

MARKET COMMENTARY MONDAY, APRIL 2, 2018

EXECUTIVE SUMMARY

Holiday-Shortened Trading – Value Outperforms Growth for the Second Straight Week
 Nasdaq Then and Now – No Comparison for Tech Stock Valuations Today vs. 2000
 Earnings Yield – Stocks Attractive Compared to Treasuries
 Money Market Fund Yields – Today, 2007 and 2000
 Econ Forecasts – OECD Raises GDP Growth Estimates
 Valuations – Newsletter Portfolios Sport Bargain Metrics
 TPS 618 – April Edition Coming Tomorrow Evening
 Target Prices – New Listing Posted
 Stock News – Updates on SHPG & WBA

Market Review

Now, that is more like it! Value stocks enjoyed a second straight week of outperformance, but this time the returns race win did not come with the hefty red ink as was endured the week prior. Thanks in large part to a huge rally (669 points or 2.84% on the Dow Jones Industrial Average) on Monday,...

AFAM THE PRUDENT SPECULATOR Outsized DJIA Single Day Price Moves

Days like March 26, 2018, are rare, but since 1927 there have been 286 other times when the Dow gained at least 2.84% in one trading session.

	1920's	1930's	1940's	1950's	1960's	1970's	1980's	1990's	2000's	2010's	Totals
Years Ending in 0	10	3	1	0	2	1	1	3	2		23
Years Ending in 1	26	1	0	0	1	0	3	4	7		42
Years Ending in 2	44	0	0	3	0	5	0	13	0		65
Years Ending in 3	33	0	0	1	3	0	0	4	0		41
Years Ending in 4	5	0	0	0	9	2	0	0	0		16
Years Ending in 5	0	0	0	0	1	0	0	0	1		2
Years Ending in 6	0	4	0	0	0	0	0	0	0		4
Years Ending in 7	6	0	1	0	0	11	3	0	0		21
Years Ending in 8	2	14	0	0	0	1	3	4	21	1	46
Years Ending in 9	13	4	0	0	0	0	1	0	9		27
Totals	15	142	8	2	4	17	23	11	54	11	287

From 12.31.27 through 03.29.18. Days of index price return gains of more than 2.84%. SOURCE: Al Frank using data from Bloomberg

	1920's	1930's	1940's	1950's	1960's	1970's	1980's	1990's	2000's	2010's	Totals
Years Ending in 0	21	6	3	0	1	0	4	4	3		42
Years Ending in 1	37	3	0	1	0	0	1	6	6		54
Years Ending in 2	51	0	0	2	0	1	0	7	0		61
Years Ending in 3	25	1	0	1	2	0	0	2	0		31
Years Ending in 4	7	0	0	0	2	0	0	0	0		9
Years Ending in 5	0	0	2	0	0	0	0	0	3		5
Years Ending in 6	4	5	0	0	0	2	2	0	1		14
Years Ending in 7	17	1	0	0	0	9	2	1	0		30
Years Ending in 8	3	9	2	0	0	3	6	22	3		48
Years Ending in 9	20	5	0	0	0	1	1	0	9		36
Totals	23	176	18	5	4	6	16	15	51	16	330

From 12.31.27 through 03.29.18. Days of index price return drops of more than 2.84%. SOURCE: Al Frank using data from Bloomberg

...stocks closed out the holiday-shortened week with a nice rebound as the S&P 500 and Russell 3000 advanced 2.06% and 1.94%, respectively, over the four trading days. Happily, the Russell 3000 Value index climbed 2.41% for the week, compared to a 1.51% increase for the Russell 3000 Growth index, with setbacks in formerly hot names like Amazon, Facebook, Nvidia and Tesla holding back the latter benchmark.

There were negative headline catalysts for the drops in those four stocks: President Trump apparently has mammoth online retailer Amazon in his sights; social media king Facebook is

under intense pressure due to the Cambridge Analytica scandal; semiconductor maker Nvidia suspended self-driving car tests after the Arizona fatality involving an Uber autonomous vehicle; and electric car giant Tesla faced renewed concerns about its production levels, automobile safety and capital position. Still, it also was good to see discussion of the rich valuation metrics associated with the stocks of these companies,...

AFAM THE PRUDENT SPECULATOR
NASDAQ Composite: 2018 Edition

Amazon, Nvidia, Tesla and Facebook are not exactly inexpensive, but we actually find six of the top twelve Nasdaq stocks to be undervalued.

NASDAQ Composite Index: Top Holdings March 2018					
Company	Weighting Percentage	Price to Earnings	Price to Sales	Price to Book Value	Dividend Yield
Apple	11.4	16.7	3.6	6.0	1.5
Amazon	9.4	314.0	3.9	25.0	-
Microsoft	9.3	27.8	6.9	8.8	1.8
Alphabet	8.9	27.9	6.3	4.6	-
Facebook	5.0	24.8	10.9	6.0	-
Intel	3.1	15.0	3.9	3.3	2.3
Cisco Systems	2.7	17.5	4.3	3.9	3.1
Comcast	2.0	16.6	1.9	2.3	2.2
Nvidia	1.8	49.1	13.7	18.0	0.3
Netflix	1.7	214.1	10.6	34.6	-
Amgen	1.7	13.6	5.4	4.9	3.1
Adobe	1.4	56.5	13.6	12.1	-
{...}					
Tesla	0.6	nmf	3.6	10.3	-
Averages:	4.5	66.1	2.5	10.7	1.1
Medians:	2.7	26.3	5.4	6.0	0.3

Source: Al Frank using Bloomberg and The Wall Street Journal

...though we note that today's multiples generally are nowhere near as crazy (after all, we own six of the top 12 Nasdaq stocks and we have our eye on one of the others) as those registered at the height of the Tech Bubble 18 years ago.

AFAM THE PRUDENT SPECULATOR
NASDAQ Composite: 2000 Edition

The tech stocks that dominated the NASDAQ Composite Index back in 2000 were very expensive from a fundamental standpoint.

NASDAQ Composite Index: Top 10 Holdings Mar 2000					
Company	Weighting Percentage	Price to Earnings	Price to Sales	Price to Book Value	Dividend Yield
Microsoft	8.0	56.2	21.1	13.1	-
Cisco Systems	7.2	200.4	37.3	29.0	-
Intel	6.2	51.0	13.4	12.1	0.1
Oracle	3.7	152.7	24.7	59.8	-
Sun Micro	2.4	122.7	11.6	28.6	-
MCI Worldcom	2.1	34.5	3.5	2.5	-
Dell	2.0	72.4	5.0	24.2	-
Yahoo	1.5	666.4	161.1	78.2	-
Qualcomm	1.3	159.5	18.9	24.1	-
Applied Materials	1.1	94.7	16.1	15.5	-
Averages:	3.6	161.1	31.3	28.7	0.0
Medians:	2.3	108.7	17.5	24.2	-

Source: Al Frank using Bloomberg and The New York Times

And speaking of that Tech Wreck, given that many pundits have been suggesting that the recent investor infatuation with tech stocks is similarly worrisome, we point out that the S&P 500 is actually much more attractively valued by the Earnings Yield calculation of 4.7% today,

compared to 3.5% back then, with the yield on the 10-Year U.S. Treasury now 2.74%, versus 6.00% in March 2000.

AFAM THE PRUDENT SPECULATOR
Fed Model: Favorable Earnings Yield

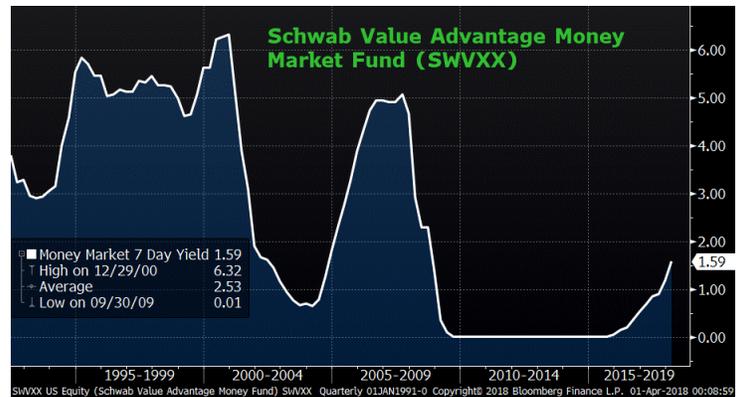
The so-called Fed Model suggests that the yield on 10-Year Treasuries should be similar to the S&P 500 Earnings Yield, which is the inverse of the P/E ratio. If the 10-Year is greater than the S&P Earnings Yield, a market is overvalued and if the reverse is true, as it is today, a market is undervalued. Though some argue that the Fed Model is no longer an effective tool, we like today's relatively generous earnings yield of 4.7%.



Indeed, the interest rate picture, we believe, remains a reason for optimism in regard to the prospects for equities, especially when one considers that the yield on money market funds today is far below what was available at the turn of the Millennium and prior to the beginning of the Financial Crisis in 2008.

AFAM THE PRUDENT SPECULATOR
Money Market Fund Yields Over Time

The yield on the Schwab Value Advantage Fund has moved up sharply of late, but there is a long way to go to approach the 2000 or 2007 levels.



Even the current dividend yield on the S&P 500 of 1.95% is attractive given the income available on competing investments, especially as we also think that an improved global and domestic economy bodes well for corporate profits, which bolsters the outlook for capital appreciation on stocks. On the subject of worldwide economic growth, we heard recently from the Organisation for Economic Co-operation and Development (OECD):

The world economy will continue to strengthen over the next two years, with global GDP growth projected to reach almost 4% in both 2018 and 2019. Growth in the United States, Germany, France, Mexico, Turkey and South Africa is projected to be significantly more robust than previously anticipated, with smaller upward revisions in most other G20 economies. The tax reductions and public spending increases announced over the past three months in the United States, together with a substantially easier fiscal stance in Germany, are key factors behind the upward revision to global growth prospects in 2018 and 2019. Ongoing improvements in business investment in the major economies should be reflected stronger global trade growth. Prospects for investment are also somewhat stronger than previously expected in commodity-producing economies, reflecting the higher level of global commodity prices.

 THE PRUDENT SPECULATOR
OECD Global Economic Growth Estimates

There were lots of green (up) arrows in the latest GDP Growth forecasts from the Organisation for Economic Co-operation and Development.

 OECD Interim Economic Outlook projections

GDP growth
Year-on-year, %. Arrows indicate the direction of revisions since November 2017

	2017	2018	2019		2017	2018	2019
World	3.7	3.9	3.9	G20	3.8	4.1	4.0
Australia	2.3	3.0	3.0	Argentina	2.9	3.2 =	3.2 =
Canada	3.0	2.2	2.0	Brazil	1.0	2.2	2.4
Euro area	2.5	2.3	2.1	China	6.9	6.7	6.4 =
Germany	2.5	2.4	2.2	India ¹	6.6	7.2	7.5
France	2.0	2.2	1.9	Indonesia	5.1	5.3	5.4 =
Italy	1.5	1.5 =	1.3 =	Mexico	2.3	2.5	2.8
Japan	1.7	1.5	1.1	Russia	1.5	1.8	1.5 =
Korea	3.1	3.0 =	3.0 =	Saudi Arabia	-0.8	1.6 =	1.7 =
United Kingdom	1.7	1.3	1.1 =	South Africa	1.2	1.9	2.1
United States	2.3	2.9	2.8	Turkey	6.9	5.3	5.1

Looking at the projections for America, the OECD explained...

In the United States, GDP growth is projected to pick up to between 2¾-3 per cent over 2018-19. Tax reductions and higher government expenditure reinforce the momentum in domestic demand from strong confidence, solid job creation, past gains in household wealth and the rebound in oil production. Taken together, the new U.S. fiscal measures could add between ½-¾ percentage point to U.S. GDP growth both this year and next, with modest positive demand spillovers for other economies. Gradual monetary policy normalisation is set to continue, bringing higher long-term interest rates, as the labour market tightens further and wage growth and inflationary pressures pick up.

To be sure, our enthusiasm for equities always comes with the caveat that market downturns can happen at any time and for almost any reason, especially as Washington remains a major uncertainty, and we concede that the first quarter was not exactly a good one for Value strategies,...

AFAM CAPITAL THE PRUDENT SPECULATOR
Value vs. Growth Returns

Returns Race					Mutual Fund Benchmarks				
2018 YTD Return %	2017 Return %	2016 Return %	Bloomberg Symbol	Index	Investment Objective	YTD	1-Year	Annualized	
								3-yr	5-yr
-1.96	28.11	16.50	INDU Index	Dow Jones Industrial Average	Large-Cap Core Funds	-1.07	13.01	9.08	11.77
2.59	29.73	8.97	CCMP Index	NASDAQ Composite Index	Large-Cap Growth Funds	3.02	22.00	11.36	14.44
-0.69	21.68	12.04	RIY Index	Russell 1000 Index	Large-Cap Value Funds	-2.47	9.23	7.70	10.39
-0.08	14.63	21.28	RTY Index	Russell 2000 Index	Mid-Cap Core Funds	-1.16	10.25	6.87	10.10
-0.64	21.12	12.72	RAY Index	Russell 3000 Index	Mid-Cap Growth Funds	2.78	19.35	8.77	12.22
-0.76	21.82	11.95	SPX Index	S&P 500 Index	Mid-Cap Value Funds	-2.14	7.52	6.78	9.91
-1.38	18.65	10.67	W5000 Index	Wilshire 5000 Total Market	Small-Cap Core Funds	-1.08	10.48	7.53	10.15
1.41	30.21	7.07	RLG Index	Russell 1000 Growth Index	Small-Cap Growth Funds	3.27	21.29	9.10	11.93
-2.83	13.64	17.33	RLV Index	Russell 1000 Value Index	Small-Cap Value Funds	-2.81	7.19	6.80	8.81
2.28	22.14	11.28	RUO Index	Russell 2000 Growth Index	Multi-Cap Core Funds	-0.84	12.42	7.89	11.23
-2.61	7.82	31.72	RUI Index	Russell 2000 Value Index	Multi-Cap Growth Funds	3.03	21.36	10.21	13.32
1.48	29.58	7.38	RAG Index	Russell 3000 Growth Index	Multi-Cap Value Funds	-2.67	8.39	7.13	10.14
-2.82	13.17	18.38	RAV Index	Russell 3000 Value Index	S & P 500 Daily Reinv	-0.76	14.07	10.89	13.30
1.93	27.43	6.89	SGX Index	S&P 500 Growth Index					
-3.58	15.35	17.39	SVX Index	S&P 500 Value Index					
4.85	26.76	4.22	SPXPG Index	S&P 500 Pure Growth Index					
-2.01	17.73	19.62	SPXPV Index	S&P 500 Pure Value Index					

Source: Bloomberg. As of 3.29.18

...but we very much like how the valuation metrics of our newsletter portfolios stack up against the major market averages and even the Value indexes.

AFAM CAPITAL 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	16.1	13.1	1.1	1.8	2.8
Buckingham	16.3	13.1	1.1	1.8	2.6
Milennium	16.6	13.2	1.2	1.8	2.7
PruFolio	16.5	13.2	1.1	1.9	2.6
Russell 3000	22.8	17.6	2.0	3.1	1.9
Russell 3000 Growth	27.2	20.8	2.7	6.4	1.3
Russell 3000 Value	19.5	15.2	1.6	2.0	2.5
Russell 2000	48.7	25.4	1.3	2.3	1.3
Russell 2000 Growth	81.4	33.7	1.7	4.4	0.7
Russell 2000 Value	33.4	19.8	1.0	1.5	2.0
Russell 1000	21.8	17.2	2.1	3.2	1.9
Russell 1000 Growth	25.7	20.1	2.9	6.6	1.3
Russell 1000 Value	18.8	14.9	1.6	2.0	2.5
S&P 500 Index	21.3	16.9	2.2	3.2	2.0
S&P 500 Growth Index	24.9	19.7	3.5	5.8	1.3
S&P 500 Value Index	18.3	14.7	1.5	2.2	2.6
S&P 500 Pure Value Index	15.0	11.8	0.6	1.4	3.4

As of 03.31.18. Weights based on model portfolios. Harmonic mean used to calculate the portfolio price metrics. Companies with negative earnings are excluded from the P/E and Estimated P/E calculations. SOURCE: AI Frank using data from Bloomberg

Stock Updates

No doubt, we respect that many are concerned about rising interest and inflation rates, and our Graphic Detail in the April edition of *The Prudent Speculator* will focus on this subject. *TPS 618*, which will also have one first-time recommendation, a pending purchase for TPS Portfolio, is slated to be emailed to readers tomorrow (Tuesday) evening. In the interim, we have posted to prudentspeculator.com updated Target Prices for all 120 formerly recommended but not yet closed out stocks and Jason Clark provides an update on two of those companies...

Shares of **Shire PLC** (SHPG – \$149.39) jumped more than 18% last week after word spread that Japanese pharma company Takeda was considering an offer to purchase the biotech

concern. Takeda said Wednesday that it was weighing the bid, raising the prospect of a combination that would create a global top-10 drug maker with a market value of more than \$80 billion. It called the study “exploratory” and said it would decide by April 25 whether to go through with such a bid. At current share prices, it would mean that Takeda would be trying to take over a company larger than itself, especially given the less-than-enthusiastic market reaction investors in Japan have thus far given the potential suitor.

Regardless of the outcome of this M&A consideration, we believe that the news that a corporate buyer is looking at Shire highlights the company’s fundamental undervaluation that we have been writing about since we initially recommended the shares in June 2016. When considering this possible union, there are some modest overlaps between the companies as Takeda has four strategic therapeutic areas: gastroenterology, oncology, neuroscience and vaccines, with the first three also key therapeutic areas for Shire. That said, there is not much overlap versus Shire’s plasma/immunology, rare diseases or hemophilia businesses, which we believe are the most important, and which we see as material catalysts even if SHPG remains free standing.

We are uncertain how Takeda would finance a purchase of Shire, and if other potential suitors might surface before the end of April deadline, while there were plenty of caveats in the Japanese concern’s official statement, “Takeda’s consideration of such an offer is at a preliminary and exploratory stage and no approach has been made to the Board of Shire. There can be no certainty that an approach, if made, will lead to any transaction. Takeda continuously considers various options aiming to accelerate its growth, focusing on prioritized therapeutic areas of gastroenterology, oncology and neuroscience plus vaccines.”


THE PRUDENT SPECULATOR
SHPG – Fine as a Standalone Company

Shire has transformed into the leading global biotech focused on rare diseases while delivering strong financial performance

- 1

Rare disease leader

 - Innovative, rare disease-focused biotech committed to differentiated and high patient-impact medicines
 - Global footprint: ~23K employees in 70 countries
- 2

Strong portfolio

 - Seven franchises, five with over \$1B in annual revenue with multiple leading brands
- 3

Clear biotech profile

 - ~65% of 2017 sales from biologics
- 4

Robust R&D pipeline

 - 40 programs in clinical development, 15 in Phase 3
 - 2 FDA Fast Track Designations, 2 Orphan Drug Designations, 1 Breakthrough Therapy Designation in 2017
- 5

Patient focus

 - Advancing diagnostics (diagnostic toolkits, biomarkers in genetic diseases)
 - Precision medicine (e.g., ADVATE+myPKFIT)

Product sales (pro forma)⁽¹⁾ and Non GAAP EPS growth⁽²⁾⁽³⁾



Year	Sales Growth	EPS Growth
2015	5%	10%
2016	11%	12%
2017	8%	16%

 ⁽¹⁾ 2016 product sales are on a pro forma basis, which include results from Baxalta (acquired on June 3, 2016) and Dyax (acquired on January 22, 2016).
⁽²⁾ This is a Non-GAAP financial measure. The most directly comparable measure under US GAAP is diluted EPS/ADS. FY 2017: \$14.26; FY 2016: \$1.27; FY 2015: \$6.59.
⁽³⁾ See slide 43 for a list of items excluded from the US GAAP equivalent used to calculate all Non-GAAP measures detailed above. See slides 44 to 47 for a reconciliation of Non-GAAP financial measures to the most directly comparable measure under US GAAP.

Even with the move higher, we continue to believe Shire shares are significantly undervalued. Overall, the firm’s integration of Baxalta is going well and has resulted in its immunology franchise continuing to expand at a double-digit rate as uptake of subcutaneous products remains strong, which would seem to be a positive offset to the challenges that are present in the hemophilia space. Additionally, the continued evolution of Shire’s rare disease portfolio

should create long-term opportunities for it or an acquirer. SHPG shares currently trade at less than 10 times NTM adjusted EPS expectations and our Target Price now stands at \$252, meaning we would need to see a very aggressive bid from Takeda to get the share price anywhere near our current three-to-five-year valuation estimate.

Despite delivering fiscal Q2 financial results that beat consensus estimates, shares of **Walgreens Boots Alliance** (WBA – \$65.47) finished the week slightly lower. The drugstore operator reported adjusted EPS of \$1.73 (vs. \$1.56 est.) on revenue of \$33.0 billion (vs. \$32.2 billion est.). Generally, we were pleased with the results, given the ever changing operating pressures and the political gusts of wind that blow out of Washington from time to time, but we note that new pressure could be hitting WBA and its competitors as news broke a few days ago that **Walmart** (WMT – \$88.97) is in talks with health insurer Humana about a range of business options that could include an acquisition.

Concerning the second quarter, Walgreen CEO Stefano Pessina said, “Our growth strategy of increasing and consolidating volume, differentiating ourselves through value and quality of service, and controlling costs is bearing fruit across our businesses. This is reflected in another good set of financial results in which we delivered the highest sales growth in eight quarters, as well as strong cash generation and record U.S. pharmacy market share. We expect to continue to grow, in part through the recent acquisition of stores from Rite Aid, and today we are raising our fiscal 2018 guidance.”

The company raised the lower and upper ends of its guidance for fiscal 2018 and now anticipates adjusted diluted net earnings per share of \$5.85 to \$6.05. This guidance assumes current exchange rates for the rest of the fiscal year and includes an expected benefit from the U.S. tax law changes that is marginally higher than the \$0.35 per share upper end of the previously announced range.

THE PRUDENT SPECULATOR
WBA – Value-Priced Growth Stock

Business initiatives *Walgreens*

- Next generation systems¹**
 - retail, pharmacy and data insights
 - investment: >\$500m to date, anticipate investing >\$500m in next 3 years¹
- Pharmacy access¹**
 - value, volume, market share and specialty
 - grown prescription market share by over 200 bps in last 3 years²
- Retail transformation¹**
 - promotions, cost discipline, merchandising & product mix, and beauty differentiation
 - retail front end gross margin improved by over 300 bps in last 3 years
- Digital expansion¹**
 - access across healthcare, retail and services
 - ~21% of all 2Q retail refill scripts initiated via digital channel¹, up ~300 bps yoy

Walgreens Boots Alliance
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While the Rite Aid locations may not materially impact 2018 results, we think that the added footprint will help the company reach a broader section of U.S. consumers and will give WBA

the opportunity to take the battle to its competitors. We also like the firm's European footprint via its Boots stores in the United Kingdom, Norway, Ireland, the Netherlands, Lithuania, Mexico, Chile and Thailand. Long-term, we believe WBA will benefit from robust growth rates on pharmaceutical products due to the aging of the U.S. and European populations, with analysts currently of the mind that EPS will climb from \$4.97 in 2017 to \$5.90 this year to \$6.46 in 2019 and \$7.11 in fiscal 2020. WBA also generates solid free cash flow and we expect the dividend payout (the yield is currently 2.4%) to continue to rise. Our Target Price has been increased to \$116.

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