MARKET COMMENTARY MONDAY, DECEMBER 18, 2017

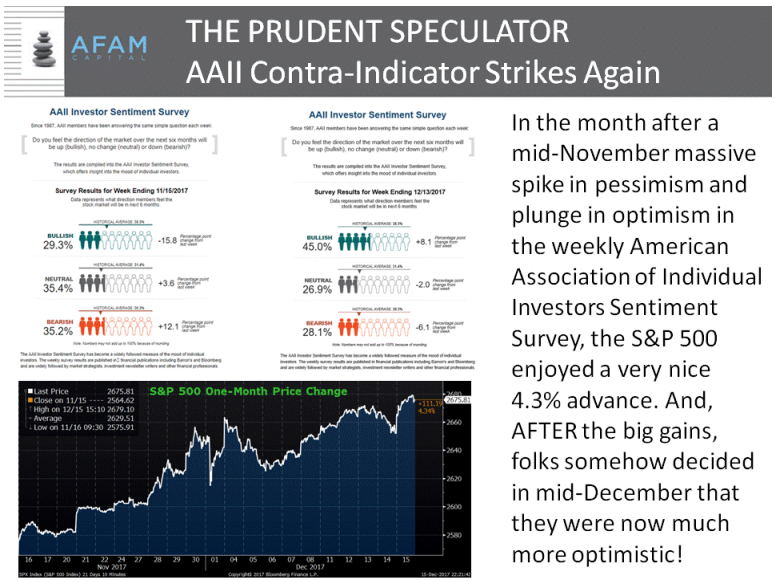
EXECUTIVE SUMMARY

Week in Review – Rally Continues
AAII Sentiment – Contrarian Indicator Strikes Again
Tax Cuts and Jobs Act – 21% Corporate Tax Rate
Target Prices – New Listing in the Process of Being Posted to theprudentspeculator.com
Undervalued High-Tax Payers – 33 *TPS* Favorites
Tax Perspective – Low-Tax Payers Have Outperformed in 2017
Fed Meeting – FOMC Lifts the Fed Funds Rate by Another 25 Basis Points
Economic News – Favorable Developments in the U.S. and Overseas
Time for Value – Undervalued Stocks Do Well When the Fed Funds Rate is Rising
Value vs. Growth – Former Looks Very Attractive
Dividends – Favorable Comparisons
2018 Outlook – 10% Returns Not Unreasonable
Company News – Updates on CAT, TRN, DIS, BA, DAL, JBL & ORCL

Market Review

A handsome market-wide advance on Friday propelled equities to another positive week, with the S&P 500 gaining 0.95%, while the Russell 3000 rose 0.84%. Growth stocks again beat Value, with a relatively large difference in total return as the Russell 3000 Growth index jumped 1.13% compared to a 0.54% climb for the Russell 3000 Value index.

While we might argue that the American Association of Individual Investors Sentiment Survey remains responsible for the stellar returns over the last month…



In the month after a mid-November massive spike in pessimism and plunge in optimism in the weekly American Association of Individual Investors Sentiment Survey, the S&P 500 enjoyed a very nice 4.3% advance. And, AFTER the big gains, folks somehow decided in mid-December that they were now much more optimistic!

…the obvious catalyst for the recent rally has been the corporate tax cut looking like it might actually becoming a reality. Culminating four weeks or so of heavy wheeling and dealing in Washington, tax reform took a major step forward on Friday when, as The Wall Street Journal put it, “Republicans stood on the verge of delivering the most significant changes the U.S. tax

code in more than three decades, after a series of last minute deals appeared to remove the last big obstacles to passage next week."

The proposed legislation is 1,097 pages long, and many folks in states like California and New York are likely facing a tax hike, rather than a reduction, due to the elimination of the deduction for state and local taxes, but the corporate tax rate is slated to be slashed to 21% from the current 35% level. Also, a 15.5% rate on cash held overseas will potentially compel companies with huge hoards abroad to repatriate some or all of those assets. While both the full House and Senate still need to approve, most seem to think passage is more or less a done deal and the Tax Cuts and Jobs Act is expected to make it to the President's desk for signing before Christmas.

Generally speaking, those companies that have been paying higher taxes should be the biggest beneficiaries of the cuts, but accounting and finance departments across Corporate America will be very busy weighing the impact of the tax law changes and seeing which loopholes might be exploited. As such, it is not cut and dry as to how earnings per share at each company will ultimately be impacted – for example, Citigroup said last week that it may face a one-time $20 billion hit on deferred tax assets and repatriated cash, even as the banking giant should see a nice boost to recurring earnings given that its tax rate over the last four quarters has been in the 30% to 31% range.

As is our hallmark, we will remain patient in terms of any major tax-related tweaks we may eventually make to our portfolios, as we would really like to hear more from our companies about their respective impacts. Of course, we have adjusted upward some of our Target Prices (see theprudentspeculator.com for our latest listing) and we note that Value stocks are generally higher tax payers,…

AFAM CAPITAL

THE PRUDENT SPECULATOR
Higher-Tax Paying *TPS* Stocks

TAX CUT STOCKS

Symbol	Common Stock	-2Q Tax Rate	-1Q Tax Rate	0Q Tax Rate	11.15.17 Price	12.15.17 Price	1-Month % Chg	Target Price	Sector	P/E	P/S	P/TBV	EV/ EBITDA	FCF Yld	Debt/ TE (%)	Div Yld	Mkt Cap
BAC	Bank of America	26%	37%	29%	$26.79	$29.04	8.4%	$34.86	Banks	16.6	nmf	1.7	nmf	nmf	nmf	1.7%	302,905
WFC	Wells Fargo	27%	28%	32%	$53.75	$59.87	11.4%	$63.88	Banks	14.6	nmf	1.9	nmf	nmf	nmf	2.6%	294,816
ARII	American Railcar	39%	45%	41%	$36.44	$39.95	9.6%	$51.73	Capital Goods	14.5	1.5	1.4	7.7	-5.5	95%	4.0%	762
BA	Boeing	26%	29%	30%	$262.86	$293.94	11.8%	$306.97	Capital Goods	30.1	1.9	nmf	15.3	6.4	nmf	2.3%	175,064
CAT	Caterpillar	31%	31%	31%	$134.10	$146.69	9.4%	$156.01	Capital Goods	26.4	2.1	12.0	17.8	5.1	342%	2.1%	87,271
DE	Deere & Co	32%	28%	29%	$132.27	$150.87	14.1%	$158.61	Capital Goods	25.5	1.6	5.8	8.0	-0.8	312%	1.6%	48,474
TPC	Tutor Perini	37%	38%	26%	$23.10	$27.10	17.3%	$35.75	Capital Goods	14.1	0.3	1.4	8.7	0.4	90%	0.0%	1,349
TRN	Trinity Industries	29%	41%	37%	$32.84	$36.71	11.8%	$42.39	Capital Goods	24.5	1.4	1.7	9.5	1.6	102%	1.4%	5,572
MAN	ManpowerGroup	34%	36%	37%	$124.62	$124.82	0.2%	$137.25	Comm/Pro Services	18.6	0.4	8.1	10.2	5.1	46%	1.5%	8,272
MDC	MDC Holdings	39%	35%	32%	$30.72	$31.55	2.7%	$50.28	Consumer Durables	11.3	0.7	1.3	11.8	11.0	62%	3.2%	1,770
COF	Capital One Fin'l	28%	30%	28%	$87.63	$96.31	9.9%	$113.87	Diversified Financials	12.7	nmf	1.5	nmf	nmf	nmf	1.7%	46,686
SYF	Synchrony Fin'l	36%	37%	37%	$32.53	$37.19	14.3%	$44.84	Diversified Financials	14.2	nmf	2.3	nmf	nmf	nmf	1.6%	29,105
CVS	CVS Health	37%	41%	38%	$69.80	$73.08	4.7%	$127.33	Food/Staples Retailing	12.8	0.4	nmf	8.2	10.9	nmf	2.7%	74,029
KR	Kroger	33%	35%	36%	$21.61	$26.45	22.4%	$36.70	Food/Staples Retailing	13.6	0.2	11.2	7.1	4.3	629%	1.9%	23,312
WMT	Wal-Mart Stores	33%	33%	34%	$89.83	$97.11	8.1%	$104.38	Food/Staples Retailing	22.2	0.6	5.0	10.1	6.3	63%	2.1%	287,677
TSN	Tyson Foods	34%	27%	32%	$76.21	$81.28	6.7%	$86.81	Food/Bev/Tobacco	15.3	0.8	nmf	11.5	5.1	nmf	1.5%	32,472
CAH	Cardinal Health	32%	26%	34%	$56.83	$63.19	11.2%	$88.76	Health Care Eq/Srvcs	12.0	0.2	nmf	11.0	9.5	nmf	2.9%	19,880
KMB	Kimberly-Clark	27%	28%	29%	$113.43	$118.51	4.5%	$143.28	Household/Personal	19.4	2.3	nmf	12.1	5.1	nmf	3.3%	41,687
ALL	Allstate	31%	32%	31%	$100.38	$103.97	3.6%	$106.85	Insurance	15.3	nmf	2.1	nmf	nmf	nmf	1.4%	37,429
CMCSA	Comcast	32%	35%	34%	$37.18	$39.71	6.8%	$46.34	Media	19.7	2.2	nmf	8.9	6.5	nmf	1.6%	185,595
DIS	Walt Disney	32%	32%	31%	$103.69	$111.27	7.3%	$139.13	Media	19.5	3.0	58.1	11.7	5.0	661%	1.5%	168,052
AEO	American Eagle	32%	34%	35%	$13.87	$17.43	25.7%	$18.73	Retailing	15.7	0.8	2.8	6.5	5.2	0%	2.9%	3,090
DSW	DSW Inc	39%	39%	38%	$19.63	$20.80	6.0%	$29.13	Retailing	15.4	0.6	1.8	6.0	11.2	0%	3.8%	1,664
FL	Foot Locker	33%	30%	35%	$31.20	$45.65	46.3%	$70.65	Retailing	10.8	0.7	2.3	4.8	9.8	5%	2.7%	5,533
KSS	Kohl's	39%	37%	36%	$42.27	$51.35	21.5%	$59.02	Retailing	13.6	0.5	1.7	4.5	11.3	88%	4.3%	8,627
LOW	Lowe's Cos	36%	36%	37%	$78.37	$86.69	10.6%	$114.69	Retailing	19.2	1.0	16.3	10.5	6.2	353%	1.9%	71,932
WSM	Williams-Sonoma	37%	35%	35%	$50.78	$50.70	-0.2%	$64.68	Retailing	14.4	0.8	3.6	6.7	7.0	0%	3.1%	4,268
T	AT&T	34%	34%	37%	$33.81	$38.24	13.1%	$44.84	Telecom Services	13.1	1.5	nmf	7.1	7.0	nmf	5.2%	234,755
VZ	Verizon	31%	36%	32%	$44.11	$52.67	19.4%	$56.31	Telecom Services	14.0	1.7	nmf	7.0	2.5	nmf	4.5%	214,864
ALK	Alaska Air Group	35%	38%	38%	$64.44	$70.83	9.9%	$107.02	Transportation	9.6	1.2	6.1	5.7	6.0	166%	1.7%	8,715
DAL	Delta Air Lines	34%	35%	35%	$49.33	$56.10	13.7%	$72.75	Transportation	11.7	1.0	nmf	5.8	2.1	nmf	2.2%	39,998
FDX	FedEx	37%	30%	39%	$214.45	$240.05	11.9%	$280.20	Transportation	20.2	1.1	7.0	9.6	-0.6	164%	0.8%	64,369
NSC	Norfolk Southern	34%	36%	37%	$126.42	$141.11	11.6%	$147.32	Transportation	22.6	3.9	3.2	11.3	3.2	73%	1.7%	40,378
	Averages:	33%	34%	34%			11.7%			16.8	1.2	6.7	9.1	5.2	171%	2.3%	77,890

As of 12.15.17. -2Q, -1Q and 0Q = Last 3 Fiscal Quarters. nmf=Not meaningful. TBV = Tangible book value. EV/EBITDA = Enterprise value to earnings before interest, taxes, depreciation and amortization. FCF Yield = Free Cash Flow Yield

…while outside of the last month or so, investors really have shown much more interest in lower tax-payers this year…

AFAM CAPITAL

THE PRUDENT SPECULATOR
Myth Busting: Lower Taxes Fully Priced In

Performance by Sector

Sector	Average Return	Average Tax Rate	Number of Companies
Consumer Discretionary	15.6%	29.8%	81
Consumer Staples	10.7%	30.0%	33
Energy	-1.0%	34.4%	29
Financials	40.4%	28.7%	62
Health Care	25.5%	26.7%	54
Industrials	31.9%	31.1%	66
Information Technology	42.6%	22.8%	59
Materials	29.2%	25.1%	23
Real Estate	16.5%	7.6%	19
Telecom Services	-18.7%	29.3%	4
Utilities	20.1%	30.9%	28
Group Average	**19.3%**	**26.9%**	**458**

Performance By Tax Rate Quintile

Quintile	Average Return	Average Tax Rate	Number of Companies
Lowest 20% of Tax Payers	26.0%	12.6%	96
40th Percentile	31.6%	24.3%	91
60th Percentile	25.3%	29.4%	92
80th Percentile	23.6%	34.0%	91
Highest 20% of Tax Payers	19.3%	39.7%	88
Group Average	**25.2%**	**28.0%**	**458**

From 11.08.16 through 12.15.17. SOURCE: Al Frank using data from Bloomberg

The tables were created by taking S&P 500 index members on 10.31.16 and calculating the mean of the last three fiscal years of effective tax rates. Outliers (including those that pushed the effective tax rates above 100%) and effective tax rates below zero were marked as "Not Available" for those year(s). Companies not present for the entire performance period were excluded. For each company, we determined the tax rate used in the analysis by calculating the mean of non-NA values. With 458 companies passing the screen (many that were excluded were in the Energy sector, which has seen extensive accounting losses over the past few years), we sorted either by Sector (top table) or Quintile (bottom table). What we found is that higher tax-payers have underperformed lower tax-payers . So much for investors already completely discounting the 21% rate.

…meaning that we think our broadly diversified portfolios of undervalued stocks are already well positioned to benefit from corporate tax relief.

This is especially true, in our view, given the improving health of the U.S. economy, even without any impact from lower taxes. Indeed, last week, sales at online retailers, brick-and-mortar stores and restaurants rose 0.8% in November from the prior month, well above the 0.3% increase expected and up 5.8% on a year-over-year basis, the best showing since 2011. Jack Kleinhenz, chief economist at the National Retail Federation, commented, "It's an impressive start to the holiday season and probably the best in the last few years. When you put the pieces together, job and wage gains, modest inflation, healthy balance sheet and elevated consumer confidence…there's an improved willingness to spend."

Those sentiments were essentially echoed by the Federal Reserve last Wednesday, when Janet Yellen and Co. raised its target for the Federal Funds rate by a quarter-point to a range of 1.25% to 1.50% and issued a fairly upbeat Statement on Monetary Policy.

AFAM CAPITAL

THE PRUDENT SPECULATOR
FOMC Statement: December 13, 2017

Information received since the Federal Open Market Committee met in November indicates that the labor market has continued to strengthen and that economic activity has been rising at a solid rate. Averaging through hurricane-related fluctuations, job gains have been solid, and the unemployment rate declined further. Household spending has been expanding at a moderate rate, and growth in business fixed investment has picked up in recent quarters. On a 12-month basis, both overall inflation and inflation for items other than food and energy have declined this year and are running below 2 percent. Market-based measures of inflation compensation remain low; survey-based measures of longer-term inflation expectations are little changed, on balance.

Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability. Hurricane-related disruptions and rebuilding have affected economic activity, employment, and inflation in recent months but have not materially altered the outlook for the national economy. Consequently, the Committee continues to expect that, with 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 remain somewhat below 2 percent in the near term but to stabilize around the Committee's 2 percent objective over the medium term. Near-term risks to the economic outlook appear roughly balanced, but the Committee is monitoring inflation developments closely.

In view of realized and expected labor market conditions and inflation, the Committee decided to raise the target range for the federal funds rate to 1-1/4 to 1-1/2 percent. The stance of monetary policy remains accommodative, thereby supporting strong labor market conditions and a sustained return to 2 percent inflation.

At her press conference following the decision on interest rates, outgoing Federal Open Market Committee Chair Yellen elaborated:

Following a slowdown in the first quarter, economic growth stepped up to a solid 3-1/4 percent pace in the second and third quarters of the year. Household spending has been expanding at a moderate rate, business investment has picked up, and favorable economic conditions abroad have supported exports. Overall, we continue to expect that the economy will expand at a moderate pace. While changes in tax policy will likely provide some lift to economic activity in coming years, the magnitude and timing of the macroeconomic effects of any tax package remain uncertain.

AFAM CAPITAL

THE PRUDENT SPECULATOR
Subdued LT Economic Growth Expected

The Fed left its longer-run projection for GDP growth at 1.8%, though its outlook for 2018 growth increased to 2.5%, up from 2.1%. 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

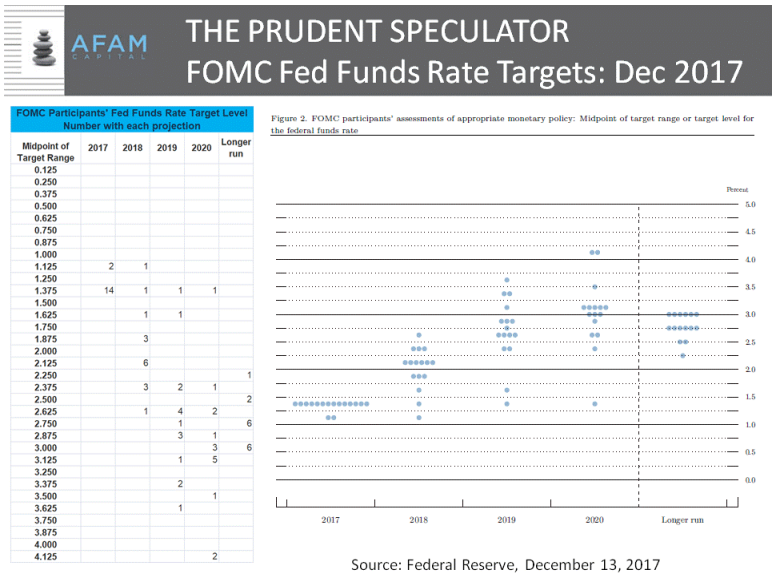
Percent

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

Returning to monetary policy, for the past two years the FOMC has been gradually increasing its target range for the federal funds rate as the economy has continued to make progress

toward our goals of maximum employment and price stability. Our decision today continues this process.

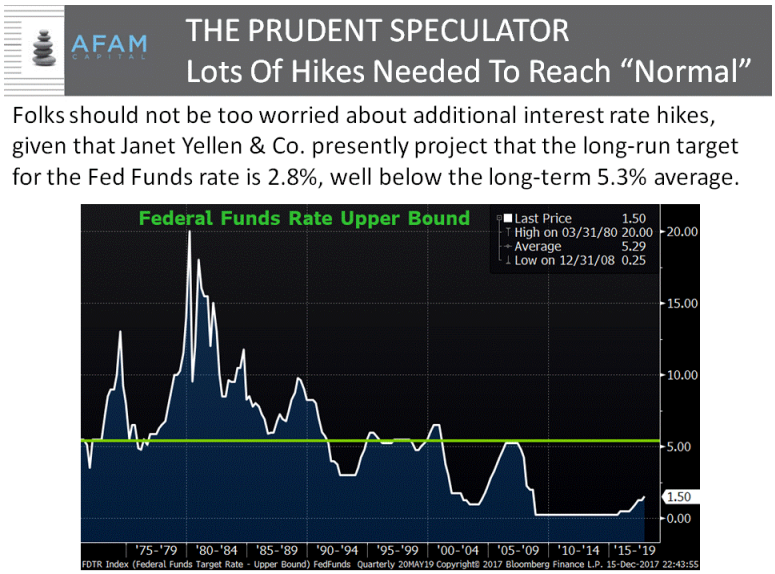


FOMC Participants' Fed Funds Rate Target Level Number with each projection

Midpoint of Target Range	2017	2018	2019	2020	Longer run
0.125					
0.250					
0.375					
0.500					
0.625					
0.750					
0.875					
1.000					
1.125	2	1			
1.250					
1.375	14	1	1	1	
1.500					
1.625		1	1		
1.750					
1.875		3			
2.000					
2.125		6			
2.250					1
2.375		3	2	1	
2.500					2
2.625		1	4	2	
2.750			1		6
2.875			3	1	
3.000				3	6
3.125			1	5	
3.250					
3.375			2		
3.500				1	
3.625			1		
3.750					
3.875					
4.000					
4.125				2	

Source: Federal Reserve, December 13, 2017

We still expect that the ongoing strength of the economy will warrant gradual increases in the federal funds rate. That expectation is based on our view that this rate remains somewhat below its neutral level–that is, the level that is neither expansionary nor contractionary and keeps the economy operating on an even keel. Because the neutral rate currently appears to be quite low by historical standards, the federal funds rate would not have to rise much further to get to a neutral policy stance. But because we also expect the neutral level of the federal funds rate to rise somewhat over time, additional gradual rate hikes are likely to be appropriate over the next few years to sustain a strong labor market and stabilize inflation around our 2 percent longer-run objective. Even so, the Committee continues to anticipate that the longer-run neutral level of the federal funds rate is likely to remain below levels that prevailed in previous decades.



Happily, economic news overseas was also fairly positive with the European Central Bank sounding more optimistic. ECB President Mario Draghi explained on Thursday, “The economic expansion in the euro area continued in the third quarter of 2017, when real GDP increased by 0.6% quarter on quarter, after 0.7% in the second quarter. The latest data and survey results point to solid and broad-based growth momentum. Our monetary policy measures, which have facilitated the deleveraging process, continue to support domestic demand. Private consumption is underpinned by ongoing employment gains, which are also benefiting from past labour market reforms, and by rising household wealth. Business investment continues to strengthen on the back of very favourable financing conditions, rising corporate profitability and strengthening demand. Housing investment has also risen further over recent quarters. In addition, euro area exports are being supported by the broad-based global expansion.”

To be sure, we realize that improving economic data should compel the U.S. Federal Reserve to raise interest rates two or three more times next year, but we like what market history shows in regard to Fed tightening and the performance of Value stocks…

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 4.675%	377	14.7%	11.2%	16.9%	9.9%
More than 4.675%	379	14.4%	8.3%	10.1%	11.2%
3-Month Drop	354	17.4%	11.6%	15.5%	11.7%
3-Month Rise	398	12.3%	8.2%	11.7%	9.6%
6-Month Drop	342	16.6%	11.9%	15.2%	11.9%
6-Month Rise	404	12.9%	7.8%	12.0%	9.3%
12-Month Drop	345	14.6%	10.7%	13.2%	10.7%
12-Month Rise	389	14.2%	8.5%	13.3%	10.1%

From 07.31.54 through 08.31.17. 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 4.675%	379	12.7%	9.2%	13.7%	9.4%
More than 4.675%	379	15.9%	9.8%	12.9%	11.3%
3-Month Drop	354	13.9%	10.2%	14.1%	10.3%
3-Month Rise	389	14.5%	8.7%	12.4%	10.2%
6-Month Drop	342	15.0%	11.2%	15.3%	11.4%
6-Month Rise	398	13.3%	7.8%	11.3%	9.1%
12-Month Drop	345	16.2%	11.5%	16.5%	11.5%
12-Month Rise	389	12.3%	7.4%	10.1%	8.6%

From 07.31.54 through 08.31.17. Subsequent 12-month return. SOURCE: Al Frank using data from Bloomberg and Professors Eugene F. Fama and Kenneth R. French

Many have incorrectly warned that rising rates will prove fatal for equities, but six decades of returns data show that stocks in general have performed admirably 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.

…while the type of companies that we have long favored are now trading at their widest valuation gap relative to Growth stocks since the peak of the Tech Bubble in 2000,…

THE PRUDENT SPECULATOR
Time for Value?

Believe it or not, despite the major market averages residing near record highs, Value stocks (as represented by the Russell 3000 Value index) trade at a lower-than-normal (over the past 22 years) price to book value ratio AND the valuation gap with Growth stocks (Russell 3000 Growth index) is as wide today as it has been since 2000.

From 05.31.95 through 11.30.17. SOURCE: Al Frank using data from Bloomberg

…which was a very good time to steer one's portfolio toward the kind of equities that have delivered the best long-term returns over the last nine decades.

THE PRUDENT SPECULATOR
Value vs. Growth Long-Term Returns

Year-by-Year Russell Returns

Year	Russell 3000 Value	Russell 3000 Growth	Russell 3000 Index
2017 YTD	12.63	29.93	20.99
2016	18.38	7.38	12.72
2015	-4.14	5.09	0.47
2014	12.69	12.44	12.55
2013	32.72	34.22	33.57
2012	17.55	15.21	16.42
2011	-0.10	2.18	1.03
2010	16.22	17.62	16.92
2009	19.71	36.95	28.29
2008	-36.27	-38.46	-37.32
2007	-1.05	11.50	5.17
2006	22.32	9.42	15.68
2005	6.82	5.15	6.10
2004	16.93	6.91	11.94
2003	31.10	30.97	31.04
2002	-15.19	-28.02	-21.54
2001	-4.32	-19.61	-11.44
2000	8.04	-22.42	-7.30
Annualized	7.15	4.17	5.86

Source: Bloomberg and FTSE Russell. As of 12.15.17

Value doesn't always win the short-term battles, as the trouncing inflicted by Growth this year attests, but it has handily won the long-term wars since both 1999 and 1927.

LONG-TERM RETURNS

	Annualized Return	Standard Deviation
Value Stocks	13.3%	26.0%
Growth Stocks	9.3%	21.5%
Dividend Paying Stocks	10.5%	18.1%
Non-Dividend Paying Stocks	8.7%	29.7%
Long-Term Corporate Bonds	6.0%	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 08.31.17. 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

Certainly, we understand that there eventually will be a market pullback as stock prices always move in both directions, while we recognize that many are concerned that the major market averages are trading at historically high valuation multiples. As such, we like the inexpensive nature of the companies that we hold in our equity strategies,…

THE PRUDENT SPECULATOR
Equity Strategies & Benchmark Metrics

CURRENT PORTFOLIO AND INDEX VALUATIONS

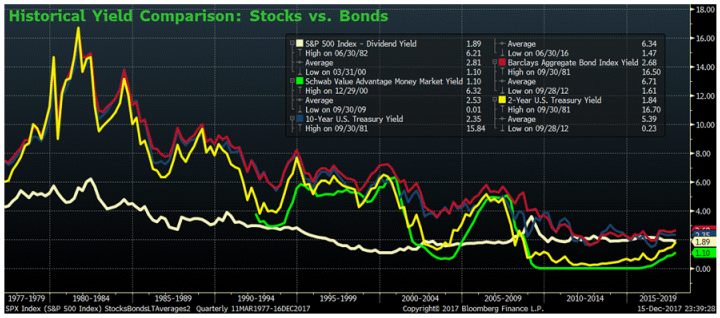
Name	Price to Earnings Ratio	Price to Fwd. Earnings Ratio	Price to Sales Ratio	Price to Book Ratio	Dividend Yield
TPS Portfolio	16.6	14.4	1.2	1.9	2.6
Select Value	17.9	15.0	1.3	2.0	2.2
Select Dividend	17.1	14.8	1.1	2.1	2.9
Select Focused Dividend	15.3	13.7	1.0	2.1	3.2
Select Focused Value	16.4	14.8	1.4	2.5	2.3
Select SMID Dividend	19.2	15.2	0.8	1.7	2.4
Russell 3000	24.0	21.1	2.1	3.1	1.8
Russell 3000 Growth	28.6	24.0	2.8	6.5	1.2
Russell 3000 Value	20.6	18.7	1.6	2.1	2.4
Russell 2000	49.9	33.7	1.2	2.4	1.4
Russell 2000 Growth	79.8	43.8	1.6	4.4	0.8
Russell 2000 Value	35.6	26.9	1.0	1.6	2.0
Russell 1000	23.0	20.4	2.2	3.2	1.8
Russell 1000 Growth	27.2	23.1	2.9	6.8	1.3
Russell 1000 Value	19.9	18.3	1.7	2.1	2.4
S&P 500 Index	22.5	20.0	2.2	3.3	1.9
S&P 500 Growth Index	25.7	22.3	3.4	5.7	1.5
S&P 500 Value Index	19.4	17.7	1.6	2.1	2.4
S&P 500 Pure Value Index	16.5	15.3	0.7	1.6	2.1

As of 12.16.17. 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: Al Frank using data from Bloomberg

…especially from a yield perspective as the income offered by our portfolios compares very favorably to what is available from competing investments,…

THE PRUDENT SPECULATOR
Income Options – Equities Very Attractive

Though the major market averages now trade near all-time highs, the payout on the S&P 500 (1.89%) is still rich when compared to yields on fixed income instruments, and when viewed against the historical averages since we began publishing *The Prudent Speculator* in 1977 for U.S. Treasuries, Money Market Funds and the Aggregate Bond Index.



…while we can't forget that dividend payouts generally rise over time!

AFAM CAPITAL

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 (**Amgen**, **AT&T**, **Abbott Labs** and **Boeing** did so this past week) , whereas the coupons on most debt instruments are fixed. Yes, stock prices are volatile, but they generally have also increased over time.

COUNT OF S&P 500 DIVIDEND ACTIONS	INCREASES	INITIATIONS	DECREASES	CESSATIONS
2017 YTD	346	5	9	1
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
2004	272	10	3	2

Source: Standard & Poor's. As of December 15, 2017

S&P 500 DIVIDENDS PER SHARE	
2018 (Est.)	$53.28
2017 (Est.)	$49.78
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
2004	$19.44

Source: Bloomberg. As of 12.15.17

So, while we are always braced for near-term volatility, an improving economy, stronger corporate profits, reasonably valuations for our stocks, especially given the historically low interest rate environment, and little in the way of investor euphoria has us optimistic about our portfolios as we head into the new year. That said, following back-to-back terrific mid- to high-teen return years, it is difficult to expect that 2018 will match 2016 or 2017, but returns in the 10% range, in line with the historical norm for stocks, would not be surprising, with Value likely outperforming.

Stock Updates

Jason Clark and Chris Quigley provide updates on a seven of our stocks that were in the news last week…

Since we last wrote about and lifted our target price for **Caterpillar** (CAT – $146.69) at the end of October, the machinery maker's shares have continued to grind higher (up more than 7%) as more analysts have climbed on board CAT's momentum train, business in important markets like Brazil has begun to pick up and November global dealer sales were solid, rising for the ninth consecutive month.

The November report showed that worldwide machinery sales continued to improve thanks to renewed strength in Latin America, indicating the worst may be in the rear-view mirror for Brazil as it recovers from recession. Sales in the three months through November rose 26% from a year earlier, the biggest gain since January 2012, as overall Latin American sales jumped 48%. The data showed the sixth straight month of gains in the region, and the biggest increase since July 2011. Latin America sales for CAT had been one of the areas that was most depressed, and as such, we think it is a region capable of a spring-loaded rebound.

We continue to be pleased that the patience we showed with CAT has been rewarded (the stock has a total return of more than 162% since its January 2016 lows) and we are optimistic

about the signs of strength and recovery in several markets it serves. We are choosing to continue to hold our shares for the time being, given the positive momentum they have been enjoying as well as the likelihood for improved earnings going forward. Additionally, with the increasing probability that U.S. tax reform could soon be passed, we wouldn't be surprised to see the current majority in Washington turn some attention to infrastructure, which could be quite beneficial for CAT. That said, while we remain long-term fans of the company and we are choosing to plow forward with our shares, we are keeping close watch on CAT and its increased valuation, especially as the stock is a long way removed from the Wall Street dog house. Our Target Price has been lifted to $156.

Shares of industrial concern **Trinity Industries** (TRN – $36.71) chugged forward last week after the Board unanimously approved a plan to pursue a spin-off of the company's infrastructure-related businesses to shareholders. The separation is planned as a tax-free spin-off transaction to TRN holders for U.S. federal income tax purposes and is expected to be completed in the second half of 2018. Management said that it expects the transaction to result in two separate public companies that will benefit from leading positions in their respective industries, strong free cash flow generation and compelling growth opportunities.

Following the transaction, each company will have distinct corporate strategies and capital allocation priorities: Trinity's portfolio of businesses will consist of rail manufacturing, leasing and services. Management states that Trinity's financial profile is "expected to generate stable cash flows and earnings growth opportunities throughout the manufacturing cycle, giving the company an ability to pursue an optimized capital structure, efficiently allocate capital, and effectively leverage its multiple rail platforms."

The new infrastructure business is being positioned as a growth-oriented company that is focused on infrastructure-related products and services. Per the company, "The infrastructure businesses have leading positions in construction, energy and marine markets throughout North America and are also positioned to grow free cash flows. The new infrastructure company will have the balance sheet strength and capital allocation flexibility to pursue growth through acquisitions and to capitalize on the large and growing market opportunity in North American infrastructure spending, especially if any headway is made on a major domestic infrastructure plan from Washington D.C."

Trinity CEO Timothy R. Wallace added, "We believe establishing two separate, independently focused public companies will allow each company to more closely align its strategic objectives and capital allocation priorities. This will also give the investment community better insight into the potential value our businesses can continue to create. We expect the two companies to be strong, high-performing businesses with the operating acumen and culture to thrive, creating employment opportunities while continuing to provide customers with the high quality products and services they have always expected from Trinity's businesses."

Mr. Wallace concluded, "In 2018, Trinity will reach its 85th year as a company, and its 60th year as a public company. As Trinity has grown through the years, we have attracted incredible teams of dedicated employees who have worked together to build an unparalleled portfolio of industry-leading businesses. Trinity's senior leadership and Board, along with a team of external

advisors have spent a great deal of time analyzing our portfolio of companies. We are proud of Trinity Industries' breadth, scale, and strength and believe that our success to date establishes an excellent foundation for our businesses to continue to build upon our rich legacy. We will continue to update our stakeholders as we progress through this process."

We will continue to study this 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. We also note that management announced a new $500 million share repurchase program as the company's financial position was recently strengthened by a favorable ruling in the long-playing guardrail litigation. We have boosted our Target Price for TRN to $42.

Trying to picture Rupert Murdoch wearing a pair of Mickey Mouse ears is admittedly difficult. That said, he may be willing to wear the iconic head gear after **Disney** (DIS – $111.27) agreed to pay $52.4 billion to buy Mr. Murdoch's 21st Century Fox, after Fox spins off it Fox Broadcasting network and stations, Fox News, Fox Business, FS1, FS2 and Big Ten Network to current Fox shareholders. What Disney will acquire is the Twentieth Century Fox Film and Television studios, along with cable and international TV businesses, including Fox Searchlight Pictures, FX Networks, National Geographic Partners, Fox Sports Regional Networks, Fox Networks Group International, Star India and Fox's interests in Hulu, Sky plc, Tata Sky and Endemol Shine Group. Fox is the home of motion picture assets like *Avatar*, *X-Men*, *Fantastic Four* and *Deadpool*, as well as *The Grand Budapest Hotel*, *Hidden Figures*, *Gone Girl*, *The Shape of Water* and *The Martian*, not to mention television assets like *The Americans*, *This Is Us*, *Modern Family* and *The Simpsons*.

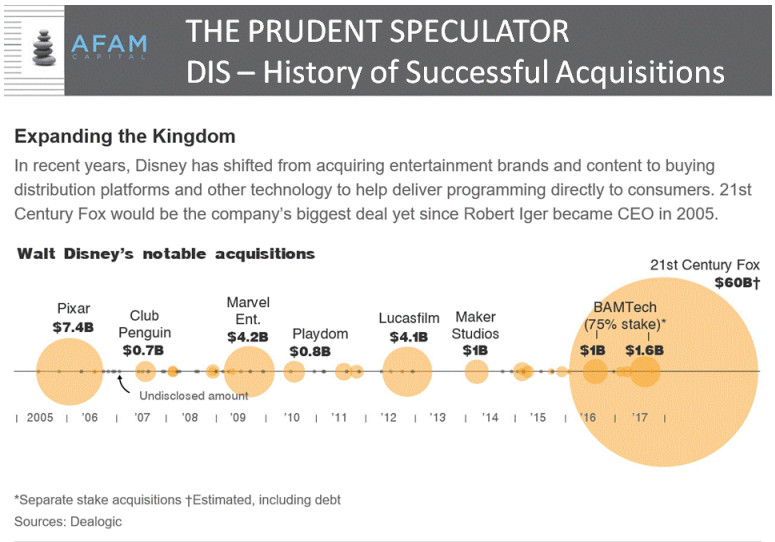
"The acquisition of this stellar collection of businesses from 21st Century Fox reflects the increasing consumer demand for a rich diversity of entertainment experiences that are more compelling, accessible and convenient than ever before," said Disney Chairman and CEO Robert Bob Iger. "We're honored and grateful that Rupert Murdoch has entrusted us with the future of businesses he spent a lifetime building, and we're excited about this extraordinary opportunity to significantly increase our portfolio of well-loved franchises and branded content to greatly enhance our growing direct-to-consumer offerings. The deal will also substantially expand our international reach, allowing us to offer world-class storytelling and innovative distribution platforms to more consumers in key markets around the world."

At the request of both 21st Century Fox and the Disney Board of Directors, Mr. Iger has agreed to continue as Chairman and Chief Executive Officer of The Walt Disney Company through the end of calendar year 2021 (which as a side note would seem to eliminate the possibility that he might make a run for President of the United States in 2020, which had been rumored by many and hoped for by others).

Disney investors seemed pleased by the deal (the stock gained ground), as it allows the company to accelerate its use of innovative technologies, including its BAMTECH platform, while the combined entity's broad international footprint and unparalleled content should bolster efforts to provide a more compelling entertainment experience through its direct-to-consumer

(DTC) offerings. This transaction will enable Disney's recently announced Disney and ESPN-branded streaming offerings, as well as Hulu, to create more appealing and engaging experiences, delivering content, entertainment and sports to consumers around the world wherever and however they want to enjoy it.

Additional rationale for the merger included, "The agreement also provides Disney the opportunity to reunite the *X-Men*, *Fantastic Four* and *Deadpool* with the Marvel family under one roof and create richer, more complex worlds of inter-related characters and stories. Disney's addition of *Avatar* to its family also promises expanded opportunities for consumers to watch and experience storytelling within these extraordinary fantasy worlds. Already, guests at Disney's Animal Kingdom Park at Walt Disney World Resort can experience the magic of *Pandora—The World of Avatar*, a new land inspired by the Fox film franchise that opened earlier this year. And through the incredible storytelling of National Geographic—whose mission is to explore and protect our planet and inspire new generations through education initiatives and resources—Disney will be able to offer more ways than ever before to bring kids and families the world and all that is in it…Disney's international reach should greatly expand through the addition of Sky, which serves nearly 23 million households in the UK, Ireland, Germany, Austria and Italy; Fox Networks International, with more than 350 channels in 170 countries; and Star India, which operates 69 channels reaching 720 million viewers a month across India and more than 100 other countries."



Source: *The Wall Street Journal*

Disney management expects the acquisition to yield at least $2 billion in cost savings from efficiencies realized through the combination of businesses, and to be accretive to earnings before the impact of purchase accounting for the second fiscal year after the close of the transaction. Of course, the deal includes a $2.5 billion breakup fee to 21st Century Fox if the purchase is blocked by federal regulators.

As our clients know, we have long been fans of Disney and we are quite 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. As we adjust our DIS Target Price upward to $139, we also note that Disney's latest installment of *Star Wars* (*The Last Jedi*) hit a stellar approximately $220 million in North American box office receipts and $450 million globally this past weekend (its opening weekend).

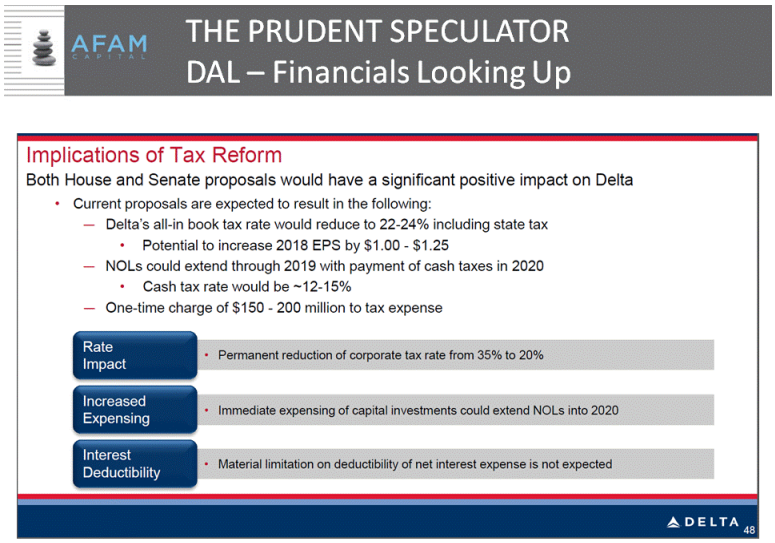
Boeing (BA – $293.94), the giant defense contractor and airplane-maker, gained 2.8% last week after the company raised its dividend by 20% and increased its share buyback plan to $18 billion. The dividend increased from $1.42 quarterly per share to $1.71, with the first payment going out to shareholders of record on 02.09.18, pushing the yield to 2.3%. Boeing did not indicate that the dividend and buyback increases were related to the imminent corporate tax reform. CEO Dennis Muilenburg said, "Boeing's strong and growing cash flow allows us to deepen our commitment to provide competitive returns to our shareholders, while continuing to invest in our people, innovation and growth. To support our balanced cash deployment strategy, our team remains focused on improving operating performance as we deliver on our substantial order backlog and work to capture a larger share of the growing aerospace market."

Although shares did not have any meaningful reactions to the news items, Boeing lost **Delta Air Lines'** (DAL – $56.10) 100-plane order to rival Airbus on Thursday, and saw Canada cancel its order for 18 Super Hornet fighter planes as part of a political spat related to the U.S. Commerce Department's sanctions on Canada-based Bombardier's C Series airplanes. The Bombardier order in question is for Delta to replace its aging smaller aircraft. Boeing's position, with which the U.S. government concurs, alleges that Bombardier engaged in price dumping, allowing Delta to acquire planes far below market value thanks to Canadian subsidies. In addition to denying unfair treatment, Bombardier also notes that more than half of the airplane will be made in the U.S., even though it's put together in Montreal. Delta CEO Ed Bastian, for his part, insists that Delta has done nothing wrong and will have the airplanes delivered without paying a penny of the punitive tariffs. We wouldn't bet against Mr. Bastian.

While we would certainly like Boeing to win every contract it bids for, we think that BA's backlog of more than 5,700 airplanes totaling $412 billion (more than seven years of production) won't be hurt by missing the Delta order. Indeed, Boeing has had a strong 2017, with 661 net commercial aircraft orders. We also like the Defense side of the business, given the drama on the global stage. At present, our Target Price for our remaining BA stake (we have previously captured some of our outsize winnings) stands at $307, but we are keeping a watchful eye on the shares to ensure that the valuation remains defensible.

Before moving on to Tech Land, we also note that Delta offered 2018 guidance this past week, indicating that the company now expects a "4% to 6% increase" in revenue and $5.35 to $5.70 in adjusted EPS (10% to 15% higher than 2017). The airline expects fuel prices to increase from $55 per barrel in 2017 to $64 in 2018. Wall Street was happy with the news, sending shares

more than 4% higher. The company is scheduled to report Q4 results on January 11. We have raised our Target Price for DAL to $73.



Shares of **Jabil** (JBL – $27.87) were flat last week, despite the posting of fiscal first quarter earnings and revenue ahead of analyst estimates. JBL earned $0.80 per share, compared to the Bloomberg analyst consensus of $0.78, and had revenue of $5.59 billion, compared to the $5.50 billion estimate. Jabil benefitted from strong revenue growth in the DMS (Diversified Manufacturing Services) and EMS (Electronic Manufacturing Services) segments.

CEO Mark Mondello said, "Jabil's EMS team is driving a progressive transformation, advancing their methods in which they serve a broad range of end markets. Markets such as energy, industrial, print and retail, automotive, semi-cap equipment, networking/telecom, and data storage. A key element of the transformation is the deliberate pivot towards higher margin businesses, as the team leverages engineering excellence and deep domain knowhow day-in and day-out. In short, this is what we refer to as EMS 2.0. In our DMS segment, starting with our high-growth healthcare and packaging businesses. These two businesses continue to grow at a rate of 20% to 25% per year through fiscal 2019, a true testament to our healthcare and packaging teams as they play squarely in areas undergoing material disruption. Examples of the disruption are the urgent demand for affordable healthcare and the convergence of intelligent, yet fully reliable, consumer packaging, both examples being relevant to Jabil's story. I feel good about the outlook we see across both of these businesses, a sour healthcare and consumer packaging teams create specialized solutions through the use of new technologies and digital innovation."

Mr. Mondello added, "Our 2Q guidance suggests another strong quarter, a quarter of 25% core EPS growth year-on-year and a quarter which would complete a very solid first half to the fiscal year. Moreover, we anticipate the core EPS for the second half of fiscal 2018 to grow 20% to 25% year-on-year when indexed against the back half of fiscal 2017. The result, I believe, will be core earnings in the neighborhood of $2.60 a share for fiscal year 2018. As we focus on cash

flows and earnings, our leadership team remains steadfast in their commitment to complete our two-year capital return framework, while we remain on target to return $1 billion to shareholders by way of stock repurchases and dividends by the end of this fiscal year."

We like Jabil's diversified business, although **Apple** (AAPL – $173.97) continues to be a major customer. The new batch of iPhones launched last month with plenty of fanfare and strong demand, leading us to believe that Jabil's Apple-related orders will continue to hold up. We think that the EMS business is also attractive, especially as the company's products reach a wide array of markets including automotive, energy, industrial, retail, networking, telecom, cloud computing and capital equipment. Of course, we also note that the stock presently trades for just 10.4 times the current EPS estimate for the next 12 months. We have boosted our Target Price for JBL to $42.

Shares of **Oracle** (ORCL – $48.30) dipped 3.8% on Friday after the software giant reported a disappointing outlook, despite beating on the top and bottom lines in its latest fiscal quarter. In fiscal Q2, Oracle earned $0.70 per share (vs. $0.68 est.) on revenue of $9.63 billion (vs. $9.57 billion est.). Oracle's total revenue increased 6% year-over-year, helped by strong growth in Cloud plus On-Premise Software revenue, Cloud Software as a Service (SaaS) and Cloud Platform as a Service (PaaS). Total Cloud segment revenue grew 44% year-over-year to $1.5 billion.

ORCL Founder Larry Ellison said, "This coming January, Oracle will deliver the world's first autonomous database. We expect this innovative new technology to dramatically accelerate the growth of our PaaS and SaaS businesses and keep our database license business strong as well. People are buying database licenses to run on premise and in the cloud. You can run them either place. They're buying options to run on premise and in the cloud. Based on machine learning, now, the new autonomous version of the Oracle Database is totally automated, a self-driving system that does not require human beings to either manage or tune the database. Using artificial intelligence to eliminate most sources of human error, the Oracle Autonomous Database delivers an unprecedented 99.995% system availability. That's less than 30 minutes of planned or unplanned downtime per year."

Mr. Ellison continued, "The Oracle Autonomous Database automatically tunes and upgrades itself without human intervention. If a security vulnerability is detected, the database automatically and immediately patches itself while the system is running. AWS (Amazon Web Services) databases can't do any of this. Even more compelling is the cost comparison between running the Oracle Autonomous Database versus running an Amazon database like Redshift. In a series of published benchmark tests the Amazon Redshift Database on average costs five times more to run the same exact amount of work as the Oracle Autonomous Database. If you take a workload from Amazon running on Redshift and move it over to Oracle, your Amazon bill will drop by 80. And this is not total cost of ownership, this is not labor, this is your Amazon bill, what you pay Amazon to do a piece of work, you can run on the Oracle Cloud and pay $0.20 on the dollar by moving from Amazon to Oracle."

Co-CEO Safra Catz said, "For the upcoming fiscal Q3 in constant currency, Cloud revenue, including SaaS, PaaS and IaaS, are expected to grow 21% to 25%.Total revenue is expected to

range from 2% to 4%. Adjusted EPS in constant currency is expected to be somewhere between $0.68 and $0.70. That puts the USD earnings per share at $0.71 to $0.73. This assumes a non-GAAP tax rate somewhere around 24%. Of course, with the current and very real possibility of tax reform, the Q3 tax rate could easily end up being very different, especially to the extent that there is repatriation." Oracle assumes that currency movements could be "as much as 3% positive for total revenue or $0.03 positive for EPS."

We remain encouraged by the substantial momentum gains in the cloud business and we continue to believe that ORCL has a quality leadership team that will drive top-line growth to the bottom line. We think that the price blip creates an opportunity to purchase an undervalued IT firm with solid fundamentals, a substantial net cash position and strong free cash flow generation. With shares having retreated from the multi-year highs in September, we think that the forward P/E ratio of 16.2 times remains on the reasonable end of the spectrum. ORCL also sports a solid balance sheet with $71 billion of cash and marketable securities, or $10.9 billion of net cash (cash less debt). Our Target Price now stands at $58. ORCL currently yields 1.6%.