the Prudent Speculator

MARKET COMMENTARY Monday, February 26, 2018

EXECUTIVE SUMMARY

Week #8 - A Good Last Day Makes it an OK Week
Don't Believe All That You Read - Problem with Pensions has been Not Enough Equities
Recession Talk - Nothing on the Horizon, but Long-Term Investors Should not Fret about Economic Downturns
Valuable Perspective - Rising Interest Rates and Inflation are NOT Fatal for Stocks
Stock News - Updates on QCOM, MOS, MDT, HFC, WMT, TRN & FLR

Market Review

It was a pleasant end to a shaky week with the big advance on Friday pushing the major market averages into the green for the four-day holiday-shortened trading period. When all was said and done, the S&P 500 managed to advance 0.58% and the Russell 3000 gained 0.53%, even as Value again lagged behind in the performance race. The Russell 3000 Growth index climbed 1.08%, while the Russell 3000 Value index actually dropped 0.06%.

Though the markets can certainly head south again (and the equity futures were pointing to a mixed opening when trading resumes this week) as 5% setbacks have happened more than twice a year on average and 10% corrections more than once a year on average,…

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THE PRUDENT SPECULATOR
Volatility is Normal: Stocks Win the Race

Selloffs, downturns, pullbacks, corrections and even Bear Markets are events that equity investors always have had to endure on their way to the best long-term performance of any of the financial asset classes.

Advancing Markets

Minimum Rise %	Average Gain	Average # Days	Count	Frequency (in Years)	Last Start	Last End
20.0%	107.6%	907	26	3.5	3/9/2009	1/26/2018
17.5%	67.4%	579	37	2.4	10/3/2011	1/26/2018
15.0%	67.1%	562	43	2.1	10/3/2011	1/26/2018
12.5%	44.0%	331	70	1.3	2/11/2016	1/26/2018
10.0%	35.2%	249	103	0.9	2/11/2016	1/26/2018
7.5%	23.4%	147	152	0.6	2/11/2016	1/26/2018
5.0%	14.7%	72	295	0.3	2/8/2018	2/23/2018

Declining Markets

Minimum Decline %	Average Loss	Average # Days	Count	Frequency (in Years)	Last Start	Last End
-20.0%	-34.3%	371	25	3.5	1/6/2009	3/9/2009
-17.5%	-30.6%	225	36	2.5	4/29/2011	10/3/2011
-15.0%	-28.5%	195	42	2.1	4/29/2011	10/3/2011
-12.5%	-22.7%	140	69	1.3	5/21/2015	2/11/2016
-10.0%	-19.2%	102	103	0.9	1/26/2018	2/8/2018
-7.5%	-15.4%	65	152	0.6	1/26/2018	2/8/2018
-5.0%	-10.9%	37	294	0.4	1/26/2018	2/8/2018

From 02.20.28 through 2.23.18. Price return series. We defined a Declining Market as an instance when stocks dropped the specified percentage or more without a recovery of equal magnitude, and an Advancing Market as in instance when stocks appreciated the specified percentage or more without a decline of equal magnitude. SOURCE: Al Frank using data from Bloomberg, Morningstar and Ibbotson Associates

LONG-TERM RETURNS

	Annualized Return	Standard Deviation
Value Stocks	13.4%	26.0%
Growth Stocks	9.4%	21.4%
Dividend Paying Stocks	10.6%	18.1%
Non-Dividend Paying Stocks	8.8%	29.6%
Long-Term Corporate Bonds	6.1%	7.5%
Long-Term Gov't Bonds	5.5%	8.5%
Intermediate Gov't Bonds	5.1%	4.4%
Treasury Bills	3.4%	0.9%
Inflation	3.0%	1.8%

From 06.30.27 through 12.31.17. Growth stocks = 50% small growth and 50% large growth returns rebalanced monthly. Value stocks = 50% small value and 50% large value returns rebalanced monthly. Dividend payers = 30% top of dividend payers, 40% of middle dividend payers, and 30% bottom of dividend payers rebalanced monthly. Non-dividend payers = stocks that do not pay a dividend. Long term corporate bonds represented by the Ibbotson Associates SBBI US LT Corp Total Return index. Long term government bonds represented by the Ibbotson Associates SBBI US LT Govt Total Return index. Intermediate term government bonds represented by the Ibbotson Associates SBBI US IT Govt Total Return index. Treasury bills represented by the Ibbotson Associates SBBI US 30 Day TBill Total Return index. Inflation represented by the Ibbotson Associates SBBI US Inflation index. SOURCE: Al Frank using data from Professors Eugene F. Fama and Kenneth R. French and Ibbotson Associates

…the handsome rebound off of the February 8 closing and February 9 intra-day lows has been impressive, illustrating yet again why those with a long-term investment time horizon should utilize a longer-term lens when looking at their portfolios. Sadly, even though most understand

that volatility is a normal part of the investment process, many seem to lose sight of the fact that equities have proved rewarding in the fullness of time.

Unfortunately, the financial press often does its part to scare folks into making detrimental investment decisions, with even *The Wall Street Journal* getting into the act last week. The publication wrote, “Public pension funds that lost hundreds of billions during the last financial crisis still face significant risk from one basic investment: stocks. That vulnerability came into focus earlier this month as markets descended into correction territory for the first time since February 2016. The California Public Employees’ Retirement System, the largest public pension fund in the U.S., lost $18.5 billion in value over a 10-day trading period ended Feb. 9, according to figures provided by the system.”

Never mind that equities are still in the black in 2018, after terrific years in 2017 and 2016, the focus often seems to be on the risk and not the reward. The *WSJ* article continued, “But the risks are sizable losses during market downturns, which then can lead to deeper funding problems. The two largest public pensions in the U.S.—California Public Employees’ Retirement System, known by its abbreviation Calpers, and the California State Teachers’ Retirement System—lost nearly $100 billion in value during the fiscal year ended June 30, 2009. Nearly a decade later, neither fund has enough assets on hand to meet all future obligations to their workers and retirees.”

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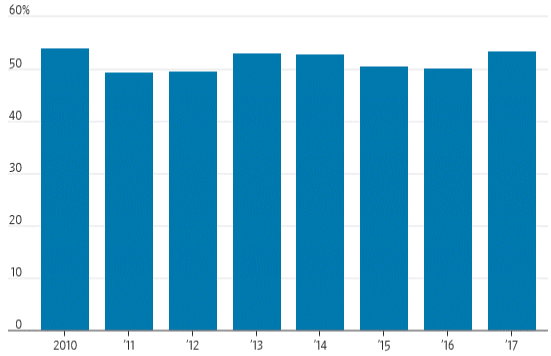
THE PRUDENT SPECULATOR

Pension Risk – Not Owning Enough Stocks

Given how well stocks have performed since the Financial Crisis, public pension plans generally have had to be net sellers of equities in order to maintain a relatively consistent and historically low allocation near 50%.

The Wall Street Journal – Major Public Pension Public Equity Allocation



Source: Wilshire Trust Universe Comparison Service

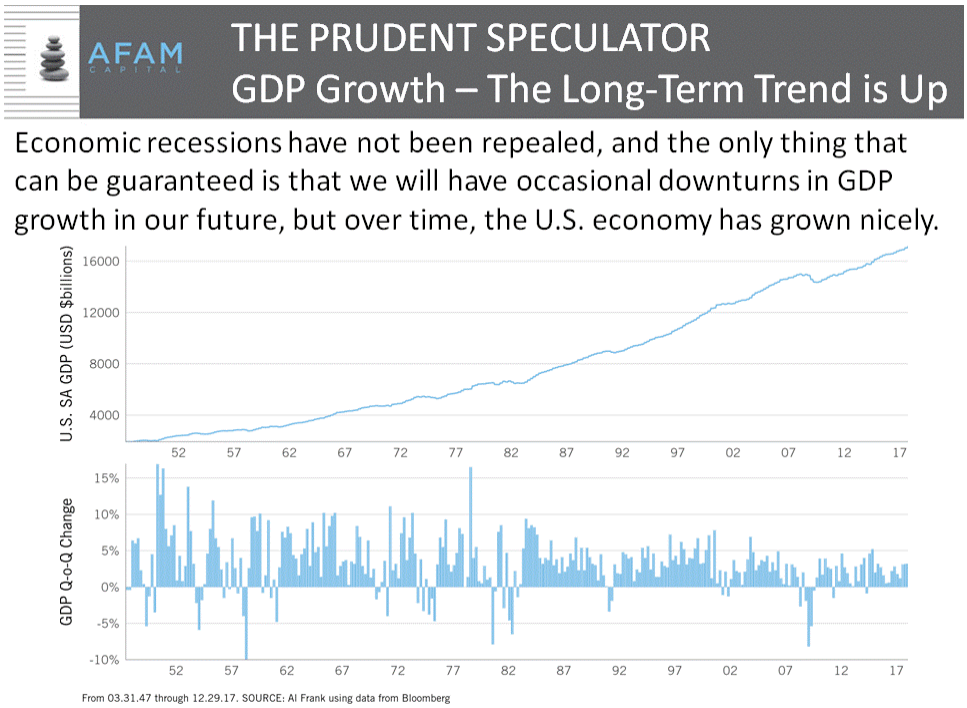
Care to guess why the big public pensions don’t have enough assets (aside from what many would call unreasonably high obligations to workers and retirees)? They don’t have enough equities, with the awful returns suffered during the Financial Crisis compelling managers and consultants to actually reduce equity exposure, closing the barn door after the horses had run out, and move dollars into supposedly less-risky alternative investment choices.

Indeed, here is what we wrote back in 2009 in regard to the aforementioned pair of big California pensions: “In reviewing disclosures made by the nation’s largest public pension fund, CalPERS, which recently had assets totaling $190 billion, we see that the plan’s allocation toward global equities has been cut from 56% to 49%, with the range relative to the target trimmed to +/- 5%, down from +/- 15%. Weightings toward private equity, fixed income and cash were increased. Same thing holds for CalSTRS, the largest U.S. teachers’ retirement fund and the second largest U.S. public pension fund, with assets of $127 billion, where the global equity long-term target was just slashed from 54% to 47%.”

Obviously, there was no guarantee that equities would perform so well in the decade or so since the big pensions decided to become cautious in their asset allocation mixes, but the pressure to mitigate short-term losses, even for entities with very long-term overall time horizons, is hard to overcome. Alas, even investment professionals often don’t realize that the secret to success in stocks is not to get scared out of them.

Not surprisingly, then, it is difficult for folks on Main Street to ignore the constant warnings against stocks, with the *Los Angeles Times* this Sunday attempting to scare its readers with a feature story: “Trump’s Market. He took credit for stock’s rise. Now he owns the volatility—or worse.” The thrust of the piece was that the tax cuts and increased spending in the recently-signed two-year budget bill are likely to lead to rising interest rates and higher inflation…and eventually to the next recession.

While we know that recessions are not rare occurrences and we understand that equities often perform poorly while a contraction in real GDP growth negatively impacts corporate profits, we do not see trouble for the U.S. economy on the horizon, especially after the prolonged period of lackluster growth seen since the end of the Financial Crisis. That is not to say that the markets won’t fall in anticipation of economic weakness, but we continue to believe that those who share our long-term time horizon would be far better riding through such an environment than trying to outguess the gyrations of incredibly fickle market participants. After all, far more money has been lost in anticipation of selloffs than has been lost in the downturns themselves.



No doubt, anything can happen in the economy and the stock markets, but we do our best to provide historical perspective, lest readers take what they hear on television and in the newspapers as the gospel. That in mind, the latest bogeyman striking fear into investors is the first part of that *Los Angeles Times* warning, namely that rising interest and inflation rates will be fatal for stocks. Here is what we have to say on that subject.

Certainly, common sense would suggest that the greater the yield on bonds (i.e. the higher the interest rate), the more attractive they should be relative to stocks, all else being equal. Of course, we would argue that all else isn't equal, while recent evidence would seem to throw cold water on the assertion that rising interest rates are bad for stocks.

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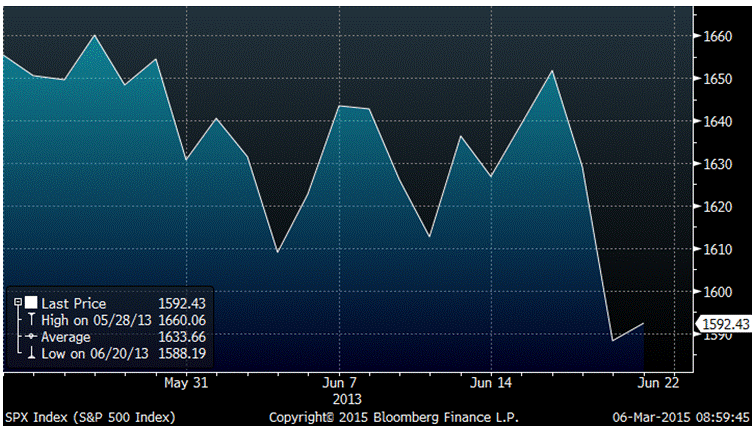
THE PRUDENT SPECULATOR
Rising Interest Rates are Bad for Stocks?

Stocks ran into turbulence as the yield on the 10-Year U.S. Treasury neared 3%, but the S&P 500 has still soared from 2130 on July 8, 2016, despite a more-than-doubling over the same period in the benchmark bond yield from its record low level of 1.36%.

Interest rates were at microscopic levels in the aftermath of the Financial Crisis, so stocks long have had to contend with the fear that the Federal Reserve might eventually begin to tighten monetary policy.

THE PRUDENT SPECULATOR
Taper Tantrum – Short Term

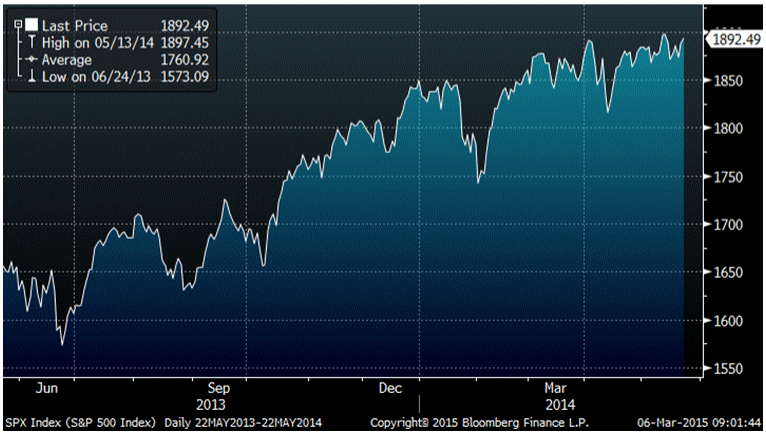
On May 22, 2013, Ben Bernanke hinted that the Federal Reserve would soon begin to taper it's $85 billion per month in purchases of bonds and mortgage backed securities. One month later, the S&P 500 had dropped by 3.8%.



Not surprisingly, the Taper Tantrum of 2013 provided some short-term consternation, even as it was a non-event when looked at over a one-year time span.

THE PRUDENT SPECULATOR
Taper Tantrum – Longer Term

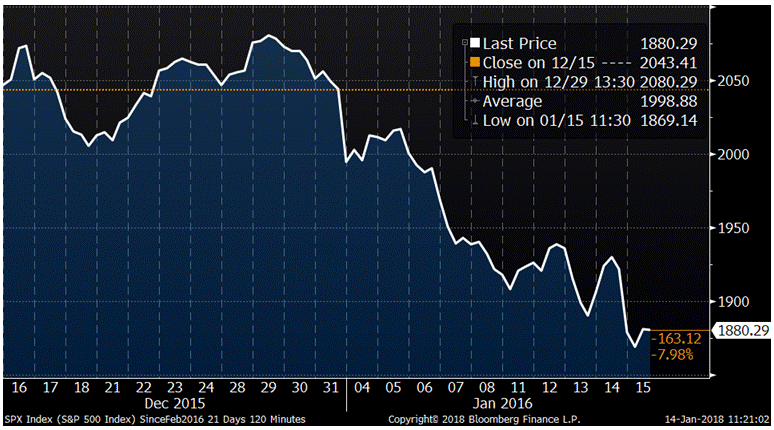
Yet, one year later, the S&P 500 had recouped those losses and then some, rising 13.6% from May 22, 2013 to May 22, 2014, even though Janet Yellen's Fed actually started to taper by $10 billion per month in January 2014.



And it was the same somewhat scary short-term story with Fed Liftoff, when Janet Yellen & Co. actually began a series of interest rate hikes,...

THE PRUDENT SPECULATOR
Fed Liftoff – Short Term

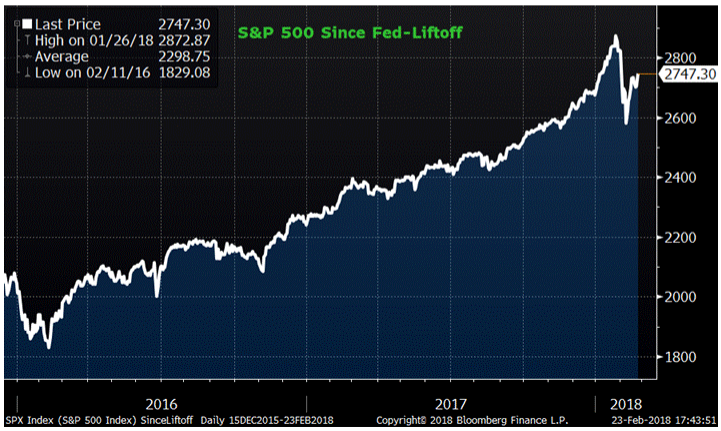
On December 16, 2015, the Federal Reserve raised the Federal Funds rate by 25 basis points to 0.50%, the first increase ("Liftoff") in the benchmark interest rate since 2006. One month later, the S&P 500 had dropped nearly 8%.



...even as equity prices are dramatically higher more than two years later,...

THE PRUDENT SPECULATOR
Fed Liftoff – Longer Term

Yet, two+ years later, the S&P 500 had recouped those losses and then some, returning 40.7% from Dec 15, 2015 to Feb 23 2018, even though Janet Yellen's Fed actually hiked the Fed Funds level four more times to a 1.50% rate.



...despite the likelihood of more interest rate increases this year.

THE PRUDENT SPECULATOR
Futures: Two, Three of Four Hikes in 2018

Though some are starting to fear a faster pace, we do not expect much change in the plan for a gradual boosting of interest rates, following the transition to Jerome Powell as Fed Chair. The odds now suggest a 27.8% chance of two and a 36.6% chance of three increases in the Fed Funds rate in 2018, though 28.8% is the probability of four or more hikes.

99) Export Data — World Interest Rate Probability

United States — Instrument: Futures: Fed Funds - Midpoint — Fed Effective Rate 1.42

1) Overview — 2) Future Implied Probability

Current Implied Probabilities — 3) Add/Remove Rates

Dates: Meeting / Calculation — Calculated 02/23/2018 — Based on rate 1.25-1.50

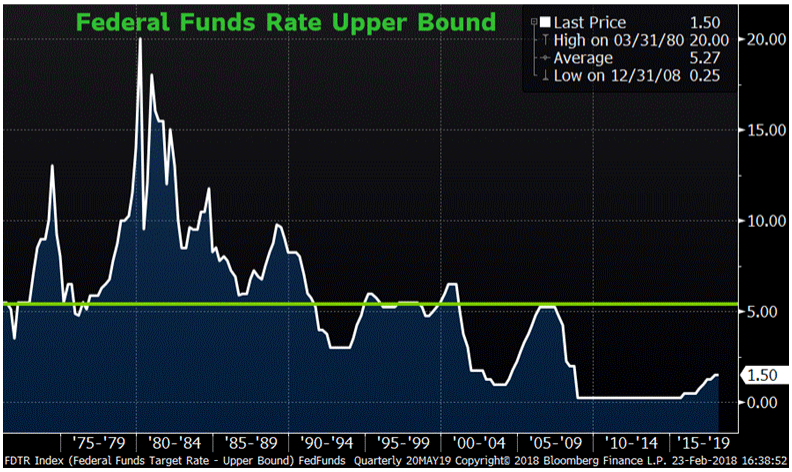
Meeting	Hike Prob	Cut Prob	1.5-1.75	1.75-2	2-2.25	2.25-2.5	2.5-2.75	2.75-3	3-3.25
03/21/2018	100.0%	0.0%	88.0%	12.0%	0.0%	0.0%	0.0%	0.0%	0.0%
05/02/2018	100.0%	0.0%	78.6%	20.1%	1.3%	0.0%	0.0%	0.0%	0.0%
06/13/2018	100.0%	0.0%	24.1%	60.6%	14.3%	0.9%	0.0%	0.0%	0.0%
08/01/2018	100.0%	0.0%	20.6%	55.4%	21.0%	2.8%	0.1%	0.0%	0.0%
09/26/2018	100.0%	0.0%	11.2%	39.5%	36.7%	11.1%	1.4%	0.1%	0.0%
11/08/2018	100.0%	0.0%	9.7%	35.7%	37.1%	14.6%	2.7%	0.2%	0.0%
12/19/2018	100.0%	0.0%	6.8%	27.8%	36.6%	21.4%	6.3%	1.0%	0.1%
01/30/2019	100.0%	0.0%	5.9%	25.3%	35.6%	23.3%	8.1%	1.6%	0.2%

Source: Bloomberg

Of course, it is important to note that interest rates remain extraordinarily low by historical standards,...

THE PRUDENT SPECULATOR
Lots Of Hikes Needed To Reach "Normal"

Folks should not be too worried about additional interest rate hikes, given that the Fed presently projects that the long-run target for the Fed Funds rate is 2.8%, well below the long-term 5.27% average.



...with subdued economic growth thus far convincing the Federal Reserve that the longer-run target for the Fed Funds rate is below 3%,...

THE PRUDENT SPECULATOR
December Fed Economic Projections

While economic data has been coming in stronger than the Fed might have anticipated back in December, Federal Reserve members then had a longer-run projection for GDP growth of 1.8% and the long-run forecast for the Federal Funds rate remained unchanged at 2.8%.

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

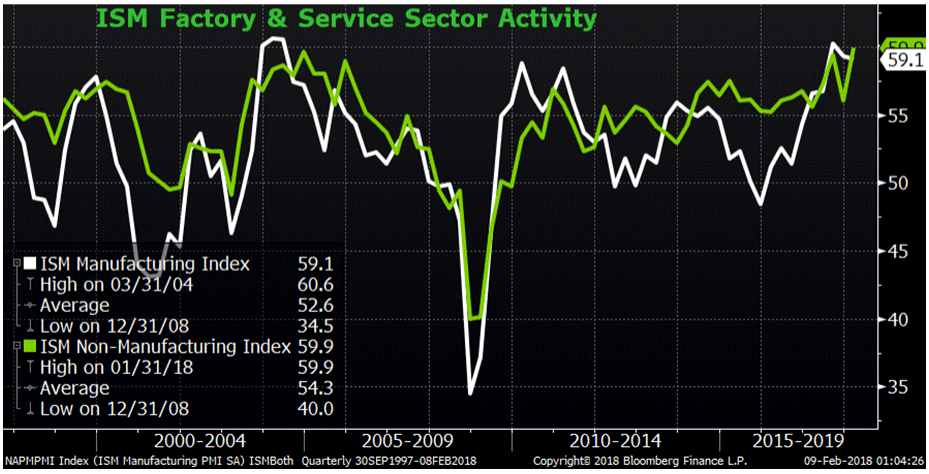
Variable	Median[1]					Central tendency[2]					Range[3]				
	2017	2018	2019	2020	Longer run	2017	2018	2019	2020	Longer run	2017	2018	2019	2020	Longer run
Change in real GDP	2.5	2.5	2.1	2.0	1.8	2.4 – 2.5	2.2 – 2.6	1.9 – 2.3	1.7 – 2.0	1.8 – 1.9	2.4 – 2.6	2.2 – 2.8	1.7 – 2.4	1.1 – 2.2	1.7 – 2.2
September projection	2.4	2.1	2.0	1.8	1.8	2.2 – 2.5	2.0 – 2.3	1.7 – 2.1	1.6 – 2.0	1.8 – 2.0	2.2 – 2.7	1.7 – 2.6	1.4 – 2.3	1.4 – 2.0	1.5 – 2.2
Unemployment rate	4.1	3.9	3.9	4.0	4.6	4.1	3.7 – 4.0	3.6 – 4.0	3.6 – 4.2	4.4 – 4.7	4.1	3.6 – 4.0	3.5 – 4.2	3.5 – 4.5	4.3 – 5.0
September projection	4.3	4.1	4.1	4.2	4.6	4.2 – 4.3	4.0 – 4.2	3.9 – 4.4	4.0 – 4.5	4.5 – 4.8	4.2 – 4.5	3.9 – 4.5	3.8 – 4.5	3.8 – 4.8	4.4 – 5.0
PCE inflation	1.7	1.9	2.0	2.0	2.0	1.6 – 1.7	1.7 – 1.9	2.0	2.0 – 2.1	2.0	1.5 – 1.7	1.7 – 2.1	1.8 – 2.3	1.9 – 2.2	2.0
September projection	1.6	1.9	2.0	2.0	2.0	1.5 – 1.6	1.8 – 2.0	2.0	2.0 – 2.1	2.0	1.5 – 1.7	1.7 – 2.0	1.8 – 2.2	1.9 – 2.2	2.0
Core PCE inflation[4]	1.5	1.9	2.0	2.0		1.5	1.7 – 1.9	2.0	2.0 – 2.1		1.4 – 1.5	1.7 – 2.0	1.8 – 2.3	1.9 – 2.3	
September projection	1.5	1.9	2.0	2.0		1.5 – 1.6	1.8 – 2.0	2.0	2.0 – 2.1		1.4 – 1.7	1.7 – 2.0	1.8 – 2.2	1.9 – 2.2	
Memo: Projected appropriate policy path															
Federal funds rate	1.4	2.1	2.7	3.1	2.8	1.4	1.9 – 2.4	2.4 – 3.1	2.6 – 3.1	2.8 – 3.0	1.1 – 1.4	1.1 – 2.6	1.4 – 3.6	1.4 – 4.1	2.3 – 3.0
September projection	1.4	2.1	2.7	2.9	2.8	1.1 – 1.4	1.9 – 2.4	2.4 – 3.1	2.5 – 3.5	2.5 – 3.0	1.1 – 1.6	1.1 – 2.6	1.1 – 3.4	1.1 – 3.9	2.3 – 3.5

Source: Federal Reserve, December 13, 2017

...even as more recent economic statistics have been more favorable,...

THE PRUDENT SPECULATOR
Terrific ISM Numbers

Both the Institute for Supply Management's Manufacturing and Non-Manufacturing indexes now stand at or near all-time highs, suggesting that domestic economic growth is improving.



...with the latest jobs numbers causing concern that higher wage growth could be inflationary.

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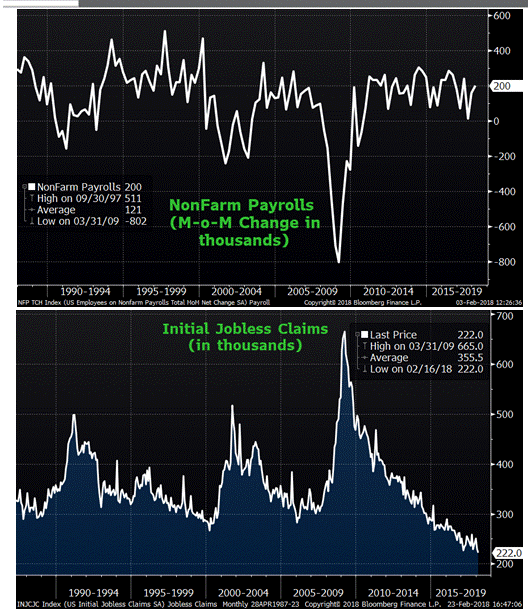
Healthy Labor Situation

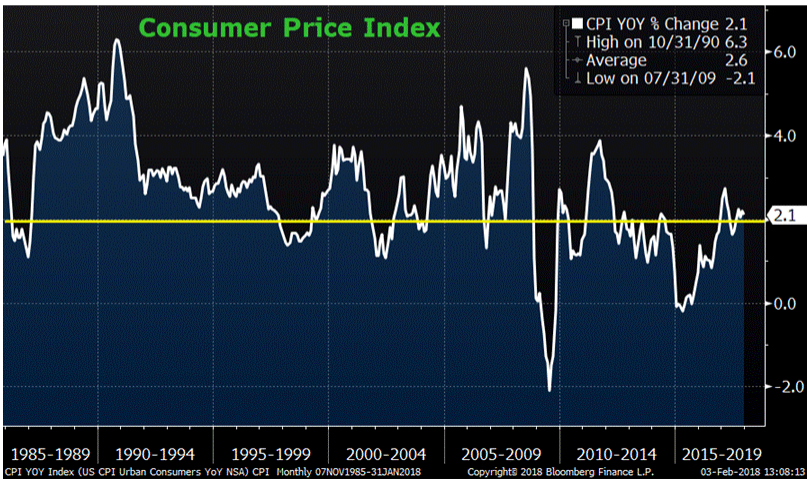


The Labor Department said that the unemployment rate remained at a 17-year low of 4.1% in January, while the number of new non-farm payrolls created came in at a better-than-expected 200,000. And it would appear that the jobs picture will continue to be healthy, as the latest tally of weekly first-time filings for unemployment benefits came in at 222,000, right near a record 30-year (monthly) low!

Of course, thus far, inflation has remained very well contained,...

THE PRUDENT SPECULATOR
Inflation Remains Relatively Low

The latest read on prices at the consumer level shows that this measure of inflation remains relatively subdued, supporting the Federal Reserve's statement of a 2% objective over the medium term.



...with the Fed's latest opining suggesting that it will remain that way for the foreseeable future,...

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THE PRUDENT SPECULATOR
Latest Federal Reserve Thinking

MONETARY POLICY REPORT

February 23, 2018

Economic activity increased at a solid pace over the second half of 2017, and the labor market continued to strengthen. Measured on a 12-month basis, inflation has remained below the Federal Open Market Committee's (FOMC) longer-run objective of 2 percent. The FOMC raised the target range for the federal funds rate twice in the first half of 2017, resulting in a range of 1 to 1¼ percent by the end of its June meeting. With the federal funds rate rising toward more normal levels, at its September meeting, the FOMC decided to initiate a program of gradually and predictably reducing the size of its balance sheet. At its meeting in December, the Committee judged that current and prospective economic conditions called for a further increase in the target range for the federal funds rate, to 1¼ to 1½ percent.

The FOMC expects that, with further gradual adjustments in the stance of monetary policy, **economic activity will expand at a moderate pace** and labor market conditions will remain strong. **Inflation** on a 12-month basis is **expected** to move up this year and **to stabilize around the Committee's 2 percent objective over the next few years**. **The federal funds rate is likely to remain, for some time, below levels that are expected to prevail in the longer run.**

...even as global economic growth looks to be stronger than previously projected.

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IMF World Economic Outlook – Jan '18

IMF Global Growth Projections

			IMF WEO Projections		Difference from 10/17	
	2016	2017	2018	2019	2018	2019
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.

We would argue that it is hard to complain about a healthier economy, given the positive backdrop for corporate profits,...

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THE PRUDENT SPECULATOR
Significant EPS Growth Estimated

S&P 500 Earnings Per Share		
Quanter Ended	Bottom Up Operating EPS 3 Month	Bottom Up Operating EPS 12 Month
ESTIMATES		
12/31/2019	$46.10	$172.42
9/30/2019	$44.21	$168.09
6/30/2019	$42.44	$164.01
3/31/2019	$39.67	$160.11
12/31/2018	$41.77	$156.22
9/30/2018	$40.13	$148.58
6/30/2018	$38.54	$139.78
3/31/2018	$35.78	$131.75
12/31/2017	$34.13	$124.79
ACTUAL		
9/30/2017	$31.33	$118.56
6/30/2017	$30.51	$115.92
3/31/2017	$28.82	$111.11
12/31/2016	$27.90	$106.26
9/30/2016	$28.69	$101.42
6/30/2016	$25.70	$98.17
3/31/2016	$23.97	$98.61
12/31/2015	$23.06	$100.45
9/30/2015	$25.44	$104.14
6/30/2015	$26.14	$108.30
3/31/2015	$25.81	$111.50
12/31/2014	$26.75	$113.01

Source: Standard & Poor's. As of 2.22.18

History shows that stock prices generally have followed earnings, so it is nice to see actual and projected EPS moving up, even as earnings forecasts often turn out to be too optimistic. Happily, the number of companies exceeding expectations in 2017 was far better than the average earnings-beat rate over the prior 5 years.

S&P 500 Quarterly Earnings Comparisons							
	BEAT	MISSED	MET		BEAT	MISSED	MET
Q3 2017	72.4%	19.3%	8.2%	Q4 2014	68.6%	21.0%	10.4%
Q2 2017	70.2%	20.1%	9.7%	Q3 2014	73.7%	17.2%	9.0%
Q1 2017	74.0%	18.9%	7.2%	Q2 2014	65.7%	21.2%	13.0%
Q4 2016	67.3%	22.0%	10.8%	Q1 2014	67.1%	22.6%	10.2%
Q3 2016	70.5%	21.1%	8.4%	Q4 2013	63.9%	25.3%	10.8%
Q2 2016	70.2%	20.9%	8.9%	Q3 2013	66.1%	23.2%	10.6%
Q1 2016	72.3%	20.6%	7.0%	Q2 2013	65.4%	26.8%	7.8%
Q4 2015	68.8%	21.6%	9.7%	Q1 2013	65.9%	25.9%	8.2%
Q3 2015	67.9%	23.0%	9.0%	Q4 2012	64.8%	24.8%	10.4%
Q2 2015	69.8%	22.0%	8.3%	Q3 2012	63.3%	23.7%	13.0%
Q1 2015	67.7%	22.9%	9.4%	AVERAGE	68.4%	22.1%	9.5%

Source: Standard & Poor's and Bloomberg

...which have been coming in much better than expected during the current Q4 earnings reporting season.

AFAM CAPITAL

THE PRUDENT SPECULATOR
Excellent Q4 Earnings Reports

While quarterly earnings reports, on average, generally beat analyst expectations, the number of companies exceeding Wall Street projections (73.9%) this go round has been greater than usual.

02/23/2018 14:12:50 [BN] Translate to...

EPS SURPRISES@:

POSITIVE SURPRISES:	334/452	= 73.9%	Median: 6.7%	
% of Surprises:			EPS Differences	(Actual-Estimate):
(0% to 10%):	213		(1 cent):	37
(10% to 20%):	64		(2 cents):	26
(20% to 30%):	25		(3 to 4 cents):	61
(30% to 40%):	11		(5 to 9 cents):	96
(40% to 50%):	3		(10 to 19 cents):	60
(more than 50%):	18		(20 to 49 cents):	38
% chg NM	0		(50 cents or more):	16
0% SURPRISES:	40/452	= 8.8%		
NEGATIVE SURPRISES:	78/452	= 17.3%	Median: -4.8%	
% of Surprises:			EPS Differences	(Actual-Estimate):
(-10% to 0%):	53		(-1 cent):	24

Australia 61 2 9777 8600 Brazil 5511 2395 9000 Europe 44 20 7330 7500 Germany 49 69 9204 1210 Hong Kong 852 2977 6000
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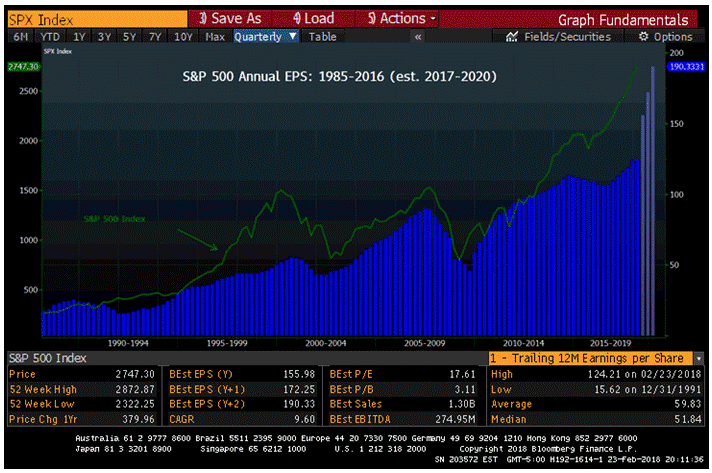
And, since stock prices often track earnings, we like that expectations are for even stronger numbers going forward.

THE PRUDENT SPECULATOR
Stock Prices Often Follow Earnings

Market history shows that sustained market downturns usually coincide with a recession in corporate profits. No guarantees, of course, but the outlook for earnings, especially given the recent tax cuts, is favorable.



To be sure, despite the data presented above, many folks will remain convinced that the future is worrisome, even as this has not been the case, on average, following previous instances of Fed Liftoff,...

THE PRUDENT SPECULATOR
Fed Liftoff & Value

Value Stocks historically have outperformed Growth Stocks, but the annualized differences are even more pronounced on average for the two-, three- and five-years following the first rate hike.

		24 Months After Liftoff			36 Months After Liftoff			60 Months After Liftoff		
Start Date	Initial Effective Fed Funds Rate	S&P	Value	Growth	S&P	Value	Growth	S&P	Value	Growth
Dec 1954	1.28%	18.4%	15.6%	13.5%	7.7%	2.5%	3.8%	15.0%	17.0%	15.7%
Aug 1958	1.53%	12.9%	15.5%	18.3%	16.3%	18.8%	18.5%	12.3%	15.9%	10.5%
Aug 1961	2.00%	6.6%	11.7%	-0.5%	9.8%	14.5%	1.8%	5.9%	12.5%	3.7%
Nov 1964	3.52%	0.8%	8.5%	6.6%	7.0%	18.4%	19.3%	5.5%	15.0%	14.0%
Aug 1967	3.90%	4.2%	10.8%	7.2%	-1.3%	1.7%	-5.3%	6.9%	8.3%	6.7%
Apr 1971	4.15%	4.5%	-2.0%	-6.4%	-1.6%	-1.7%	-10.7%	3.2%	8.2%	-2.5%
Mar 1972	3.83%	-3.4%	-3.0%	-19.2%	-4.6%	-1.9%	-16.0%	2.1%	10.4%	-4.4%
Mar 1974	9.35%	9.3%	23.3%	9.1%	6.0%	20.3%	6.9%	6.4%	19.9%	10.8%
Feb 1977	4.68%	3.4%	15.1%	11.8%	10.0%	20.7%	19.1%	8.0%	17.5%	13.7%
Aug 1980	9.61%	4.3%	14.8%	0.1%	16.1%	28.8%	16.0%	14.5%	24.6%	10.3%
Jan 1982	13.22%	22.6%	37.9%	18.1%	20.1%	30.5%	15.1%	23.3%	28.9%	16.8%
May 1983	8.77%	13.1%	19.7%	0.0%	20.2%	23.5%	11.2%	14.5%	16.3%	5.2%
Apr 1987	6.37%	7.3%	11.1%	1.2%	8.3%	7.1%	3.2%	11.2%	11.0%	8.3%
Apr 1988	6.87%	16.5%	11.8%	12.2%	16.9%	10.7%	14.3%	14.7%	16.1%	11.9%
Feb 1994	3.25%	20.2%	15.4%	16.6%	22.2%	17.4%	15.5%	24.1%	16.0%	15.8%
Jun 1999	4.76%	-4.4%	16.2%	1.1%	-9.2%	8.8%	-8.1%	-2.2%	11.1%	0.3%
Jun 2004	1.03%	7.5%	17.8%	4.8%	11.7%	18.9%	8.8%	-2.2%	-1.0%	-1.7%
Averages:	5.18%	8.5%	14.1%	5.5%	9.2%	14.1%	6.7%	9.6%	14.6%	7.9%

...or when the yield on the 10-Year U.S. Treasury has been rising,...

AFAM CAPITAL

THE PRUDENT SPECULATOR
Δ in 10-Year & Value/Growth

Concurrent Stock Performance & Change in 10-Year Treasury Rate

	Count	Value	Growth	Small	Large
Less than 4.02%	543	12.0%	10.1%	11.2%	10.1%
More than 4.02%	542	14.9%	8.7%	13.2%	10.0%
3-Month Drop	521	14.0%	11.0%	11.8%	11.8%
3-Month Rise	560	13.0%	7.9%	12.5%	8.3%
6-Month Drop	521	13.6%	10.2%	11.5%	10.8%
6-Month Rise	554	13.2%	8.4%	12.7%	9.1%
12-Month Drop	533	12.4%	9.4%	10.3%	9.8%
12-Month Rise	530	14.4%	8.9%	13.9%	9.8%

From 06.30.27 through 12.31.17. Concurrent annualized 12-month returns. SOURCE: Al Frank using data from Professor Robert J. Shiller and Professors Eugene F. Fama and Kenneth R. French

Subsequent Stock Performance & Change in 10-Year Treasury Rate

	Count	Value	Growth	Small	Large
Less than 4.02%	545	12.5%	10.1%	11.5%	10.4%
More than 4.02%	542	14.2%	8.3%	12.7%	9.3%
3-Month Drop	516	15.8%	12.7%	15.7%	11.9%
3-Month Rise	556	11.1%	5.8%	8.8%	7.8%
6-Month Drop	520	15.2%	12.0%	15.4%	11.4%
6-Month Rise	549	11.5%	6.2%	8.9%	8.2%
12-Month Drop	533	13.0%	10.3%	13.6%	10.0%
12-Month Rise	530	13.4%	7.4%	10.3%	9.1%

From 06.30.27 through 12.31.17. Subsequent 12-month return. SOURCE: Al Frank using data from Professor Robert J. Shiller and Professors Eugene F. Fama and Kenneth R. French

Many have incorrectly warned that rising rates will prove fatal for equities, but nine decades of returns data show that stocks in general, whether Small-Cap or Large-Cap, have performed admirably both concurrent with and subsequent to increases in the yield on the 10-Year Treasury, with Value stocks really asserting their dominance.

...or when the Fed Funds rate has been climbing,...

AFAM CAPITAL

THE PRUDENT SPECULATOR
Δ in Fed Funds Rate & Value/Growth

Concurrent Stock Performance & Change in Federal Funds Eff. Rate

	Count	Value	Growth	Small	Large
Less than 4.65%	380	14.9%	11.3%	17.0%	10.1%
More than 4.65%	380	14.5%	8.4%	10.2%	11.3%
3-Month Drop	354	17.5%	11.7%	15.7%	11.8%
3-Month Rise	402	12.3%	8.3%	11.8%	9.7%
6-Month Drop	342	16.6%	11.9%	15.2%	11.9%
6-Month Rise	408	13.0%	8.0%	12.1%	9.4%
12-Month Drop	345	14.6%	10.7%	13.2%	10.7%
12-Month Rise	393	14.2%	8.6%	13.4%	10.2%

From 07.31.54 through 12.31.17. Concurrent annualized 12-month returns. SOURCE: Al Frank using data from Bloomberg and Professors Eugene F. Fama and Kenneth R. French

Subsequent Stock Performance. & Change in Federal Funds Eff. Rate

	Count	Value	Growth	Small	Large
Less than 4.65%	382	12.9%	9.4%	13.7%	9.5%
More than 4.65%	380	15.9%	9.8%	12.9%	11.3%
3-Month Drop	354	13.9%	10.2%	14.1%	10.3%
3-Month Rise	393	14.6%	8.9%	12.4%	10.3%
6-Month Drop	342	15.1%	11.2%	15.3%	11.4%
6-Month Rise	402	13.4%	8.0%	11.4%	9.2%
12-Month Drop	345	16.2%	11.5%	16.5%	11.5%
12-Month Rise	393	12.4%	7.6%	10.2%	8.8%

From 07.31.54 through 12.31.17. Subsequent 12-month return. SOURCE: Al Frank using data from Bloomberg and Professors Eugene F. Fama and Kenneth R. French

No matter how the data are sliced, holding equities, on average, has been rewarding. And, six-plus decades of returns show that stocks in general have performed well both concurrent with and subsequent to increases in the Fed Funds rate, while Value stocks really assert their dominance when the Fed is tightening monetary policy.

...or even when inflation has been increasing.

THE PRUDENT SPECULATOR
Δ in Inflation & Value/Growth

Concurrent Stock Performance & Change in Inflation Rate

	Count	Value	Growth	Small	Large
Less than 2.7%	549	15.3%	13.4%	16.2%	12.7%
More than 2.7%	530	11.4%	5.0%	8.1%	7.0%
3-Month Drop	590	15.4%	12.3%	14.8%	12.4%
3-Month Rise	485	11.0%	5.5%	9.0%	6.9%
6-Month Drop	562	16.2%	12.4%	15.6%	12.3%
6-Month Rise	507	10.2%	5.5%	8.2%	7.1%
12-Month Drop	544	14.5%	10.2%	12.8%	11.1%
12-Month Rise	513	12.0%	7.8%	11.1%	8.2%

From 12.31.27 through 12.31.17. Concurrent annualized 12-month returns. SOURCE: Al Frank using data from Bloomberg and Professors Eugene F. Fama and Kenneth R. French

Subsequent Stock Performance. & Change in Inflation Rate

	Count	Value	Growth	Small	Large
Less than 2.7%	551	11.6%	9.6%	11.1%	9.8%
More than 2.7%	530	15.0%	8.4%	12.9%	9.6%
3-Month Drop	585	14.5%	9.7%	13.2%	10.6%
3-Month Rise	481	11.7%	7.9%	10.5%	8.4%
6-Month Drop	561	14.8%	9.6%	13.1%	10.9%
6-Month Rise	502	11.4%	8.1%	10.7%	8.1%
12-Month Drop	544	15.3%	10.0%	13.5%	11.5%
12-Month Rise	513	11.0%	7.6%	10.6%	7.3%

From 12.31.27 through 12.31.17. Subsequent 12-month return. SOURCE: Al Frank using data from Bloomberg and Professors Eugene F. Fama and Kenneth R. French

A stronger economy and tax cuts have some folks thinking that inflation will pick up in 2018 and beyond…which is fine by us. After all, Value stocks, on average, have seen a sizable return advantage over Growth, both concurrent with and subsequent to an increase in the inflation rate, with the performance gap widest when inflation is higher.

In fact, just about any way the data are sliced and diced, Value stocks, like those that we have long favored, have performed admirably.

THE PRUDENT SPECULATOR
Most Inflation Rates No Problem for Value

There are a few sizable negative next-12-month returns in the numbers, but Value Stocks, on average, have enjoyed very good absolute and relative returns when the inflation rate is anywhere from 1% to 3%.

Inflation Rates and Average Equity Returns

Value Stocks

Inflation Rate	< 0%	0% to 1%	1% to 2%	2% to 3%	3% to 4%	4% to 5%	5% to 6%	6% to 7%	> 7%
COUNT	136	76	195	183	173	84	52	45	131
Mean NTM TR	22.7%	10.6%	15.0%	17.9%	21.7%	5.1%	2.4%	24.8%	24.6%
Min NTM TR	-71.4%	-47.9%	-45.9%	-49.7%	-66.3%	-54.7%	-55.8%	-6.6%	-27.9%
Max NTM TR	358.1%	85.1%	83.8%	93.8%	149.1%	39.9%	62.1%	75.2%	134.0%
# Neg	46	34	49	41	32	29	25	4	18
# Pos	90	42	146	142	141	55	27	41	113
+/- Ratio	2.0	1.2	3.0	3.5	4.4	1.9	1.1	10.3	6.9

Growth Stocks

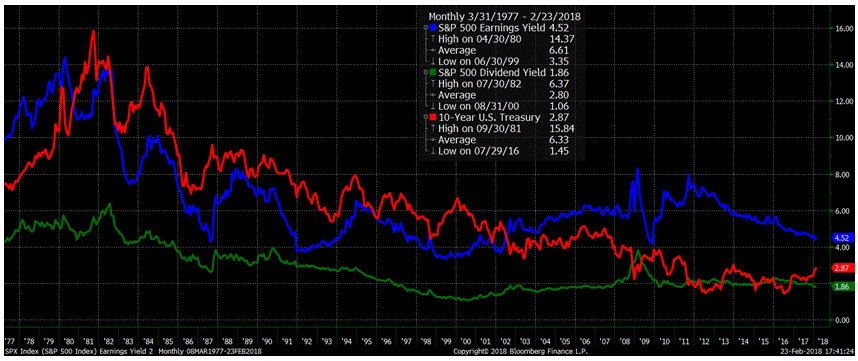
Inflation Rate	< 0%	0% to 1%	1% to 2%	2% to 3%	3% to 4%	4% to 5%	5% to 6%	6% to 7%	> 7%
COUNT	136	76	195	183	173	84	52	45	131
Mean NTM TR	19.1%	6.4%	12.4%	13.4%	9.6%	4.4%	4.2%	21.7%	14.2%
Min NTM TR	-64.8%	-45.5%	-42.2%	-43.4%	-55.1%	-42.1%	-45.3%	-17.4%	-48.1%
Max NTM TR	221.9%	55.9%	58.2%	58.2%	70.0%	33.2%	56.0%	76.3%	83.8%
# Neg	40	30	37	46	54	29	18	4	35
# Pos	96	46	158	137	119	55	34	41	96
+/- Ratio	2.4	1.5	4.3	3.0	2.2	1.9	1.9	10.3	2.7

Source: Al Frank Using Data from Morningstar and Professors Eugene F. Fama and Kenneth R. French

To be sure, there is likely an interest rate level at which we might be singing a different tune, with that figure presently residing around 4.5% on the 10-Year Treasury (the rate was 2.86% as this missive was drafted).

THE PRUDENT SPECULATOR
Fed Model: Favorable Earnings Yield

The so-called Fed Model suggests that the yield on 10-Year Treasuries should be similar to the S&P 500 Earnings Yield, which is the inverse of the P/E ratio. If the 10-Year is greater than the S&P Earnings Yield, a market is overvalued and if the reverse is true, as it is today, a market is undervalued. Though some argue that the Fed Model is no longer an effective tool, we like today's relatively generous earnings yield of 4.5%.



We are not predicting such an interest rate any time soon, but should we get there, about the only thing we would know for sure is that it would not have been good...for bonds!

THE PRUDENT SPECULATOR
Rising Rates are Bad for...Bonds

Returns Race

2018 YTD Return %	2017 Return %	2016 Return %	Since 10-Yr Yield Low (7.8.16) %	Bloomberg Symbol	Index
Stock Indexes					
2.74	28.11	16.50	45.13	INDU Index	Dow Jones Industrial Average
6.46	29.73	8.97	50.92	CCMP Index	NASDAQ Composite Index
2.86	21.68	12.04	33.08	RIY Index	Russell 1000 Index
1.02	14.63	21.28	34.41	RTY Index	Russell 2000 Index
2.72	21.12	12.72	33.18	RAY Index	Russell 3000 Index
3.04	21.82	11.95	33.28	SPX Index	S&P 500 Index
5.41	30.21	7.07	41.87	RLG Index	Russell 1000 Growth Index
0.27	13.64	17.33	24.58	RLV Index	Russell 1000 Value Index
2.83	22.14	11.28	38.21	RUO Index	Russell 2000 Growth Index
-0.92	7.82	31.72	30.46	RUJ Index	Russell 2000 Value Index
5.21	29.58	7.38	41.58	RAG Index	Russell 3000 Growth Index
0.18	13.17	18.38	25.02	RAV Index	Russell 3000 Value Index
5.97	27.43	6.89	39.23	SGX Index	S&P 500 Growth Index
-0.03	15.35	17.39	26.15	SVX Index	S&P 500 Value Index
Largest Bond Funds					
-2.14	3.57	0.79	-2.31	VBTIX Equity	Vanguard Tot Bd Mkt Idx-Inst
-2.16	3.53	0.75	-2.39	VTBIX Equity	Vanguard Tot Bnd Mkt Ii-Inv
-0.75	8.17	0.82	11.39	PONAX Equity	Pimco Income Fund-A
-0.33	2.39	0.81	-0.01	VTABX Equity	Vanguard Total Intl Bnd-Adm
-1.96	3.10	0.76	-1.66	MWTRX Equity	Mtrpltn Wst Ttl Rtrn Bnd-M
-1.61	5.13	0.73	0.97	PTTRX Equity	Pimco Total Return Fund-Inst
-0.70	7.36	0.63	10.77	PIMINIA Equity	Pimco Gis-Income Fund-Ins Ac
-0.61	2.02	-0.01	0.85	VFSTX Equity	Vanguard S/T Invest Grd-Inv
-1.30	4.53	0.21	-0.71	VWITX Equity	Vanguard Intm Trm T/E-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 Rtrn Bnd-I
-0.47	1.89	0.07	1.82	LDLAX Equity	Lord Abbett Shrt Dur Inc-C

Source: Bloomberg. As of 2.23.18. 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 has been an entirely different story since, as high-flying Growth stocks like Amazon, Facebook, Alphabet and Tesla captured the fancy of investors. Of course, given that the yield on the 10-Year U.S. Treasury has more than doubled since July 8, 2016, the real "risk" in the financial markets has been in bonds, not stocks!

Stock Updates

All of us at AFAM Capital would like to congratulate Chris Quigley on the birth of his first child. Madison Evelyn Quigley came into the world on February 22 and she and the happy parents are all doing just fine. Alas, with Chris predisposed, Jason Clark has pulled double-duty in drafting this week's stock commentary.

The drama at **Qualcomm** (QCOM - $63.32) intensified last week, with shares of the maker of wireless communications equipment pulling back approximately 3%. The company announced that it was raising its bid for NXP Semiconductors (NXPI) from approximately $110.00 a share to $127.50, which prompted Broadcom to reduce its offer to acquire QCOM to $79.00 per share, down from $82.00.

While we still believe that buying the chipmaker would be very beneficial to Qualcomm on many levels, many believe that the QCOM's increased bid was as much about the company fending off Broadcom's desired takeover as it was about acquiring NXPI. Broadcom was certainly of that mind as it said that is now prepared to acquire Qualcomm for $79.00, consisting of $57.00 in cash and $22.00 in Broadcom shares, BUT that it would raise the cash portion back to $60.00 in the event that the NXPI acquisition is not completed. Other terms remained unchanged, including Broadcom's willingness to pay an $8 billion regulatory reverse-termination fee and 6% per annum (net of dividends) ticking fee accruing from and after the 12-month anniversary of the date of the merger agreement.

In a letter to shareholders, Qualcomm management offered a spirited argument against the Broadcom proposal…

AFAM CAPITAL

THE PRUDENT SPECULATOR
QCOM – February 22 Shareholder Letter

By lowering its proposal to $79.00 per share, Broadcom has made an inadequate proposal even worse despite the indisputable increase in value and certainty that Qualcomm stockholders will receive from the compelling and highly accretive acquisition of NXP. Importantly, Broadcom has refused and continues to refuse to engage with Qualcomm on price.

The Board unanimously believes that Broadcom's current $79.00 per share proposal undervalues Qualcomm, fails to take into account the strategic and financial benefits of acquiring NXP, and continues to face a long and highly uncertain path to regulatory approvals.

Members of this Board and management met with Broadcom earlier this month to discuss a path to a transaction that both appropriately valued Qualcomm and provided a sufficient level of certainty around the regulatory issues. We entered the meeting with Broadcom in a constructive manner, seeking a price increase and engagement on issues related to transaction certainty. However, Broadcom did not engage on the topic of price – repeatedly stating that $82 per share was "best-and-final."

Broadcom also insisted it had to control all material decisions regarding our licensing business, one that has realized annual revenues exceeding $7 billion, during a lengthy regulatory process, despite the fact that this is not permitted under antitrust laws. Additionally, Broadcom was unwilling to agree to commitments that could be expected to be required by the FTC, European Commission, MOFCOM and other government regulatory bodies. Their proposed $8 billion reverse termination fee – which equates to only $5.40 per share – does not come close to compensating our stockholders for the substantial value destruction likely to result if the transaction were to fail to close due to regulatory issues.

The Qualcomm Board is highly confident in our ability to deliver $6.75-7.50 in FY19 Non-GAAP EPS. At any realistic multiple, that would result in a value for Qualcomm well in excess of even an $82.00 proposal. Moreover, the value to Qualcomm stockholders of executing our growth plan is not only higher but carries far less risk than Broadcom's proposal. We are unwilling to give Broadcom an option at $79.00 per share for 18 months while we deliver on our strategy, as 5G gains momentum and NXP is integrated.

…though it is difficult for us to continue to support a "just-say-no" defense, given that even the lower $79 offer is above our updated $74 Target Price. Of course, that determination of fair value assumes no completion of the NXPI deal and its supposed substantial accretion to

earnings nor does it contemplate a cessation of the company's hostilities with Apple and other of its big customers over royalties.

In short, we believe that QCOM is worth much more than $74, but we are not convinced that current management will lead us to the promised land. As such, we like the "compromise" offered by proxy advisory firm ISS, which is recommending that shareholders vote for four of the six directors put forth by Broadcom in the March 6 proxy fight, which would NOT give the suitor control of the 11-member board. Of course, as ISS stated, such a mixed board would "require appropriate and demonstrable flexibility on both sides."

ISS added, "The Qualcomm board has yet to communicate to Broadcom (in the course of private discussion) its expectations regarding an acceptable equity value range. This continues to raise the question of whether the incumbent board is engaging with seriousness and an objective to maximize shareholder value." Yet, the firm also said that Qualcomm has "created more certainty for investors on its standalone plan by raising its own offer to buy NXP," and added that Qualcomm isn't paying too much and is giving "sound strategic rationale" for the purchase.

The bottom line is that we would like to see Broadcom and Qualcomm sit down to work out a truly fair price that provides adequate compensation to QCOM shareholders if the regulatory hurdles cannot be surmounted. A mixed-board would seem the best option, rather than simply seeing entrenched management continuing to fail to seriously negotiate or allowing Broadcom to force through a questionable $79.00 or $82.00 offer.

Shares of **Mosaic** (MOS – $28.74) jumped more than 11% last week after the fertilizer and agricultural chemical firm posted Q4 financial results that were better than consensus analyst estimates. MOS reported adjusted earnings per share of $0.34, versus estimates of $0.28, on sales of $2.1 billion (vs. $1.9 billion est.). Revenue for the period was primarily driven by higher realized prices throughout its businesses. Improved operating earnings during the quarter were driven by higher gross margins in both Potash and Phosphates.

"After a strong fourth quarter, we entered 2018 with positive market momentum and expect this year will be a transformational year for Mosaic," said CEO Joc O'Rourke. "The addition of Vale Fertilizantes, the construction completion of the Ma'aden phosphate project and progress on the Esterhazy K3 complex further enhance our position as a world class, global fertilizer company. Now that the Vale Fertilizantes acquisition is closed, our focus shifts to delivering the targeted $275 million of synergies and operational improvements from the combined Brazil businesses. We are confident in our ability to execute and get back to our through-cycle balance sheet targets by the end of 2020."

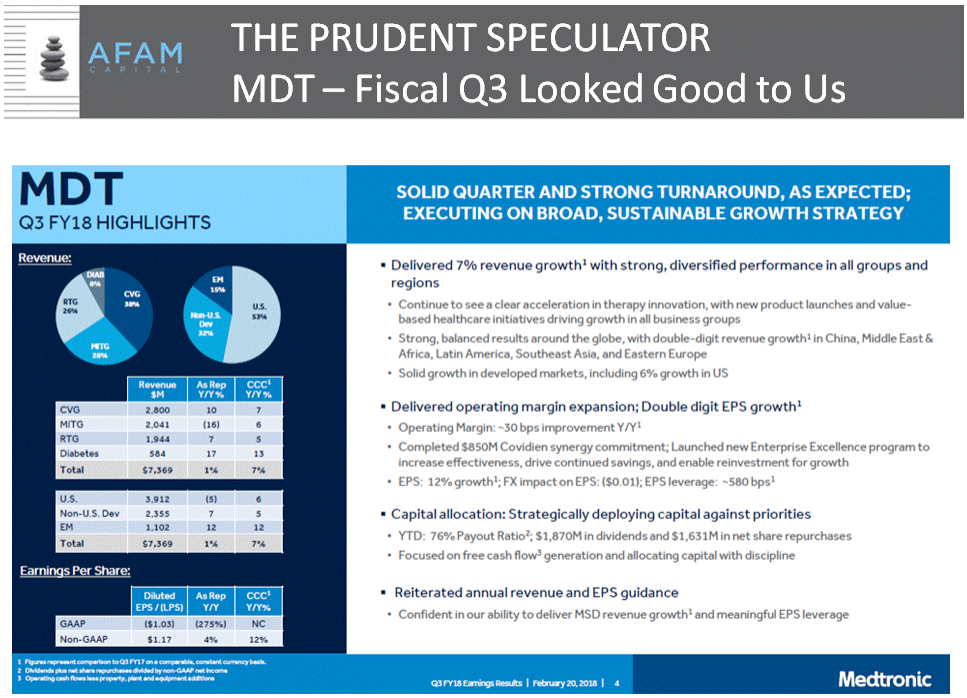
The enactment of the Tax Cuts and Jobs Act resulted in a non-cash $458 million charge during Q4. Additionally, while the company's long term, through-cycle tax rate is expected to decline marginally from the low 20% range, Mosaic anticipates an approximate $200 million reduction in cash taxes paid over the next five-year period. The estimated effective tax rate for 2018 is in the 20% range.

"We are optimistic about 2018," Mr. O'Rourke concluded. "We are seeing improving market conditions in both potash and phosphates, which, combined with benefits from our actions across our three business units, puts Mosaic in an excellent position to create value for all of our stakeholders."

Highly cyclical Mosaic shares are still down over the last 12 months, but we think the earnings news is a sign that some tailwinds are emerging as it continues to battle through a challenging operating environment. We continue to believe that the company will be a major long-term beneficiary of the global agricultural story (growing population demanding a higher protein diet as well as a shortage of arable land requiring more crop nutrients to produce better yields), while it should be a significant global competitor. We think that further levels of commodity price recoveries will significantly benefit MOS. Our Target Price has been hiked to $44.

Health care equipment developer and manufacturer **Medtronic** (MDT – $80.39) reported adjusted earnings per share of $1.17, which were in line with consensus forecasts for fiscal Q3 2018, on sales of $7.37 billion, which outpaced analyst predictions of $7.20 billion. Despite delivering the best revenue growth (6.6%) the company has seen in years and strong 11% EPS growth, MDT shares fell a bit more than 3% on the week. Seemingly, the investment community remains skeptical of the company's ability to consistently deliver appealing EPS growth. Additionally, negative commentaries from analysts that floated about after the release focused more on limited Q3 operating margin leverage and management comments on 2019 headwinds than on the robust Q3 revenue growth.

Despite the weakness in shares, Chairman and CEO Omar Ishrak offered the following positive comments on the quarter. “Our results reflect a solid quarter for Medtronic, and as we expected, a strong turnaround from the first half of our fiscal year. We continue to execute on our broad, sustainable growth strategy, driving therapy innovation and global market penetration, while delivering enterprise synergies to enable margin improvement.”



For fiscal year 2018, the company continues to expect comparable, constant currency revenue growth to be in the range of 4% to 5%. While the impact of foreign currency remains fluid, if current exchange rates remain similar for the remainder of the fiscal year, the company's revenue would be positively affected by approximately $480 million to $500 million, including an

approximate $300 million to $320 million positive impact in the fourth fiscal quarter. The company continues to expect diluted adjusted EPS growth to be in the range of 9% to 10% on a comparable, constant currency basis from the prior year comparable EPS of $4.37.

“Looking ahead, we are confident in our ability to deliver mid-single digit constant currency revenue growth and strong constant currency EPS leverage, this fiscal year and beyond,” said Mr. Ishrak. “We remain keenly focused on executing to deliver dependable results as we continue to leverage our global diversification and scale to fulfill our Mission of alleviating pain, restoring health, and extending life for millions of people around the world.”

We think the negative response to fiscal Q3 performance was overdone and incorrect. We believe that MDT continues to offer appealing long-term returns and continue to think that the acquisition of Covidien a few years ago has produced a stronger and more appealing company. Pairing MDT’s diversified product portfolio aimed at a wide range of chronic diseases with Covidien’s breadth of products for acute care in hospitals has strengthened the firm’s position as a key partner for its hospital customers, which boosts our optimism about the long-term growth prospects. We remain fans of Medtronic’s diverse portfolio, as when certain product lines wane, new offerings are seemingly always rolled out to help offset slowdowns and foster growth. With domestic demographic trends in its favor, we like its products and pipeline, including treatments for atrial fibrillation, aortic stenosis and various neurological disorders. MDT yields 2.3% and trades at less than 16 times NTM adjusted EPS projections. Our Target Price for MDT has been bumped up to $101.

HollyFrontier (HFC – $45.00) reported Q4 adjusted earnings per share of $0.70, versus consensus analyst estimates of $0.83. Despite the miss on the bottom-line, the oil and gas refiner had sales of $3.99 billion, more than 8% better than what investors were expecting, while EPS grew markedly on a year-over-year basis from the $0.30 posted in Q4 2016.

HFC’s operations continue to be supported by strong industry fundamentals. CEO George Damiris explained, “In comparison to last year, HollyFrontier's significant financial improvement for the fourth quarter reflects both better refinery operations and the improved macroeconomic environment. Additionally, Lubricants and Specialty Products had a strong fourth quarter led by the Rack Forward Business. We are excited about 2018 based on our improving refinery reliability, our positive outlook for both product cracks and crude spreads, as well as the growth potential of converting a higher percentage of base oil sales into finished products.”

Industry experts are expecting heavy Canadian differentials to persist, given pipeline bottlenecks, which should benefit HFC due to its refineries' proximity to Canadian crude. Additionally, with the outlook for cash flow generation continuing to improve, management expects to resume share repurchases in 2018.

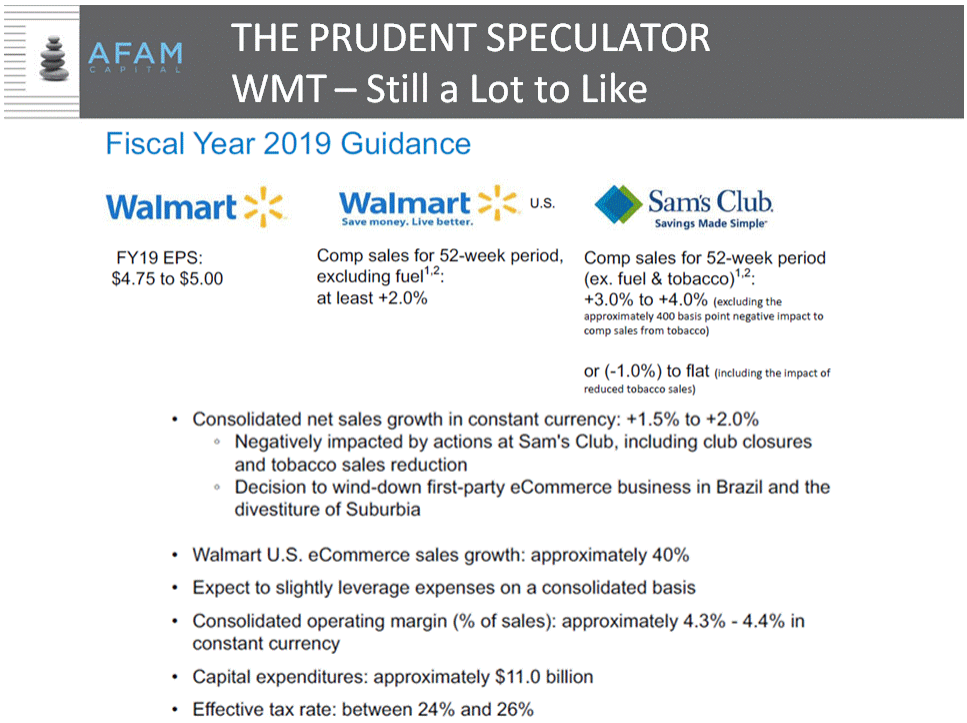
Though the company has a sizable amount of long-term debt ($2.5 billion) at last count, we like that HollyFrontier has a decent balance sheet and has kept operating costs under control. With continued opportunity for improved industry fundamentals and company execution, analysts project Holly to deliver adjusted earnings per share of $3.68, $3.96 and $4.23 for 2018, 2019 and 2020, respectively. HFC shares currently trade at 12.4 times NTM expected adjusted EPS and yield 2.9%. Our Target Price is now $57.

Discount superstore chain **Walmart** (WMT – $92.89) saw its shares fall more than 11% last week after reporting its fiscal Q4 2018 financial results. While revenue for the period of $136.27

billion was better than consensus estimates of $134.8 billion, adjusted EPS for the three months of $1.33 fell 3% short of what investors were looking for. Although bottom line results disappointed, what really bothered numerous analysts and investors alike was that WMT said that online sales growth came in at "only" 23% (well short of where it has been). While we obviously don't like to see this data point weaken with the ongoing battle for sales with the likes of Amazon, especially considering previous sales growth had been 40%-plus for the past few quarters, we think the reaction was way overdone as this is not only just one quarter of data, but also is for a portion of Walmart's business that represents just 4% of overall revenue.

On a brighter note, Walmart's U.S. same store comparative sales increased 2.6%, and comp traffic increased 1.6%. On a two-year-basis, comparative sales growth of 4.4% marked the best performance in eight years. Net sales at Walmart International were $33.1 billion, an increase of 6.7%, and excluding currency, those sales were $31.9 billion, an increase of 2.8%. Nine of eleven markets posted positive comp sales, including WMT's four largest markets.

For the coming fiscal year (2019), WMT sees its U.S. comparative store sales increasing 2%, while management believes its Sam's Clubs will see a 3% to 4% improvement. Despite concerns over online sales, WMT forecasts eCommerce sales growth to be at least 40% over the next year. Adjusted EPS for fiscal 2019 is expected to come in between $4.75 and $5.00, impacted by continued capital expenditures (approximately $11 billion) used to further transform WMT for the future. Wal-Mart also announced that following U.S. Tax Reform, its sees its effective tax rate falling to between 24% and 26%.



"We have good momentum in the business with solid sales growth across Walmart U.S., Sam's Club and International. We're making real progress putting our unique assets to work to serve customers in all the ways they want to shop, and I want to thank our associates for their great work this past year. We're making decisions to position the business for success and investing to win with customers and shareholders," said CEO Doug McMillan

While we know that WMT's competitive landscape will only get more intense versus rivals Amazon, Target and numerous others, we think that the steps the company has taken over the last few years to transform itself has it on the right track for long-term success. We continue to like that WMT generates strong free cash flow and remains committed to returning capital to shareholders via buybacks and dividends (the stock yields 2.2%). While the forward P/E ratio is still above 18, we believe that this is not unreasonable given the amount of investment the firm has been making in its operations (noting that if this was marginally slowed, earnings would materially jump). All said, our Target Price for WMT is now $110.

Shares of industrial concern **Trinity Industries** (TRN – $33.57) were down more than 3% last week following the company's Q4 financial results release that showed revenue almost 14% below consensus expectations, while adjusted EPS were largely in line with expectations. For the three month period, Trinity reported adjusted EPS of $0.43 on revenue of $906 million. Unadjusted EPS for the quarter came in at $3.42, which included a one-time $3.03 per share benefit related to the effects of the Tax Cuts and Jobs Act, partially offset by $0.04 per share of transaction costs incurred related to the company's planned spin-off transaction of its infrastructure business. Not including the impact of the planned spin, TRN reported a backlog of almost $3.2 billion.

"2017 was an eventful year for our company, with a number of positive events occurring. From a consolidated financial results standpoint, we outperformed our original expectations heading into the year. Despite persistent oversupply conditions throughout the year in the North American railcar and inland barge markets, our teams were able to maintain operational flexibility and adjust to demand fluctuations," said CEO Timothy R. Wallace.

Mr. Wallace continued, "In September, we were very pleased to receive the reverse and render ruling from the U.S. Court of Appeals for the Fifth Circuit in the Company's federal False Claims Act litigation. Over the course of 2017, Trinity's management and Board of Directors continued to spend a great deal of time evaluating a variety of strategic options to create shareholder value, culminating in our recent announcement to spin-off Trinity's infrastructure-related businesses. This year will be a transformational year for Trinity as we implement our plan. We are enthusiastic about the opportunity to maximize shareholder value through the creation of two strong, independent companies."

The 2018 earnings guidance reflects consolidated results for the company and has not been adjusted to incorporate the proposed completion of a potential spin-off transaction. Trinity now anticipates earnings of between $1.15 and $1.35 per common diluted share, excluding transaction costs of approximately $25 million that it expects to incur related to the potential spin-off and with a revised effective tax rate of 24% as a result of the Tax Cuts and Jobs Act. Total earnings for the full year 2018, including the additional transaction costs, are anticipated to be between $1.00 and $1.20 per common diluted share. This compares to previous guidance of between $0.90 and $1.25 per share, which did not include any spin-off related costs and assumed an effective tax rate of 36%.

The company now anticipates 2018 railcar deliveries of 20,500, compared to deliveries of 18,395 railcars in 2017. The company also anticipates sales of leased railcars of approximately $350 million in 2018. Finally, we would expect management to be buying back stock, given the new $500 million share repurchase program effective January 1, 2018 through December 31, 2019, that was put in place two months ago. The buyback currently represents about 10% of the company's market capitalization.

We will continue to study the proposed spin-off and the two resulting companies as we move closer to an action date. Some have postulated that the Trinity rail business as a stand-alone could be an attractive take-out candidate, while the spun-off business could be boosted from increasing North American infrastructure spend. Our Target Price for TRN now stands at $41.

Global construction and engineering firm **Fluor** (FLR – $58.15) posted earnings per share of $0.70, versus an estimate of $0.63, for Q4 of 2017. While shares initially jumped in after-hours trading following the release, the stock was up only slightly on the week, even as Fluor had revenue of $5.03 billion, versus consensus estimates calling for $4.9 billion. Management also announced that the firm's business backlogs totaled $31 billion at the end of 2017.

"Over the past year, we continued strengthening our integrated solutions offering, maintaining a cost-efficient organization and developing predictive analytics and other tools to enhance our project execution capability," said CEO David Seaton. "As we go into 2018, these actions should serve us well with clients across the diverse markets we serve expressing increased optimism in pursuing advantaged projects."

For 2018, the company established initial EPS guidance at a range of $3.10 to $3.50, with the forecast assuming an increase in oil and gas, mining and infrastructure opportunities, and reflecting a new revenue recognition standard and Fluor's current interpretation of recently enacted U.S. tax reform legislation. The company now expects the latter two items to result in a $0.75 to $0.95 increase in EPS.

AFAM CAPITAL

THE PRUDENT SPECULATOR
FLR – Increased Guidance

OUTLOOK

- **Establishing 2018 guidance range of $3.10 – $3.50 per diluted share**
- **Guidance assumes:**
  - Annual G&A expense of approximately $210 to $220 million
  - Tax rate of 25 to 30 percent
  - Annual NuScale expense of approximately $75 million
  - Benefit of new revenue recognition standard and tax reform in the U.S. will be approximately $0.75 to $0.95 per diluted share
    - Approximately 2/3 related to the new revenue recognition standard and 1/3 related to U.S. tax reform
  - Anticipate margins for 2018 as follows:
    - Energy & Chemicals – 6.0 to 7.0 percent
    - Industrial, Infrastructure & Power (incl. mining, excluding NuScale) – 3.5 to 4.5 percent
    - Diversified Services – 4.5 to 5.5 percent
    - Government – approximately 3 to 4 percent

FLUOR 10

While challenges remain for FLR, we think its results in the last half of 2017 and its cost control initiatives have the company heading in the right direction. As we move deeper into 2018, it is yet to be seen if a U.S. infrastructure plan will make it through Congress, but if it does, we would expect Fluor to meaningfully benefit from the numerous projects that would transpire from such legislation. Given the recent results and the potential catalysts that are ahead, we have boosted

our Target Price for FLR to $69.

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