing and scope of dry docks related to our ship upgrades, together with the lapping of the benefits from hardware changes. Taking all of this into account, we expect adjusted earnings per share to be approximately \$0.95 per share for Q1 2018."

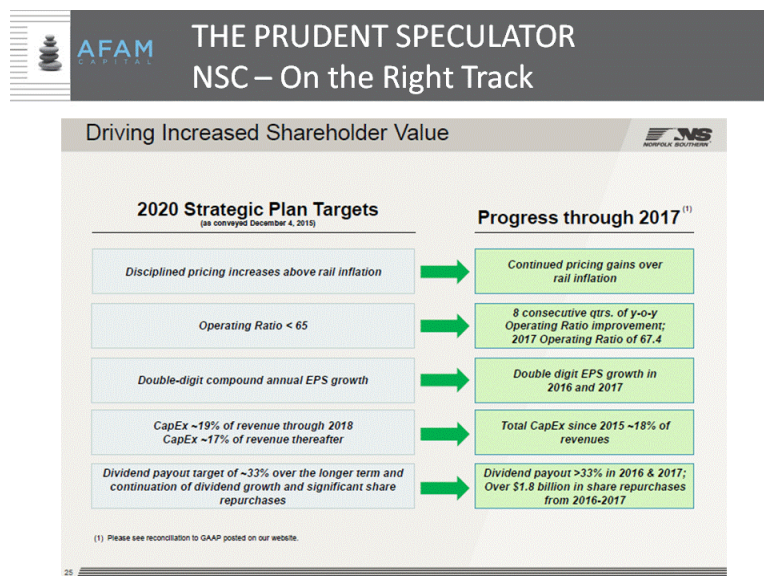
Management denied that there was a direct benefit for bookings related to the U.S. tax policy changes. As far as RCL's effective corporate rate, we expect it to remain at zero for the foreseeable future. We remain fans of RCL and the overall prospects of the cruise industry, especially given favorable demographic and cruise-pricing trends. Shares trade for a reasonable 15.4 times projected next-12-month earnings with a dividend yield of 1.8%. We have again sailed our Target Price ahead on RCL, this time to \$145, though we do note that our very low cost basis (the stock was initially recommended at \$28.49 in February 2012) might soon compel taking a little Royal Caribbean money off of the table.

East coast railroad transportation company **Norfolk Southern** (NSC - \$150.97) earned \$1.69 per share in fiscal Q4 2017 (vs. \$1.57 est.). NSC had sales of \$2.7 billion, versus the \$2.6 billion estimate. Shares slid 1.1% following the announcement, due to soft guidance for the upcoming year. NSC expects annual volume and RPU increases of 2% per year between 2018 and 2020, with coal volume falling 4% per annum and intermodal gaining 4% per annum over the time horizon. The company expects its tax rate to fall to 24%, down from an average of 35.5% over the past four quarters.

CEO Jim Squires said, "We were able to lower our fourth quarter operating ratio by 170 basis points to 67.7%. For the full year, net income increased 15% to 1.9 billion, and earnings per

share increased to 18% to \$6.61. We achieved a record 67.4% operating ratio, which was 150 basis point improvement over 2016. Demonstrating our focus on productivity, cost control and growth as we move forward under our strategic plan. Each of these achievements is a testament to the hard work and dedication of our employees, whose determination has powered our successes of the past several years, and who I'm confident will make Norfolk Southern even stronger in 2018."

Mr. Squires continued, "This year's budget supports growth and the continuation of investment in our core assets. We are investing in the expansion of various terminals and infrastructure to ease capacity constraints and we're acquiring freight cars in support of our volume growth. Similar to prior years, the roadway category represents our programs to replace track, bridges and communication systems. In 2018, locomotive capital will be focused on the rebuild and conversion of locomotives from DC to AC power. To improve customer service and further enhance the productivity of our employees and the reliability of our assets, we have also increased our technology spend."



While Norfolk Southern has had to continue to deal with strong headwinds in coal shipping, the railroad operator has benefitted from increased intermodal volumes over the past 10 years (as intermodal revenue surpassed coal revenue a few years ago). We think this trend will continue and we believe that NSC will benefit in 2018 from recent capacity and speed improvements, changes the company is making to meet its goal of getting its operating ratio below 65% by 2020, and greater carloads from stronger industrial production activity and tightening truck capacity. While shares are currently trading a bit above 17 times NTM adjusted earnings projections of \$8.55 for 2018, forecasts for 2019 and 2020 adjusted EPS are currently pegged at \$9.44 and \$9.85, respectively. We have boosted our Target Price to \$168.

Electronic components designer and manufacturer **AVX Corp** (AVX - \$17.90) earned \$0.22 per share in fiscal Q3 2018 (vs. \$0.18 est.). AVX had revenue of \$432.0 million, versus the \$422.0 million estimate. The company reported healthy product demand in "most markets" and said it

took a \$129.8 million one-time charge last quarter related to un-repatriated income that was held overseas (noting that the loss was excluded from the aforementioned EPS gain of \$0.22 for Q3; the tax would have reduced earnings by \$0.77). Shares stumbled 7.5% following the announcement.

CEO John Sarvis explained, “The PC market did not return to growth in 2017, declining in the low single-digit area. There is some optimism for 2018 but we see this largely as a flat market for this year. Our participation in this market is in the applications' specific components for high-end products. In contrast, the server market is expecting to continue its growth of about 7% and 8%, driven by the increasing amount of data to be processed with the coming of 5G, IoT and artificial intelligence technologies. The solid state disk market is also enjoying continued strong demand due to the same factors but tampered this past year due to component shortages, particularly memory.”

AVX also announced its intention to acquire Ethertronics, an antenna technology company. Management expects that the purchase will allow AVX to “become a leader in the wireless connectivity space.” We believe that AVX will benefit as smartphone demand (expected to reach 1.8 billion shipments in 2018 according to Statista) keeps growing, especially as Chinese and Korean telecom manufacturers roll out next-generation 4G and 5G networks. With AVX’s strong balance sheet and incoming mountain of cash, the company said it expects no changes in uses for cash related to buybacks and acquisitions, though having cash in the U.S. makes it “a lot easier and more convenient” to deal with. AVX shares yield 2.6%. Our Target Price has been cut to \$20.

Semiconductor giant **Intel** (INTC - \$50.08) posted earnings per share of \$1.08, versus the \$0.86 estimate in fiscal Q4 2017. INTC had sales of \$17.1 billion (vs. \$16.3 billion est.). Guidance for 2018 exceeded expectations, with Intel reporting that it expects revenue between \$64 billion and \$66 billion (consensus estimate was \$63.9 billion) and adjusted EPS between \$3.37 and \$3.72 per share (\$3.29 est.). INTC also raised its quarterly dividend from \$0.2725 to \$0.30 per share. Shares rose 10.6% following the announcement.





On the topic of the recent hardware flaws, CEO Brian Krzanich said, “We’re working to incorporate silicon-based changes to future products that will directly address the Spectre and Meltdown threats in hardware, and those products will begin appearing later this year. However, these circumstances are highly dynamic and we updated our risk factors to reflect both the evolving nature of these specific threats and mitigations, as well as the security challenge more broadly. Security has always been a priority for us, and these events reinforce our continuous mission to develop the world’s most secure products. This will be an ongoing journey, but we are committed to the task, and I’m confident we’re up to the challenge. To keep you informed, we’ve created a dedicated website and we’re approaching this work with customer-first urgency. I’ve assigned some of the very best minds of Intel to work through this, and we’re making progress.”

Looking ahead, Mr. Krzanich commented, “In 2018, our highest priorities will be executing to our strategy and meeting the commitments we make to our owners and our customers. This includes our commitment to restoring customer confidence in the security of their data. This year, Intel will celebrate a half-century of innovation that has profoundly changed the world. Over the last 50 years, we invented the architecture and manufacturing technologies that have made personal computing, the Internet, and the cloud not only possible, but pervasive. The journey hasn’t been without challenges; nothing worth doing ever is. Our culture has been forged through taking challenges head-on and developing solutions our customers can count on. That includes working directly to address the Spectre and Meltdown security threats. We leave 2017 on a financial high note, but I’m even more excited about what’s to come, about our strategy producing great products for our customers and great returns for our owners. I see Intel innovation changing the world for another 50 years, and that journey starts with 2018. Over the coming year, we’ll bring amazing innovation and performance to the PC market, advance the state of art in the artificial intelligence, lead the way towards mass 5G deployment, launch the industry’s first new memory architecture in two decades, and take another step toward a safer world in which autonomous driving is a reality.”

Wall Street has seemingly moved past the 'big' plunge related to the chip architecture flaws from earlier this month, with shares having added another 8.4% YTD on the heels of a 31% (including dividends) return in 2017. We continue to be fans of Intel and like the company's diversified revenue stream, low levels of debt, forward P/E ratio of 14.2 and 2.4% dividend yield. Our Target Price for INTC has jumped to \$56.

West coast airline **Alaska Air Group** (ALK - \$64.54) reported earnings per share of \$0.83, versus the \$0.82 estimate in fiscal Q4 2017. ALK had revenue of \$2.0 billion, matching the analyst consensus estimate.

CEO Brad Tilden discussed the Virgin America integration, "We have this with our operational processes and capability, with the fantastic service our people provide to our guests, with the very clear cost advantage that's matched with the history of offering low fares, with our growing route network, and, most importantly, with the way we work with our employees to bring all of this together. The merger closed on December 14, 2016, or just 13 months ago. Today, as we expected, we have substantially all of the cost of the combined company in our results with very little of the revenue. Of the 300 million original synergy target, we expect to realize \$65 million in 2018, consistent with our prior forecast. We continue to believe the revenue potential of the new Alaska network is substantial and we expect synergies to reach \$200 million in 2019. More important than the synergies, however, is the incredible platform that we'll have to grow revenue and profit in the years ahead and create value for our owners, our customers and our employees, just as we have in the last couple of decades. On April 25th, we'll transition to a common PSS system, which will give us a single shopping, buying, flight scheduling and airport check-in system, as well as a single branded digital and airport experience. At that point, which will be just 16 months after closing, will be through 75% of the merger work and we'll begin realizing the full potential of the merger, as Andrew will further describe in just a moment."

Mr. Tilden said of capacity, "As we look at our business in 2018, we have work in front of us. There is substantial competitive capacity in our markets and we expect that this level of capacity will continue to put pressure on unit revenue, but there are a number of levers that we can and will hold this year. We plan to attack the revenue pressure by reconfiguring our Airbus fleet for greater revenue, by undertaking significant cross-leading in high volume markets, by driving continued loyalty growth, and, most importantly, by tapping into segmentation and upsell opportunities post PSS. While we're focused on expanding our network in 2017, our growth will stabilize in 2018 and we're expected to slow to about 4% in 2019 and 2020, as we take advantage of the substantial growth of the last few years and optimize and refine our networks. Of the growth plan for 2018, approximately 70% is flying today and Paine Field represents the bulk of the rest."

Although ALK beat EPS estimates in Q4, shares tumbled 6.3% last week after Alaska and a few of its rival air carriers reported that they were making substantial increases to capacity over the coming few years. As a result, shares of most U.S.-traded airlines whipsawed as investors tried to make sense of the news, although ALK ended up cutting its losses on Friday. For his part, Southwest Airlines CEO Gary Kelly said that the capacity concerns were "overblown" by Wall

Street. And American Airlines CEO Doug Parker said, “When people hear growth, they think ‘Here we go again.’ Sometimes, you can get overreactions to a [capacity] number.”

We think that capacity ultimately drives valuations for the airlines (perhaps more so than P/E or P/S ratios), and capacity growth in excess of demand (even if demand is high) weakens the ability of airlines to price fares with healthy margins. With long lead times for airplane orders and long leases once they arrive, overshooting capacity can be an expensive mistake. However, we think that airlines deserve to let out a little bit of slack, having operated with tightly controlled costs, especially as economic growth around the world seems to be picking up. With load factors at or near records and ‘new’ ancillary fee revenue possibilities (new in the sense that airlines have generally operated without tons of add-on fees since Kitty Hawk), we are fans of ALK, especially after the sell-off.

Moreover, we think that Alaska will remain the premier airline in the Pacific Northwest, offering travelers low fares and a top-level customer experience, while we note that Virgin was named “Best U.S. Airline” by Condé Nast Traveler in their 2017 Reader’s Choice Awards for the 10th year in a row. We would not be surprised to see Alaska take the top spot next year. ALK trades for 10.8 times NTM earnings and yields 2.0%. Our Target Price now stands at \$104.

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