

#### **MARKET COMMENTARY MONDAY, APRIL 16, 2018**

#### **EXECUTIVE SUMMARY**

Roller-Coaster Friday – Short-Term Gyrations Not Easy to Explain
Keep Calm and Carry On – Syria the Latest Scary Headline
Buckingham and Fink on Market Timing – Don't Do It
Sentiment – Investors Turn Very Pessimistic; Major Indexes Rally 2%
Reasons for Optimism – Rising Dividends and Earnings
Facts Don't Lie – Least Volatile Start to Year in History...Using the Proper Measuring Stick
Target Prices – Updated Listing to be Posted This Evening
Stock News – Updates on PNC, JPM, WFC & DAL

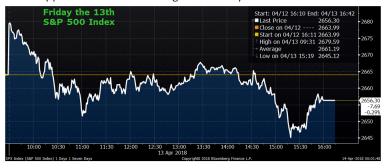
#### **Market Review**

Friday's market action provided another vivid illustration of the silliness of attempting to explain daily market gyrations. *The Associated Press*, in that day's morning papers told us that Thursday's 294-point move higher in the Dow Jones Industrial Average was because, "Investors got ready for big banks to announce their first quarter results and let go of some of their concerns about the trade dispute between the United States and China." Indeed, one investment strategist proclaimed, "Part of the reason the markets were strong this week is in anticipation of perhaps better-than-expected earnings."

That certainly made sense, especially when the big banks actually announced Q1 EPS that topped expectations before the open of trading on Friday. *Bloomberg's Daybreak* column reported, "Jamie Dimon got Wall Street's latest earnings season off to a good start. Increased market volatility helped JPMorgan's trading income rise 7% in the first quarter, driven by equity gains. Return on equity was 19%, topping the bank's medium target. The shares rose premarket. Citigroup delivered a solid earnings beat and equity trading topped estimates at \$1.1 billion, but the FICC business missed forecasts. At Wells Fargo, the efficiency ratio — a key measure of profitability — came in above target at 64.9%. U.S. equity futures pushed higher, following gains in Europe and Asia, as the prospects of a trade war dimmed."

But then, stocks tumbled with *CNBC.com* educating us around mid-day, "Bank shares initially traded higher before falling, as the strong results were already priced in. The SPDR S&P Bank ETF (KBE) fell 1.8 percent, while J.P. Morgan dropped 3.5 percent." If the strong results were already priced in, why were the futures higher on the favorable earnings news and why did the bank stocks rise on the open?

Equities opened trading on 4.13.18 sharply higher on the back of strong bank earnings, but prices quickly reversed because the excellent results supposedly were already priced in, before the selling accelerated due to fears of holding stocks into the weekend, only to see a sizable bounce for no apparent reason that mitigated the day's losses.



To be fair, analysts did find some nits to pick with the bank-stock results (we actually chose to raise our Target Prices – see our discussion below), so the early gains quickly evaporated with the S&P 500 bouncing around modestly below the breakeven line. However, as the final hour of trading approached, the markets began another leg down, with the pundits suggesting that many folks would not want to hold stocks into the weekend on worries about a possible U.S.-led strike on Syria and/or continued trade tensions.

That appeared to be a reasonable assertion until the indexes moved sharply higher, cutting in half the intra-day declines, with it anyone's guess as to why investors somehow gained more courage about being able to survive the scary weekend. This was especially true when five hours later, the U.S., U.K. and France launched airstrikes against Syria, focusing on the Assad regime's chemical weapons. According the Pentagon, the mission targeted a scientific research center used to develop and produce chemical and biological agents, a chemical-weapons storage facility and a military command post.

Though it was relatively limited in scope and was supposedly a one-time event, the military action did draw a strong rebuke from Syrian allies Iran and Russia, but thus far there has been no immediate major response from Moscow. The Wall Street Journal reported, "Russia wasn't planning to strike back unless it's troops were hit," said Ivan Konovalov, an independent military analyst. "It's clear that the U.S., U.K. and France did everything they could to prevent that from happening." U.S. Ambassador to Russia Jon Huntsman said in a statement that Moscow was warned ahead of time of the strike "to reduce the danger of any Russian or civilian casualties."

No guarantee, of course, that the Syrian situation won't evolve into something much worse, and we know that there are plenty of other issues to worry about on the geo-political stage, but we would not alter our long-term investment strategy in hopes of somehow avoiding the next big downturn. That was one of your Editor's admonitions in a relatively lengthy interview last week on *Bloomberg Radio*(https://www.bloomberg.com/news/audio/2018-04-11/bloomberg-markets-zuckerberg-faces-congress-fomc-minutes – the Buckingham portion starts around minute 21),

and our long-held view that the only problem with market timing is getting the timing right was also echoed last week by Lawrence Fink.

The CEO of Blackrock, the nation's largest asset management firm, told *CNBC Television*, "I think we spend too much time talking about market timing. And our big thrust is focusing on being in the market, all the time, because most of us are not good enough at market timing. For those who have been in the market, stayed in the market after the 2008 crash into 2009, really benefited. And those who ran way really were quite harmed by that action. And so, at the time when you had the greatest fear that was probably the time to buy the most. So, the key for investors is staying in the market."

Last week helped illustrate the point that time in the market trumps market timing, as despite the pullback on Friday and continuing concerns about the trade battle with China, the S&P 500 and Russell 3000 indexes enjoyed respective gains of 2.04% and 2.01% over the five trading days. And the advance arrived just as investors had become the most pessimistic they have been in more than a year. Indeed, according to the American Association of Individual Investors (AAII), "At current levels, pessimism is unusually high and optimism is unusually low." Sadly, or happily, depending on one's perspective, the AAII folks often have been great contrarian indicators!



Warren Buffett states, "Be greedy when others are fearful and fearful when others are greedy," and the weekly AAII Bull-Bear Spread and subsequent performance supports the Oracle of Omaha's assertion...at least on the "others are fearful" argument. And the latest -16.7 reading is in the lowest 10% (people are scared!) of the 1600+ weekly calcs.



While equities historically have proved the place to be for long-term-oriented investors, no matter the disconcerting headlines that seem to always pop up, with average annualized gains over the past nine decades of 10.6% for Dividend Payers and 13.4% for Value Stocks, our current enthusiasm is supported by favorable dividend yield comparisons. Our newsletter portfolios sport yields in the 2.6% to 2.8% range, and provide excellent income relative to the current 2.8% yield on the 10-year U.S. Treasury. And even the S&P 500's yield of 2.0% looks pretty attractive, especially as we think dividends are likely to continue to grow over time (137 members of the S&P 500 have boosted their payouts so far in 2018),...

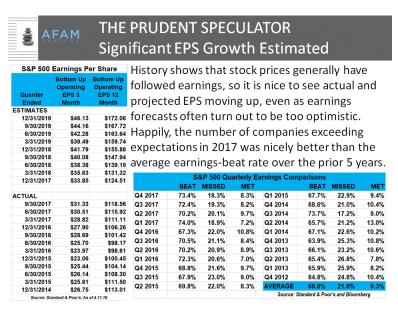
# THE PRUDENT SPECULATOR Dividends Have Grown Over Time

While dividends are never guaranteed, the historical evidence suggests that Corporate America has a long history of raising quarterly payouts, whereas the coupons on most debt instruments are fixed.

| COUNT OF S&P    |                |             |           |            |
|-----------------|----------------|-------------|-----------|------------|
| 500 DIVIDEND    |                |             |           |            |
| ACTIONS         | INCREASES      | INITIATIONS | DECREASES | CESSATIONS |
| 2018 (YTD)      | 137            | 1           | 0         | 0          |
| 2017            | 351            | 5           | 9         | 2          |
| 2016            | 344            | 7           | 19        | 2          |
| 2015            | 344            | 7           | 16        | 3          |
| 2014            | 375            | 8           | 8         | 0          |
| 2013            | 366            | 15          | 12        | 0          |
| 2012            | 333            | 15          | 11        | 1          |
| 2011            | 320            | 22          | 5         | 0          |
| 2010            | 243            | 13          | 4         | 1          |
| 2009            | 151            | 6           | 68        | 10         |
| 2008            | 236            | 5           | 40        | 22         |
| 2007            | 287            | 11          | 8         | 4          |
| 2006            | 299            | 6           | 7         | 3          |
| 2005            | 306            | 10          | 9         | 2          |
| Source: Standar | d & Poor's. As | of 4.11.18  |           |            |

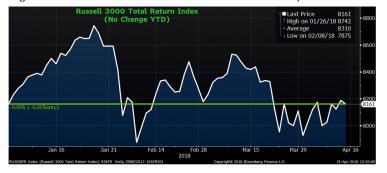
| S&P 500                          |         |  |  |  |  |
|----------------------------------|---------|--|--|--|--|
| DIVIDENDS PER                    |         |  |  |  |  |
| SHARE                            |         |  |  |  |  |
| 2019 (Est.)                      | \$57.65 |  |  |  |  |
| 2018 (Est.)                      | \$53.39 |  |  |  |  |
| 2017                             | \$50.47 |  |  |  |  |
| 2016                             | \$46.73 |  |  |  |  |
| 2015                             | \$43.49 |  |  |  |  |
| 2014                             | \$39.44 |  |  |  |  |
| 2013                             | \$34.99 |  |  |  |  |
| 2012                             | \$31.25 |  |  |  |  |
| 2011                             | \$26.43 |  |  |  |  |
| 2010                             | \$22.73 |  |  |  |  |
| 2009                             | \$22.41 |  |  |  |  |
| 2008                             | \$28.39 |  |  |  |  |
| 2007                             | \$27.73 |  |  |  |  |
| 2006                             | \$24.88 |  |  |  |  |
| 2005                             | \$22.22 |  |  |  |  |
| Source: Bloomberg. As of 4.13.18 |         |  |  |  |  |

...as the outlook for corporate profits remains very robust, with Standard & Poor's now estimating bottom up operating EPS for the S&P 500 of \$155.88 this year and \$172.06 in 2019, up markedly from \$124.51 last year.



Certainly, the markets are likely to remain very volatile, when looked at on a minute-by-minute, hourly, daily or even weekly basis, but we trust that nearly all of our followers are actually investing for the long-term. As such, we think it is far more important to utilize the proper lens when viewing one's portfolio. After all, while a legendary Wall Street luminary like John Bogle might somehow find the current market environment to be the most volatile in his six-plusdecade career, if one measured volatility with a three-and-one-half-month yardstick, 2018 thus far has been the least volatile span in history, given that the Russell 3000's year-to-date total return is 0.00%!

Given that the Russell 3000 Index presently stands with a 0.00% year-to-date total return (i.e. no change), one could argue that 2018 has been the least volatile year in history thus far, assuming only two check-ins on the market, one on New Year's Day and one on the Ides of April. And long-term-oriented investors should care little about daily fluctuations.



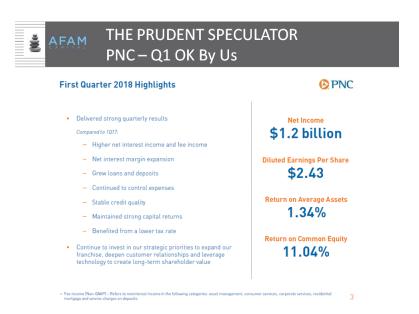
#### **Stock Updates**

Come what may with short-term price movements, we expect to be raising our long-term fair valuation targets for most of our stocks over the next few weeks as Q1 earnings reporting season kicks into high gear. We will be posting updated Target Prices to our Web site theprudentspeculator.com later today and Jason Clark and Chris Quigley take a look at four of the early reporters...

Despite delivering a relatively solid quarter that saw the big bank meet analyst bottom-line expectations, shares of **PNC Financial Services** (PNC – \$145.46) tumbled 4.6% on Friday. For Q1, PNC reported adjusted EPS of \$2.43, versus \$2.06 in the year-ago period. Net interest margin increased to 2.91% in Q1, which was a bump up from Q4 of 2017 (2.88%) and Q1 of 2017 (2.77%).

CEO Bill Demchak commented, "PNC delivered another quarter of strong earnings. Our expanded net interest margin, well-managed expenses and stable credit quality contributed to our results as we maintained strong capital returns. We see loan demand strengthening and look forward to launching our national retail digital strategy as the year goes on, and we continue to invest in our strategic priorities to expand PNC's franchise, deepen customer relationships and leverage technology to create long-term shareholder value."

While Q1 results weren't boosted by the one-time gains from the new tax law that the company realized in Q4, the bank did benefit from a lower effective tax rate (17%). The company also delivered return on average assets of 1.34%, compared with 1.19% in the same period of 2017, and achieved a return on equity of 11.0%, compared with 9.5% a year ago.



Though we know that competition for deposits will continue to rise, we have been relatively pleased with PNC's ability to control overall costs. Additionally, we like that overall credit quality has remained strong. We support management's continued effort to evolve the firm and we think the firm's asset management business will add to the bottom line. PNC shares currently trade for 13.4 times NTM earnings projections, while the dividend yield is 2.1%. The market may not have been enthused by the numbers, but our Target Price for PNC has been edged up to \$167.

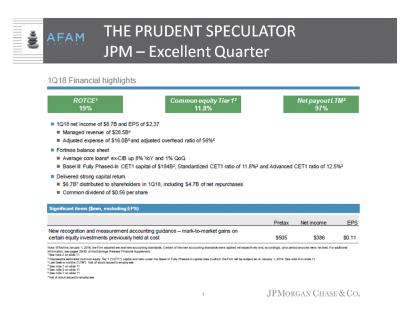
Despite delivering stellar Q1 results, shares of **JPMorganChase** (JPM – \$110.30) fell 2.7% on Friday. The banking powerhouse posted adjusted EPS of \$2.31, versus consensus analyst estimates of \$2.28. Average core loans were up 6%, with strength in commercial and consumer banking, while net charge-offs were only modestly higher. Credit card and auto loans added to the consumer banking segment revenue being up 15%, along with 6% deposit growth and higher net interest income.

JPM CEO Jamie Dimon explained, "2018 is off to a good start with our businesses performing well across the board, driving strong top-line growth and building on the momentum from last year. We have been outpacing the industry on consumer deposit growth while attracting significant net new money and growing client investment assets 13%. Card sales and merchant processing volume both grew double digits, reflecting our investments in new products and innovation focused on our customers' needs."

Mr. Dimon continued, "In the Corporate & Investment Bank we maintained our #1 rank in Global IB fees, including #1 in M&A which grew share in every region. A strong Markets performance was driven by record Equities revenue. Our multi-year investments in Treasury Services and Securities Services are paying off, with revenue up 14% and 16% in those businesses. Commercial Banking continued to see revenue growth driven by rates and good capital markets flows. Despite client sentiment remaining high, the environment is intensely competitive and lending was flat for the quarter. Our Asset & Wealth Management business delivered strong

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results, with long-term net inflows this quarter across all regions, even as volatility returned to the market."



He concluded, "The global economy continues to do well, and we remain optimistic about the positive impact of tax reform in the U.S. as business sentiment remains upbeat, and consumers benefit from job and wage growth. We are committed to doing our part – and this company can be an engine that helps drive inclusive economic growth for all Americans, including our \$20 billion long-term investment in our employees and communities, and we're working to tackle broader issues, like healthcare, that can help the whole country."

We wrote in January that we thought that consensus analyst EPS estimate of \$8.73 for 2018 might be too conservative, and we note that the number now sits at \$8.88, which could still be on the safe side. JPM shares are currently trading for just 12 times NTM projections. We also expect the quarterly dividend of \$0.56 per share to rise in the coming year (current yield is 2.0%). With the continued progress and momentum, we think the financial titan is well positioned for 2018 and beyond. Our Target Price for JPM has been lifted to \$130.

Shares of **Wells Fargo** (WFC – \$50.89) fell more than 3% after the bank reported preliminary Q1 2018 results including a net interest margin that was below the analyst consensus estimate (2.84% vs. 2.88% est.) and cautioned that its final Q1 results may worsen depending on a settlement with regulators. WFC's preliminary report included earnings per share of \$1.12 (vs. \$1.06 est.) in Q1 2018, with management noting that a charge that could reach \$1 billion related to the outcome of a CFPB/OCC matter could wipe out those gains when the company files its SEC 10-Q quarterly report.

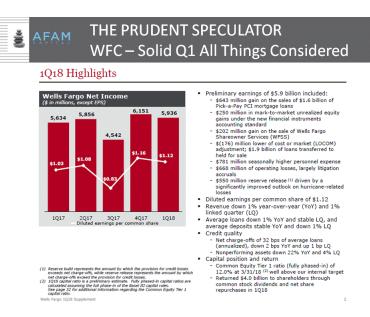
CEO Tim Sloan explained, "These preliminary results are subject to change due to ongoing discussions that we're having with the CFPB and OCC to resolve matters regarding our compliance risk management program and our past practices involving certain automobile collateral protection insurance policies and certain mortgage interest rate lock extensions. The CFPB and the OCC have collectively offered to resolve for an aggregate of \$1 billion in civil

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money penalties. At this time, we're unable to predict the final resolution of the CFPB, OCC matter and cannot reasonably estimate our related loss contingency."

Mr. Sloan added, "As part of our goal of delivering long-term shareholder value, we've been making progress on streamlining and centralizing processes and our organizational structures. Branches continue to play an important part in serving our customers and we will have as many branches for our customers to use for as long as they want to use them. However, our customers are increasingly using our digital channels and digital sessions and they increased 13%from a year-ago while teller and ATM transactions declined 4%. We closed 58 branches in the first quarter and we're on track to close approximately 300 branches this year which is an increase from the 250 branches we announced at our last Investor Day. As we highlighted last quarter, we currently expect our total branch network to decline to approximately 5,000 by the end of 2020. I'm confident that we're on the right path with the transformational changes we are making and with our progress against our six goals. We have more work to do and it will take time to put all of our challenges behind us, but the result will be a better Wells Fargo for all of our stakeholders."

CFO John Shrewsberry said, "From an interest rate risk management standpoint, we're fairly well-balanced, and we will generally perform better in both higher and steeper interest rate environments. We have much larger repricing exposure for both assets and liabilities at the front end of the curve, and our earnings simulations are particularly dependent on deposit rate betas given the scale of that funding source. While we have significantly less assets and liabilities with repricing exposure at the long end of the curve, our net asset sensitivity to long-term rates is a meaningful part of our overall asset sensitivity profile. This sensitivity reflects both the reinvestment and premium amortization that occurs in our long-term debt securities and loan portfolio."



Wells Fargo returned \$4 billion to shareholders via dividends and net share repurchases, an increase of 30% from a year ago. Shares are trading at less than 10.5 times NTM earnings

expectations, and offer a dividend yield of 3.1%. 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 inched up \$68.

Shares of **Delta Air Lines** (DAL – \$52.92) climbed 3% after the Atlanta-based air carrier reported Q1 2018 results that exceeded analyst expectations. DAL earned \$0.74 per share on \$9.97 billion of revenue, compared with analyst estimates of \$0.73 and \$9.89 billion, respectively. Delta expects EPS for Q2 to be between \$1.80 and \$2.00, with full-year EPS in the \$6.35 and \$6.70.

CEO Ed Bastian said, "More customers than ever are choosing Delta because of the great service our people provide and the reliability of the product that we deliver. Not only are we seeing record numbers of passengers, we're also seeing solid improvements in our customer satisfaction scores. We reached all-time high Net Promoter Scores in each geographic region in 2017 and recorded a strong 44% rating domestically for the most recent month of February. All these results are a credit to the dedication and determination of the Delta people. Every day, they make a difference to our customers and they are truly our greatest competitive asset. And I want to thank them and say congratulations for starting the year with \$183 million already made towards next year's profit sharing payment."

"We are seeing Delta's best revenue momentum since 2014, with positive domestic unit revenues, improvements in all our international entities, strong demand for corporate travel and double-digit increases in our loyalty revenues," added Glen Hauenstein, Delta's President. "With our solid pipeline of commercial initiatives, delivered with industry-leading Delta service, we expect to maintain this momentum and deliver total revenue growth of 4 to 6 percent for the full year."

We like that DAL is keeping capacity growth in check (too much capacity is akin to a retailer having too much inventory), is benefitting from a branded credit card agreement with American Express and is continuing to seek out high-value business travelers. We still see DAL as attractively valued with a forward P/E ratio of 8.5 and a dividend yield of 2.3%. With the capacity growth outlook modest and orders on the books for hundreds of new planes, we think that DAL is in a solid position to push fare prices and ancillary fees higher, while benefitting from still-low fuel, maintenance and interest costs. Our Target Price for DAL has been elevated to \$77.

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