

MARKET COMMENTARY MONDAY, FEBRUARY 12, 2018

EXECUTIVE SUMMARY

Week #6 – A Good End to an Awful Week

Valuable Perspective – 10% Corrections are Normal; Dismal Trading Weeks are not Unusual

Sentiment – Pessimism Spikes and Stock Fund Investors Bail

Down Under 25 – *Forbes Cruise* Bargains

Stock News – Updates on WFC, QCOM, GM, TPR, ADM, GILD, SNY, BHE, TSN, CAH, GT & DIS

Market Review

Whew! That was quite a week, capped by another roller-coaster ride in Friday's trading, that included somewhat rough seas as the *Forbes Cruise* crossed the Great Australian Bight. Happily, given the time difference, your Editor had the good fortune of being asleep Saturday morning when the 2:39 AM CNBC headline, "Dow falls 500 points as it heads for the worst week in 9 years," hit my iPhone over the spotty Crystal Symphony Internet reception.

Indeed, it was far better to wake up to a "Dow bounces more than 300 points" headline, even as the balance of that missive, "Still ends the week down 5%," was hardly reason for celebration. Obviously, it was a brutal week, with the S&P 500 dropping 5.10% to be precise, and the Russell 3000 index losing 5.04%. Growth performed a little better than Value, with the Russell 3000 Growth index sinking 4.85%, compared to a 5.25% decline for the Russell 3000 Value index.

And the ugly first full week of February followed a sizable plunge the week prior, when the S&P 500 skidded 3.82%, with those twin declines wiping out and then some the gains enjoyed over the first four weeks of the year and pushing the S&P 500 to a year-to-date loss of 1.84%. Interestingly enough, that equity market return actually is better than the year-to-date 2.13% setback in the Aggregate Bond Index, illustrating that fixed income can also be a risky asset class, if risk is viewed as loss of capital. Of course, there are no quadruple-point-on-the-Dow down days in bond land.

THE PRUDENT SPECULATOR Historical Evidence – Short Term

Returns Race					
2018 YTD Return %	2017 Return %	2016 Return %	Since 10-Yr Yield Low (7.8.16) %	Bloomberg Symbol	Index
Stock Indexes					
-1.90	28.11	16.50	38.56	INDU Index	Dow Jones Industrial Average
-0.32	29.73	8.97	41.31	CCMP Index	NASDAQ Composite Index
-2.00	21.68	12.04	26.79	RIT Index	Russell 1000 Index
-3.67	14.63	21.28	28.16	RTY Index	Russell 2000 Index
-2.12	21.12	12.72	26.89	RAV Index	Russell 3000 Index
-1.84	21.82	11.95	26.96	SPX Index	S&P 500 Index
-0.50	30.21	7.07	33.91	RLG Index	Russell 1000 Growth Index
-3.52	13.64	17.33	19.87	RLV Index	Russell 1000 Value Index
-2.79	22.14	11.28	30.66	RUO Index	Russell 2000 Growth Index
-4.63	7.82	31.72	25.58	RUJ Index	Russell 2000 Value Index
-0.58	29.58	7.38	33.66	RAG Index	Russell 3000 Growth Index
-3.60	13.17	18.38	20.30	RAV Index	Russell 3000 Value Index
-0.24	27.43	6.89	31.06	SGX Index	S&P 500 Growth Index
-3.51	15.35	17.39	21.75	SVX Index	S&P 500 Value Index
Largest Bond Funds					
-1.94	3.57	0.79	-2.11	VBTIX Equity	Vanguard Tot Bd Mkt Idx-Inst
-2.05	3.53	0.75	-2.28	VTBIX Equity	Vanguard Tot Bd Mkt II-Inv
-0.71	8.17	0.82	11.41	PONAX Equity	Pimco Income Fund-A
-0.60	2.39	0.81	-0.28	VTADIX Equity	Vanguard Total Intl Bnd-Adm
-1.75	3.10	0.76	-1.45	MWTRX Equity	Mtprltn Wst Ttl Rtn Bnd-M
-1.60	5.13	0.73	0.98	PTTRX Equity	Pimco Total Return Fund-Inst
-0.84	7.36	0.63	10.62	PIMINIA Equity	Pimco GIS-Income Fund-Ins Ac
-0.40	2.02	-0.01	1.06	VPSTX Equity	Vanguard S/T Invest Grid-Inv
-1.17	4.53	0.21	-0.58	VNTRX Equity	Vanguard Intm Trm TFE-Inv
-1.16	4.36	0.63	2.86	DODIX Equity	Dodge & Cox Income
-1.21	3.79	0.51	1.21	DBLTX Equity	Doubleline Ttl Rtn Bnd-I
-0.36	1.89	0.07	1.93	LDLAX Equity	Lord Abbett Shrt Dur Inc-C

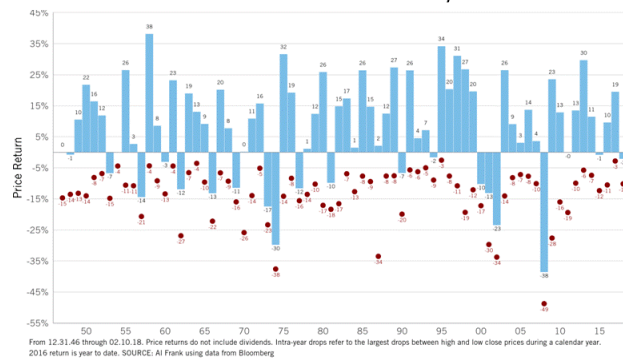
Source: Bloomberg. As of 2.9.18. 10-Year Treasury Yield Low (1.38%) was July 8, 2016.

While Value strategies won the performance spoils by a wide margin in 2016, it was an entirely different story in 2017, as high-flying Growth stocks like Amazon.com, Facebook, Alphabet and Tesla captured the fancy of investors. Of course, most everything, bonds included, is in the red at present in 2018.

Obviously, we understand that the recent volatility is disconcerting and we chose to publish two Special Market Commentaries last week to offer perspective, but we trust that most of our readers took the ups and downs in stride – none of the Forbes Cruisers jumped overboard, though there was certainly plenty of consternation. After all, as we've constantly admonished, 10% corrections are not unusual.

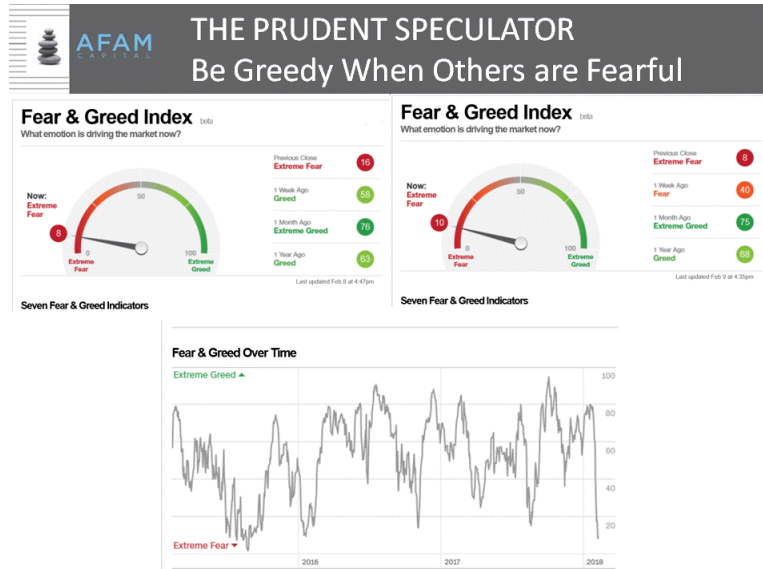
THE PRUDENT SPECULATOR A Big Selloff Happens Almost Every Year

While the S&P 500 has enjoyed excellent long-term returns and endured a far more winning than losing years over the past seven+ decades, there were corrections of equal or greater magnitude to what has taken place thus far in 2018 in more than 50 of the 72 years.

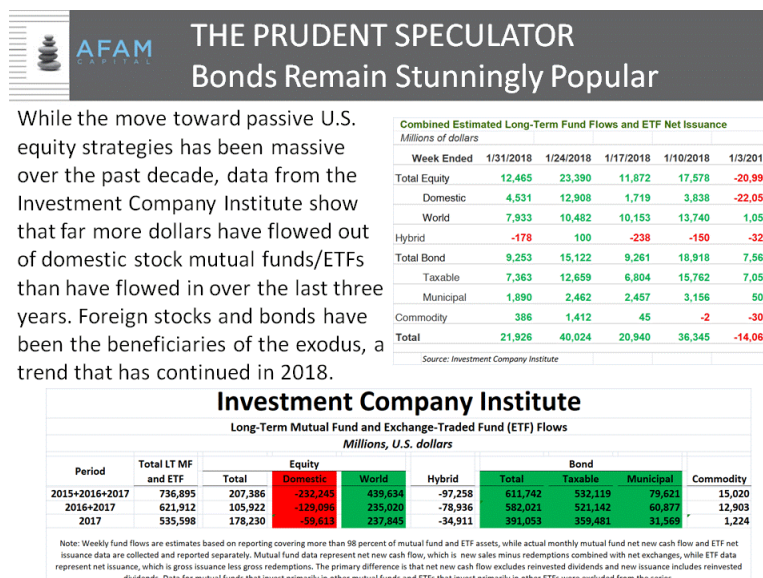


While not part of my hopefully reassuring pair of on-board presentations, we have also crunched numbers on weekly results for the S&P 500 dating back to 1928. Believe it or not, there have been 4700 weeks over the past nearly 90 years, with 112 of those periods coming in worse than what was endured last week and 230 lagging the return of the week prior. Those numbers work out to 2.38% of all weeks seeing bigger losses on a percentage basis than last week's and 4.89% of all weeks suffering greater red ink than the week prior.

This does not mean to suggest that the correction is somehow ho-hum, but it is fascinating (and somewhat reassuring from a contrarian standpoint) to see how quickly investors have shifted from optimism to pessimism, with the *CNNMoney Fear & Greed Index* arguably emitting a major market buy signal,...



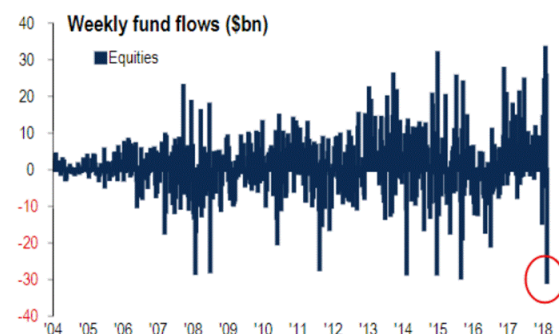
...which was supported by activity in the exchange traded fund and mutual fund world. Incredibly, after finally deciding it was safe to buy U.S. equities in January, with sizable inflows into U.S. stock funds, following several years of net outflows,...



...fund players bailed on domestic stocks last week, providing yet another example of why so few investors manage to match, much less beat, the market.

THE PRUDENT SPECULATOR Buying High and Selling Low

Chart 2: Record outflows (\$30.6bn) from equity funds



Source: BofAML Global Investment Strategy, EPFR Global

After record inflows into global equity funds in January, most of which went into foreign stocks, the February swoon sent equity investors of all kinds heading for the exits.

We remain braced for additional downside as the new trading week begins, though we note that the yield on the 10-Year U.S. Treasury ended last week at 2.85%, only a smidge higher than the 2.84% a week earlier. Certainly, interest rates can and likely will move even higher, but the 9% plunge in stock prices the past two weeks has lowered the chances of the Federal Reserve hiking the Fed Funds rate at least three times in 2018.

Of course, we continue to see no reason to alter our enthusiasm for the long-term prospects of our broadly diversified portfolios, especially given our relatively inexpensive valuation metrics...

THE PRUDENT SPECULATOR Equity Strategies & Benchmark 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	16.3	13.3	1.2	2.0	2.6
Select Value	17.6	13.9	1.3	2.1	2.3
Select Dividend	16.8	13.8	1.2	2.4	2.9
Select Focused Dividend	15.1	12.8	1.0	2.3	3.2
Select Focused Value	15.8	13.7	1.3	2.4	2.5
Select SMID Dividend	18.9	14.0	0.8	1.9	2.4
Russell 3000	23.4	17.9	2.0	3.1	1.8
Russell 3000 Growth	27.9	21.0	2.8	6.4	1.2
Russell 3000 Value	20.0	15.5	1.6	2.0	2.4
Russell 2000	55.7	24.5	1.2	2.3	1.4
Russell 2000 Growth	107.0	32.3	1.7	4.4	0.7
Russell 2000 Value	36.4	19.2	1.0	1.5	2.1
Russell 1000	22.4	17.5	2.1	3.2	1.8
Russell 1000 Growth	26.3	20.5	2.9	6.7	1.3
Russell 1000 Value	19.4	15.2	1.7	2.1	2.4
S&P 500 Index	21.8	17.3	2.2	3.3	1.9
S&P 500 Growth Index	25.2	19.9	3.6	5.8	1.3
S&P 500 Value Index	19.0	15.1	1.6	2.2	2.5
S&P 500 Pure Value Index	15.4	12.0	0.7	1.4	3.3

As of 02.08.18. 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

...and the strength we have been seeing in Q4 corporate profit reports.

THE PRUDENT SPECULATOR Excellent Q4 Earnings Reports

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EPS SURPRISES@:

POSITIVE SURPRISES:	259/337 = 76.9%	Median: 5.9%	
% of Surprises:		EPS Differences	(Actual-Estimate):
(0% to 10%):	172	(1 cent):	26
(10% to 20%):	47	(2 cents):	19
(20% to 30%):	19	(3 to 4 cents):	46
(30% to 40%):	10	(5 to 9 cents):	72
(40% to 50%):	2	(10 to 19 cents):	51
(more than 50%):	9	(20 to 49 cents):	32
% chg NM	0	(50 cents or more):	13

0% SURPRISES: 28/337 = 8.3%

NEGATIVE SURPRISES:	50/337 = 14.8%	Median: -3.9%	
% of Surprises:		EPS Differences	(Actual-Estimate):
(-10% to 0%):	34	(-1 cent):	15
(-20% to -10%):	8	(-2 cents):	2
(-30% to -20%):	2	(-3 to -4 cents):	6
(-40% to -30%):	2	(-5 to -9 cents):	5

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For those with the courage to do a little buying this week, we put together another special 25-stock undervalued dividend payer list for the *Forbes Cruise* audience,, with each stock yielding at least 1.6% and down at least 6% thus far in 2018.

THE PRUDENT SPECULATOR Down (in 2018) Under Dividend Bargains

Down Under 2018 Selloff Shopping List														
Symbol	Common Stock	2018 YTD TR %	2.9.18 Price	Target Price	Sector	P/E	P/S	P/TBV	EV/ EBITDA	FCF Yld	Debt/ TE (%)	Div Yld	Mkt Cap	
AAPL	Apple	-7.2	\$156.41	\$202.36	Technology Hardware	16.1	3.3	6.0	8.5	6.6	79%	1.6%	793,626	
ALK	Alaska Air Group	-12.0	\$64.72	\$104.10	Transportation	9.8	1.0	4.9	5.5	6.6	138%	2.0%	7,963	
ALL	Allstate	-13.2	\$90.89	\$110.35	Insurance	13.5	nmf	1.7	nmf	nmf	nmf	1.6%	32,266	
ANH	Anworth Mortgage	-13.2	\$4.72	\$6.44	Diversified Financials	8.9	nmf	0.8	nmf	nmf	nmf	12.7%	463	
CE	Celanese	-6.4	\$100.21	\$123.77	Materials	13.3	2.2	8.6	14.1	3.9	209%	1.8%	13,610	
CM	Cummins	-7.1	\$164.05	\$197.14	Capital Goods	15.4	1.3	5.2	9.7	6.5	31%	2.6%	27,183	
DAL	Delta Air Lines	-9.9	\$50.46	\$74.72	Transportation	10.2	0.9	nmf	5.1	3.5	nmf	2.4%	35,977	
DLR	Digital Realty Trust	-10.3	\$102.21	\$129.26	Real Estate	17.1	nmf	3.8	nmf	nmf	nmf	3.6%	21,244	
DOC	Physicians Realty	-13.3	\$15.39	\$23.81	Real Estate	14.7	nmf	1.1	nmf	nmf	nmf	6.0%	2,758	
DPSGY	Deutsche Post AG	-6.8	\$44.37	\$58.25	Transportation	15.6	0.7	nmf	9.5	4.0	nmf	2.5%	54,535	
DSW	DSW Inc	-8.8	\$19.53	\$29.85	Retailing	14.5	0.6	1.7	5.6	11.9	0%	4.1%	1,562	
GLW	Corning	-10.1	\$28.77	\$41.75	Technology Hardware	16.6	2.5	2.3	10.1	0.9	44%	2.2%	25,003	
GT	Goodyear Tire	-6.8	\$29.99	\$50.91	Automobiles & Components	9.6	0.5	1.9	6.1	4.1	131%	1.9%	7,208	
HF	HollyFrontier	-13.1	\$44.50	\$57.86	Energy	27.3	0.6	3.6	9.6	8.4	103%	3.0%	7,889	
JNJ	Johnson & Johnson	-7.3	\$129.53	\$153.26	Pharmaceuticals, Biotech	17.7	4.6	14.3	14.5	5.3	110%	2.6%	347,985	
JNPR	Juniper Networks	-10.7	\$25.44	\$37.13	Technology Hardware	12.1	1.9	6.5	8.0	11.5	147%	2.8%	9,538	
KIM	Kimco Realty	-21.9	\$14.18	\$24.39	Real Estate	9.2	nmf	1.4	nmf	nmf	nmf	7.9%	6,036	
KMB	Kimberly-Clark	-7.6	\$111.44	\$145.09	Household/Personal Products	17.9	2.1	nmf	11.5	5.4	nmf	3.6%	39,083	
MAN	ManpowerGroup	-8.3	\$115.60	\$145.25	Commercial/Pro Services	16.6	0.4	6.7	9.2	4.5	42%	1.6%	7,661	
MDC	MDC Holdings	-6.6	\$29.48	\$49.96	Consumer Durables	11.8	0.6	1.2	11.7	3.9	78%	4.1%	1,655	
PRU	Prudential Fin'l	-7.8	\$106.04	\$135.86	Insurance	10.0	nmf	0.9	nmf	nmf	nmf	2.8%	44,961	
SYF	Synchrony Fin'l	-8.9	\$35.03	\$50.97	Diversified Financials	13.4	nmf	2.2	nmf	nmf	nmf	1.7%	27,414	
T	AT&T	-6.0	\$36.05	\$49.36	Telecom Services	11.8	1.4	nmf	7.4	7.7	nmf	5.5%	221,311	
TRN	Trinity Industries	-14.5	\$31.90	\$42.39	Capital Goods	21.3	1.3	1.5	8.7	1.8	102%	1.6%	4,842	
XOM	Exxon Mobil	-8.5	\$75.78	\$100.21	Energy	21.4	1.4	1.8	12.0	4.8	14%	4.1%	321,088	

Stock Updates

Jason and Chris have been holding down the fort while I have been Down Under, and they offer updates on a dozen of our stocks in the news last week.

Once again, **Wells Fargo** (WFC – \$56.13) found itself in the doghouse this past week. Shares fell more than 9% as a direct result and 12.4% overall last week, after the Federal Reserve imposed sanctions on the company. The Federal Reserve said via press release, “Responding

to recent and widespread consumer abuses and other compliance breakdowns by Wells Fargo, the Federal Reserve Board on Friday announced that it would restrict the growth of the firm until it sufficiently improves its governance and controls. Concurrently with the Board's action, Wells Fargo will replace three current board members by April and a fourth board member by the end of the year. In addition to the growth restriction, the Board's consent cease and desist order with Wells Fargo requires the firm to improve its governance and risk management processes, including strengthening the effectiveness of oversight by its board of directors. Until the firm makes sufficient improvements, it will be restricted from growing any larger than its total asset size as of the end of 2017. The Board required each current director to sign the cease and desist order."

It continued, "We cannot tolerate pervasive and persistent misconduct at any bank and the consumers harmed by Wells Fargo expect that robust and comprehensive reforms will be put in place to make certain that the abuses do not occur again. The enforcement action we are taking today will ensure that Wells Fargo will not expand until it is able to do so safely and with the protections needed to manage all of its risks and protect its customers. In recent years, Wells Fargo pursued a business strategy that prioritized its overall growth without ensuring appropriate management of all key risks. The firm did not have an effective firm-wide risk management framework in place that covered all key risks. This prevented the proper escalation of serious compliance breakdowns to the board of directors. The Board's action will restrict Wells Fargo's growth until its governance and risk management sufficiently improves but will not require the firm to cease current activities, including accepting customer deposits or making consumer loans."

"Emphasizing the need for improved director oversight of the firm, the Board has sent letters to each current Wells Fargo board member confirming that the firm's board of directors, during the period of compliance breakdowns, did not meet supervisory expectations. Letters were also sent to former Chairman and Chief Executive Officer John Stumpf and past lead independent director Stephen Sanger stating that their performance in those roles, in particular, did not meet the Federal Reserve's expectations," the release concluded.

As a result of the sanctions, which are rarely used by the Federal Reserve, Standard & Poor's downgraded the company's Long-Term Foreign Issuer Credit and Long-Term Local Issuer Credit scores from A to A-. Moody's did not downgrade the bank, but opted to mark the Outlook as "Negative." Fitch's ratings were unchanged.

We were disappointed and surprised by the Federal Reserve's actions, though we think that the restrictions probably fit the crime, given that the bank's improper conduct was more widespread than initially thought. That said, WFC shares are trading at less than 12 times NTM earnings expectations and offer a dividend yield of 2.8%. While there are still plenty of improvements needed, we think there is solid opportunity as management drives expenses lower and cleans up its reputational mess. Our Target Price for WFC has been pared to \$68.

Broadcom made a "final" overture to **Qualcomm** (QCOM – \$63.99) last week, according to Broadcom CEO Hock Tan, who has been struggling to arrange a meeting with QCOM CEO Paul Jacobs, offering an \$8 billion breakup fee if the deal is halted by regulators and reminding

that the existing \$82 bid was already “best and final.” Certainly, it’s a strange collection of thoughts from Mr. Tan, only made stranger by his complaining via SEC filing:

Mr. Tan said in the filing/letter, “Broadcom has long sought a meeting to discuss Broadcom’s acquisition of Qualcomm. Following Qualcomm’s announcement today that it is willing to meet with us, we offered to meet with Qualcomm on Friday, Saturday or Sunday. I was astonished to hear that Qualcomm is not willing to meet until Tuesday – only after Qualcomm’s and Broadcom’s respective meetings with Glass Lewis and ISS. We hope that your willingness to meet with us reflects Qualcomm’s genuine intent to reach an agreement with respect to our February 5 proposal. After having met with most of your largest stockholders this past week, we have no doubt that this is their strong desire as well. We urge you to meet with us without further delay, and stand ready to meet this Saturday or Sunday in New York or another mutually convenient location. To make our meeting more productive, we are providing you with a proposed merger agreement that we are prepared to enter into. As you will see, the agreement is highly favorable to Qualcomm and its stockholders and includes an \$8 billion regulatory reverse termination fee and a 6% per annum regulatory ticking fee on the cash portion of the merger consideration (net of dividends). We want to reiterate that \$82 per Qualcomm share is our best and final offer.”

While some outlets reported that QCOM also ignored the letter in the SEC filing, the *Financial Times* reported on Friday afternoon that the companies had arranged a meeting for Tuesday, February 13. We think that the Broadcom deal is not ideal for Qualcomm shareholders if it results in abandonment of the pending NXP Semiconductors acquisition that QCOM has been having difficulty closing. However, Broadcom seems desperate to dance with QCOM. And for that reason, we hope that QCOM uses the leverage to work out a solid deal for its shareholders. We are staying tuned. Our Target Price for QCOM remains \$75.

General Motors (GM – \$41.46) reported another solid quarter with its Q4 2017 financial release. The giant auto maker posted adjusted EPS of \$1.65, versus consensus estimates of \$1.38. Revenue for the period was \$37.72 billion, versus projections of \$37.11 billion. The company recorded another earnings record in 2017, following records in 2016 and 2015, and sold 8.9 million autos globally. That said, GM recently announced that it expects 2018 to be largely in line with 2017 as auto sales have likely hit a plateau.

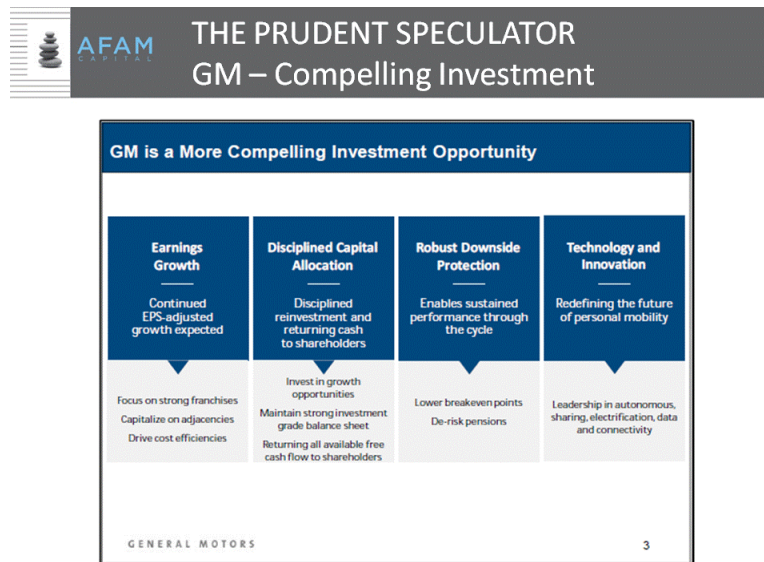
CEO Mary Barra said, “The actions we took to further strengthen our core business and advance our vision for personal mobility made 2017 a transformative year. We will continue executing our plan and reshaping our company to position it for long-term success.”

CFO Chuck Stevens added, “Improvements in all operating segments and an intense focus on cost reductions generated a record quarter and another record year. We plan to build on this momentum in 2018 and beyond as we focus on growth opportunities across many parts of our business.”

Toward those ends, GM continues to focus resources on its most profitable franchises, it sold its Opel/ Vauxhall and GM Financial European operations, and it exited South and East Africa, and India. The company reduced U.S. inventories to align supply with demand, while preparing for

its all-new full-size pickups, and completed the refresh of its crossover portfolio by launching the Chevrolet Traverse and Equinox, Buick Enclave and GMC Terrain. GM also laid out plans to introduce at least 20 new all-electric vehicles that will launch by 2023. The company also recently filed a Safety Petition asking the U.S. Department of Transportation to allow GM to safely deploy its fourth-gen self-driving Cruise AV on public roads. This vehicle eliminates the steering wheel, pedals and other unnecessary manual controls. GM expects to deploy self driving vehicles in a ride sharing environment in 2019.

GM returned \$6.7 billion to shareholders in 2017 through share buybacks of \$4.5 billion and dividends of \$2.2 billion. Since 2012, GM has returned more than \$25 billion, which represents more than 90 percent of available free cash flow generated over that time. Happily, GM's 2017 year-end global automotive pension underfunded position was \$14.1 billion, an improvement from \$18.2 billion at the end of 2016. The funded status of the company's \$68.5 billion 2017 year-end U.S. defined-benefit pension plan obligation improved to about 92%, up from approximately 90% in 2016, as plan assets grew to \$62.6 billion from \$61.6 billion.



While Tesla gets most of the investor love for electric vehicles, we think more people need to pay attention to GM. Its Volt continues to do well and it is planning multiple new offerings in the coming years. Needless to say, GM has far fewer production issues than Elon Musk's company. We continue to like the company's solid balance sheet (\$21 billion in cash and marketable securities), improving cost controls, healthy free cash flow and generous capital return initiatives. The stock now trades for 6.6 times NTM earnings projections and yields 3.7%. Our Target Price for GM shares is currently parked at \$58.

Despite the wild week of stock market volatility, shares of luxury retailer **Tapestry** (TPR – \$49.06), formerly known as Coach (COH), jumped 6.7% as the company posted adjusted earnings per share of \$1.07, versus an \$0.88 estimate in fiscal Q2 2018. Tapestry had sales of \$1.79 billion, slightly better than the consensus estimate.

CEO Victor Luis commented, “Our second quarter performance exceeded our expectations, driven by a return to growth for Coach, sales gains at Stuart Weitzman and the contribution of Kate Spade as we continued to make progress on the brand’s integration. Importantly, Coach comparable store sales rose globally, led by outperformance in North America, reflecting our strong holiday offering and improved inventory mix, all supported by festive marketing campaigns. In addition to the top line gains, we drove significant operating income growth on better-than-expected profitability metrics, notably gross margin, while expenses were well controlled and also benefitted from timing shifts.”

He went on to say, “We are also thrilled to announce several important business development initiatives, which will allow each of our brands to assume greater direct control over their international distribution. To that end, we have now taken operational control of the Kate Spade joint ventures, for Mainland China, Hong Kong, Macau and Taiwan. We also entered into a purchase agreement to acquire the Stuart Weitzman business in Northern China from our distributor. These transactions are in keeping with our strategic priority to maximize the opportunity with Chinese consumers globally across our brands. In addition, we are excited to announce the buyback of the Coach business in Australia and New Zealand from our distributor, with an expected closing in the third fiscal quarter. As a result, we will be creating a Tapestry hub and center of excellence in Sydney to drive growth across our portfolio, further unlocking the value of a multi-brand operating model.”

He continued, “Importantly, given our strong year-to-date financial performance, we expect that we will be able to fund these strategic actions while maintaining our operating income growth targets for the year. In addition, in January, we used excess cash to pay down \$1.1 billion in debt, increasing our financial flexibility and reducing our interest expense. Taken together with the anticipated benefits from a lower tax rate, we expect to drive strong double-digit adjusted earnings growth and exceed the annual earnings guidance we set out for Tapestry at the beginning of the fiscal year.”

Mr. Luis concluded, “As we look forward to the balance of our fiscal year, we are well positioned to drive continued positive comparable store sales for Coach. We’re very excited about the heightened level of innovation we will be delivering across categories and channels as well as the launch of our Spring marketing campaign featuring Selena Gomez. For Stuart Weitzman, Giovanni Morelli’s new creative direction is gaining traction. His first collection of footwear and handbags was very well-received by wholesale partners and the editorial community and we were excited to unveil a new Stuart Weitzman store concept at the brand’s Rodeo Drive flagship this past month. And for Kate Spade, our priority remains integration and executing the strategic initiatives to build the foundation for growth under the creative direction of Nicola Glass in FY19 and beyond.”

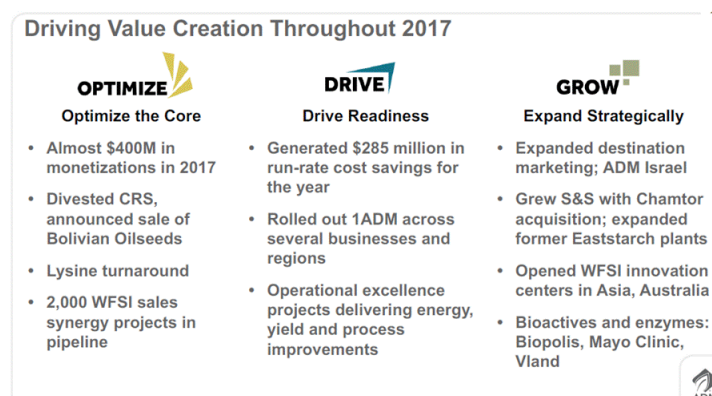
Lots to like about what has been happening at Tapestry and the future would appear very bright as the company continues to expect revenue for fiscal 2018 to increase about 30% versus fiscal 2017, to \$5.8 billion to \$5.9 billion, with low-single digit organic growth and the acquisition of Kate Spade adding over \$1.2 billion in revenue. Tapestry now projects earnings per diluted

share in the range of \$2.52 to \$2.60, an increase of about 17% to 21% for the year, including mid-to-high single digit accretion from the acquisition of Kate Spade.

We are pleased that Tapestry is realizing positive momentum in its Coach brand, and thus far the fold in of Kate Spade is going well. We also are glad that management increased financial flexibility by proactively paying down debt and believe this trend will continue as the effective tax rate drops to between 19.5% and 21% (which should amp free cash flow). TPR shares carry a dividend yield of 2.8%. Though the trailing-12-month P/E ratio for TPR is now \$20, our Target Price has been increased to \$58.

Archer-Daniels-Midland (ADM – \$41.49) posted Q4 EPS of \$0.82, versus consensus forecasts of \$0.70. The agricultural products firm had sales of \$16.1 billion, which lagged average estimates of \$16.7 billion. The strong fourth-quarter results were anchored by the agricultural services segment, which houses the trading desk, which increased operating profits 27% year-over-year on strong grain merchandising results.

CEO Juan Luciano explained, “We ended 2017 with a solid fourth quarter. We pulled the levers under our control—including cost and capital initiatives and interventions throughout the year—to deliver value for shareholders. I am also proud that our more than 31,000 colleagues delivered the best quarterly employee safety record in ADM’s history....For 2017 as a whole, we grew earnings per share, improved returns on invested capital and generated positive EVA. Looking ahead, we expect improving results through 2018 as our strategy advances. Our increasing international presence and expanding capabilities in areas such as destination marketing, food and beverage innovation, and health and wellness, all help to position ADM for continued growth and value creation.”



While rumors have been floating around that ADM might be moving to acquire competitor Bunge (BG), management was mum on its earnings call about the subject; however, they did proclaim that they desired expansion in South America (strangely enough Bunge’s home base).

Operational headwinds remain, but we are optimistic about the longer-term global secular growth trends in agriculture and we like that ADM's scale gives it advantages over regional competitors. We also note that the company continues to work to strengthen its balance sheet, reshape its portfolio and return cash to shareholders (\$1.5 billion in 2017 via buybacks and dividends). ADM currently yields 3.2% and trades for less than 15 times NTM adjusted EPS forecasts. Our Target Price is now pegged at \$52.

Biopharma firm **Gilead Sciences** (GILD – \$79.32) reported Q4 results last week that contained a better top- and bottom-line than expected. Adjusted EPS for the quarter came in at \$1.78, versus consensus estimates of \$1.67. Revenue for the period came in at \$5.95 billion, while investors were looking for \$5.71 billion.

The top-line beat was primarily driven by ex-U.S. Hepatitis-C (HCV) meds and U.S. HIV sales, despite a slight U.S. HCV miss. Harvoni and Epclusa sales in the U.S. of \$425 million and \$262 million both missed projections, which were largely attributed to lower patient starts, pricing erosion and share loss as a result of the launch of Abbvie's Mavyret. Ex-US HCV sales, however, remained strong. While 2018 HCV guidance of \$3.5 billion to \$4.0 billion was lower than projected, it's been widely anticipated by investors and management seems to believe that domestic HCV sales will stabilize beyond mid-2018. Additionally, we believe GILD's leadership in the HIV space will continue to strengthen despite the entry of generic competition.

GILD provided 2018 guidance of net product sales of \$20 billion to \$21 billion, lower than consensus estimates of \$21.7 billion. While the R&D and SG&A guidance, both of \$3.4 billion to \$3.6 billion, was in-line with investor expectations, effective tax-rate guidance was lowered to 21% to 23% due to tax reform.

With the addition of Kite Pharma and the focus on building up the company's pipeline of products, we wouldn't be surprised to see GILD use some of its \$36.7 billion of cash on hand to scout additional opportunities. We continue to believe that GILD offers attractive long-term upside. While domestic HCV still has stiff headwinds ahead, international HCV, HIV, the Kite acquisition, large cash reserves and a growing pipeline provide the company opportunities for growth. GILD trades for 12.3 times estimated NTM earnings and yields 2.9%. Our Target Price for GILD shares is \$125.

Global pharma giant **Sanofi** (SNY – \$38.98) saw its shares drop almost 10% last week as the equity markets retreated and the company reported results that trailed both top- and bottom-line expectations. Weakness in the quarter partly stemmed from biosimilar Lantus competition, causing Sanofi's top drug to fall 21% operationally. However, strength from most of the remaining business lines was able to largely offset the decline, helping stabilize total sales.



Sanofi CEO, Olivier Brandicourt commented, "In 2017, we continued to execute on our strategic goals with the strong launch of Dupixent, the positive pivotal data for cemiplimab and for dupilumab in asthma. At the same time, we managed the challenges in U.S. diabetes as well as the impact from sevelamer generics and Dengvaxia. Recently, we announced a series of strategic steps – we are obtaining the global rights to fitusiran and plan to acquire Bioverativ and Ablynx – which will establish Sanofi as a new global leader in rare blood disorders. Additionally,

these actions will further strengthen our pipeline and provide us with the powerful new Nanobody technology platform. Overall, after a period of significant reshaping since 2015, we are positioned to drive growth in 2018.”

Sanofi expects 2018 EPS to grow between 2% and 5%, including the anticipated contribution from the recently announced acquisitions, barring unforeseen major adverse events. Applying the average December 2017 exchange rates, the currency impact on 2018 business EPS is estimated to be -3% to -4%.



Strategically and Financially Compelling M&A to Enhance Sanofi's Growth Profile and Create Value

	Value	Value Creation ⁽¹⁾	Build Leadership Position	Strengthen Pipeline	Immediate EPS Accretion ⁽²⁾
 Transforming the lives of people with hemophilia, cold agglutinin disease and other rare blood disorders	\$11.6 bn	✓	✓	✓	✓
 Nanobody® technology to develop therapeutics in areas of high unmet medical need	€3.9 bn	✓	✓	✓	~

SANOFI (1) ROIC-WACC in 3 to 5 years (2) Business EPS is a non-GAAP financial measure (see appendix to Sanofi quarterly financial release definitions)

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While it seems likely that the diabetes franchise will continue to face operational hurdles, we believe that many investors under-appreciate Sanofi's non-diabetes businesses and think that the strength from the rest of the company will provide plenty of opportunity for upside, including the new acquisitions and pipeline. The recent slide in shares makes SNY an attractive purchase in our eyes. SNY shares currently yield 3.4% on a net basis, and trade at 11.4 times expected NTM adjusted EPS. Our Target Price has been trimmed to \$59.

Electronic manufacturing services firm **Benchmark Electronics** (BHE – \$29.35) posted earnings per share of \$0.49, versus the \$0.37 estimate in fiscal Q4 2017. BHE had sales of \$680.0 million (vs. \$601.0 million est.). Following the terrific quarter, shares of the thinly traded stock rose more than 5%. BHE now expects to post sales between \$585 million and \$605 million and adjusted earnings per share between \$0.34 and \$0.38 next quarter, ranges that were both above expectations (though we note there were only two and three estimates, respectively).

Benchmark CEO Paul Tufano stated that Benchmark continues to focus on three key areas, “First, in our business development groups, our go-to-market sales teams are fully-staffed, and two-thirds of the leadership of this group has been refreshed. Our bookings growth has improved sequentially. Secondly, as it relates to engineering, we continue to expand our engineering skills and capabilities. During 2017, we increased our engineering service head count by almost 10%. And more importantly, we added key skills in the areas of fluidics,

electronics, optical to be more value-added and more important to our customers. Thirdly, we won over 60 engineering projects. We also expanded our solutions are technology building blocks. As we've previously discussed, we've established two new design centers here in Phoenix, one for RF and high-speed designs. That center is being staffed now and coming to online."

"As I look at 2018, we must leverage the work that we did in 2017. 2018 will be a year to refine and optimize our investments. I am more excited today about the prospects with Benchmark than I was a year ago, and I believe the progress we make in 2018 will shape the trajectory for 2019 and beyond. And my optimism is predicated on market trends that I see favoring the company going forward. And I'd like to take a few minutes and talk about those market trends," said Mr. Tufano.

Benchmark has made considerable progress with efficiency initiatives that are expected to help achieve its \$250 million bookings goal by 2019, with \$150 million of bookings in 2017 and 66% percent of the bookings coming from "high value" segments. We like that Benchmark continues to expand its product offerings and that it has been pushing for growth outside of its original markets. Our Target Price has been bumped up to \$37, and we are enthused about the balance sheet, which boasts more than \$10 per share of net cash. On the strong earnings, the forward P/E ratio dropped to 17.

Tyson Foods (TSN – \$74.87) announced fiscal Q1 2018 financial results last week and saw its shares end the five trading days relatively flat despite the big market setback. The protein producer generated revenue of \$10.23 billion, versus consensus expectations of \$9.91 billion. Additionally, adjusted EPS for the quarter came in at \$1.81, compared to projections of \$1.50. Q1 was another record for quarterly adjusted profitability, which benefited from record operating margins in the company's prepared food segment.



Q1'18 Highlights

Highlights
• Record Adjusted EPS ^{1,2} of \$1.81, up 14% from last year
• Total volume growth of 5% with value-added volume growth of 9%
• Record Prepared Foods Adjusted Operating Margin ¹ at 11.9%
• Operating Cash Flow of \$1.1 billion
• Adjusted EPS guidance ^{3,4} of \$6.55-\$6.70 an approximate 23-26% increase from last year

¹Represents a non-GAAP financial measure. Adjusted EPS, adjusted operating income and adjusted operating margin are explained and reconciled to comparable GAAP measures in the footnotes.
²Represents incremental \$0.21 earnings per share due to tax reform.
³Revised Adjusted EPS as of 2/28/18. Represents a non-GAAP financial measure. A further explanation of any non-GAAP guidance is included in the appendix.
⁴Includes incremental \$0.05 earnings per share due to tax reform.

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Tyson Foods, Inc. | February 6, 2018

(\$ in millions, except per share data)	Q1'18
Sales	\$10,229
Adjusted Operating Income ¹	\$950
Adjusted Operating Margin ¹	9.3%
Adjusted EPS ²	\$1.81

(\$ in millions)	Q1'18	
Adjusted Operating Income ¹	Dollars	ROS%
Beef	\$257	6.6%
Pork	152	11.8%
Chicken	281	9.4%
Prepared Foods	273	11.9%
Other	(13)	n/a
Total	\$950	9.3%

"At Tyson Foods, we're creating a modern food company focused on protein," said CEO Tom Hayes. "Building on our momentum from a record year in fiscal '17, we're off to a strong start in

fiscal '18. We delivered record adjusted EPS and our second-strongest quarter of operating income in Q1, with operating cash flows of more than \$1.1 billion...The strength and diversity of our portfolio are evident. We drove solid results in each of our segments – beef, pork, chicken and prepared foods. We grew topline sales, with our retail and food service sales both outpacing the industry. We're encouraged by the position we're in today...As we look to the long-term, we're confident in our ability to continue growing the business. Demand for protein continues to rise, and we're well-positioned to take advantage of that opportunity – and to fulfill our aspiration of sustainably feeding the world.”

We remain impressed with the operational momentum the company has been enjoying, and believe that continued expansion in prepared foods and increasing protein consumption around the globe, especially in emerging economies, provide a solid long-term footing for top-line growth. We are pleased to see the firm pay down \$500 million of debt during the last quarter, and like the potentially even stronger cash flow moving forward (with continued cost containment and an expected effective tax rate of 24% in 2018 and 25% in 2019). Tyson expects fiscal 2018 adjusted EPS to come in between \$6.55 and \$6.70. TSN currently trades at 11.3 times the midpoint of fiscal 2018 midpoint guidance. Our Target Price has been hiked to \$92.

Health care distributor **Cardinal Health** (CAH – \$66.72) earned \$1.51 per share in fiscal Q2 2018 (vs. \$1.15 est.). CAH had sales of \$35.2 billion (vs. \$34.6 billion est.). Shares traded higher by 2.3% following the announcement.

“Overall, we are very pleased with the results. Performance across the vast majority of the business was at or above plan, and this translated into the numbers, with 6% revenue growth and non-GAAP earnings per share, excluding the benefit of tax reform, of \$1.31, ahead of our expectations,” said Chairman and CEO Mike Kaufmann. “Among the highlights this quarter was the Pharmaceutical segment performance, where results were better than expected. And in the Medical segment, the Patient Recovery, at-Home, and naviHealth businesses all performed well. On the flip side, we have some work to do in a couple of discrete areas, specifically in exam gloves and at Cordis, and we are on it.”

Mr. Kaufmann added, “I am very excited about the outlook for our company. With the breadth and balance of our portfolio, Cardinal Health is well positioned for the future. We have an excellent foundation on which to build. We are a valued partner to our customers across the healthcare continuum. And as our strategies have taken hold, we are poised to capitalize on the trends taking place in the global healthcare environment from the aging population to the continued shift of care to more efficient settings. As an organization, we are focused on continuing to innovate to improve the delivery and efficiency of healthcare. As always, our talented team of nearly 50,000 colleagues around the world are the core of our success and what truly differentiates Cardinal Health.”

We remain constructive on CAH. While the talk from Washington about health care pricing, not to mention worries about a possible competitive threat from Amazon, will keep the level of uncertainty on Cardinal and its peers elevated, we still believe that demographic trends in the U.S. are favorable as the population continues to age and requires greater health care usage.

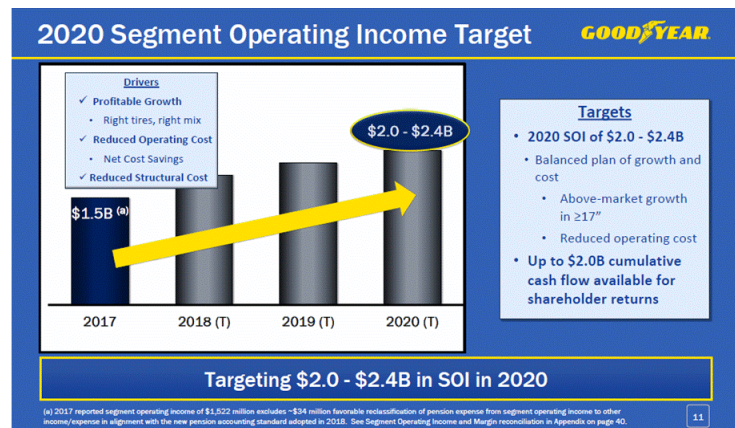
CAH continues to generate strong free cash flow, which can be used to increase the dividend (the yield is currently 2.8%), buy back stock and invest in the business via research & development and mergers & acquisitions. CAH shares trade for less than 11.4 times NTM earnings. We have upped our Target Price to \$95.

Tire maker **Goodyear Tire & Rubber** (GT – \$29.99) earned \$0.99 per share in fiscal Q4 2017 (vs. \$0.78 est.). GT had revenue of \$4.1 billion, versus the \$4.0 billion estimate. Shares fell 8.1% after the company slashed its 2020 operating income outlook from a target of \$3.0 billion given in September 2016 to a range of \$2.0 billion to \$2.4 billion.

CEO Rich Kramer said, “Two of our three business units showed year-over-year growth in segment operating income despite continuing significant raw material headwinds. Moreover, our Asia Pacific business unit saw all-time records in both volume and segment operating income in the quarter, driven by our continuing strength in China. On a full year basis, we delivered more than 1.5 billion in segment operating income and cash flow from operating activities of 1.2 billion. Looking ahead, I continue to be optimistic about the opportunities for growth in our markets. Our strategy is designed to take advantage of the long-term trends shaping our industry, particularly in the larger rim size segments of the market, which we define as greater than or equal to 17 inches.”

Mr. Kramer continued, “On taxes, given the impact of tax reform, we do not expect to pay cash taxes in the US through 2025. For the 2018 through 2020 time period, we see our book tax rate between 20% and 25% and a 15% cash tax rate. Next, we’ve set a good guideline for sustaining CapEx at around \$750 million a year. Finally, we see a use of \$100 million to \$200 million in working capital over the next three years. Now, that leaves us with 3 billion to 3.5 billion over the next three years that we can use to drive enterprise value. We have a strong track record of executing on our rationalization programs to address our cost structure. Over the last five years, we have achieved about a two-year payback on these programs. Debt repayment and pension are \$400 million to \$600 million over the period. We’ve remained committed to achieving an investment grade balance sheet over time.”

AFAM CAPITAL THE PRUDENT SPECULATOR
GT – 2020 Target Still Very Good



While overall vehicle demand remains strong, we think that GT should be more sensitive to overall miles traveled than to new sales, given the company's two-pronged market exposure. We feel that strong employment, rising wages and moderate fuel prices are conducive to folks traveling more and therefore creating more wear and tear on tires (spurring replacements). We think that Goodyear should gain from higher long-term demand in emerging markets, and management remains focused on reducing expenses, improving cash flow and strengthening the balance sheet. GT continues to target a dividend yield of 2.0% (with the remaining cash used for repurchases) and trades at 8.1 times estimated earnings. Our Target Price is \$50.

Movies, entertainment and theme park company Walt Disney Co (DIS – \$103.09) earned \$1.89 per share in fiscal Q1 2018 (vs. \$1.61 est.). DIS had sales of \$15.4 billion (vs. \$15.4 billion est.). Although shares 'only' slid 1.3% following the announcement, they have retreated 8% since January 26. Disney reported a one-time \$1.6 billion (\$0.22 per share) benefit from U.S. tax reform and said that its Theme Park segment increased operating income 21% year-over-year, the latter being called by one analyst "a reminder of the Disney monetization machine."

In addition, Disney made more progress towards launching its direct-to-consumer ESPN experience. CEO Bob Iger said, "ESPN Plus will launch sometime this spring when we unveil a completely re-conceived and redesigned ESPN app which will deliver important new services and experiences to users. The changes will be dramatic, with more compelling visuals, as well as an easy, intuitive interface and exceptional video and sound quality. This subscription service will feature thousands of additional live events, giving fans access to more leagues, more teams and more games than ever before, including Major League Baseball, Major League Soccer and the NHL, along with a rich array of college sports, as well as Grand Slam Tennis, Boxing, Golf, Rugby and Cricket, that aren't available on the ESPN linear networks." The service will cost \$4.99 per month.

In December, Disney said it was working on acquiring 21st Century Fox. On that front, Mr. Iger explained, "I spent the last several weeks meeting with a number of business leaders at Fox,

gaining insight that will be invaluable when it comes to integrating our organizations once we have regulatory approval. After these discussions, I'm even more enthusiastic about the businesses we're acquiring and the management teams that are leading them. As we said, when we announced this deal, there are three primary strategic priorities fulfilled by this acquisition. It will deliver more content and the production capabilities and talent to produce even more. It will enhance our direct-to-consumer initiatives with platforms, technologies, brands and existing customer relationships to build on. And it will greatly diversify our businesses geographically. All three of these elements sync up perfectly with our own core strategies, and all three are designed to create growth in a very dynamic global marketplace."

We are optimistic about the addition of the announced 21st Century Fox assets. We see the acquisition strengthening an already best-in-class content portfolio. Also, DIS should enjoy increased production and marketing scale. Furthermore, we like that this combination affords Disney the chance to meaningfully enhance its global reach and should spur growth because of greater access to emerging market regions. We also like that the acquisition of Fox's sports assets should significantly enhance ESPN's sports leadership position in the U.S., while all offerings could be leveraged DTC via BAMtech. Our Target Price has been lifted to \$145.

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