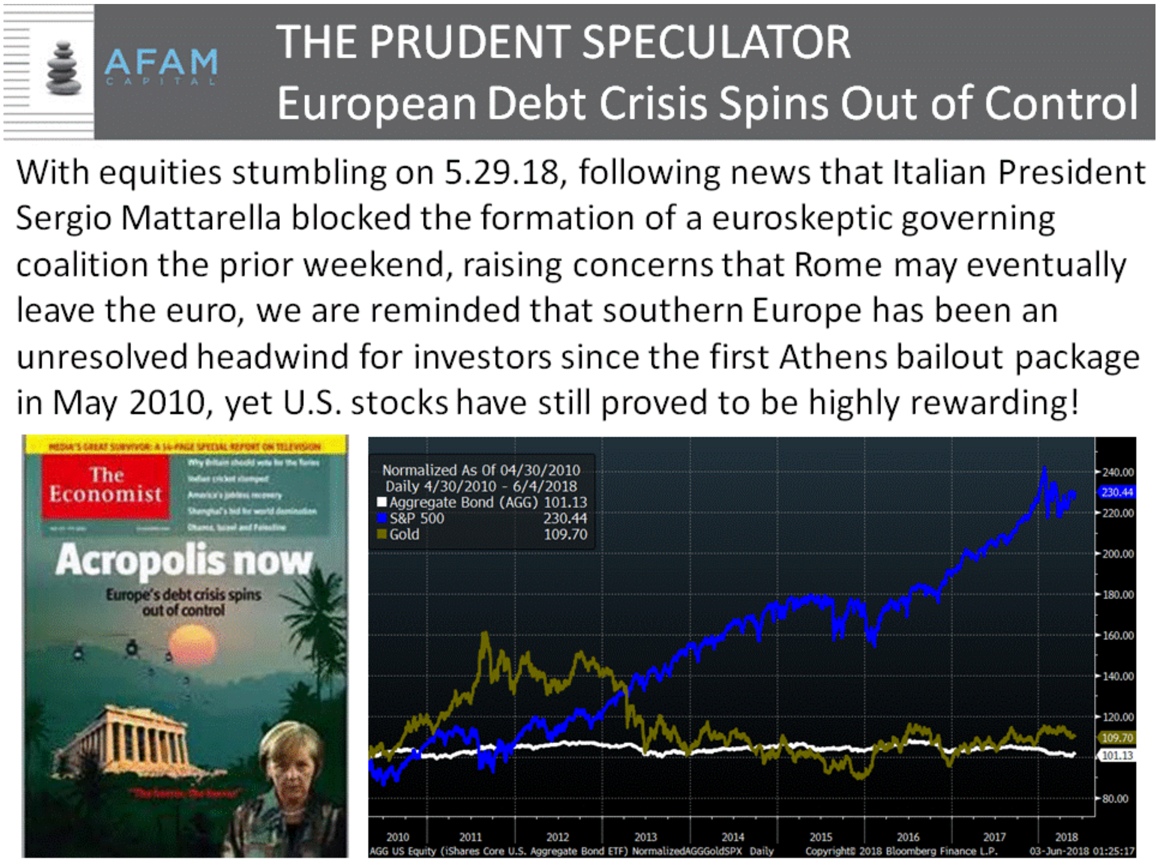
EXECUTIVE SUMMARY

TPS 620 - June Newsletter Emailed
Italy - Short-Lived Downturn
Southern Europe Perspective - Problematic Since 2010, Yet Stocks Have Soared
Week in Review - Jobs Numbers and North Korea Trump European Drama and Tariffs
Interest Rates and Stocks - More Myth Debunking Short- and Long-Term
Trump Jobs Tweet - Not Easy to Profit from Advance Information
Al Frank Advice - Partner with Great Corporations, Growing in Wealth
Stock News - Updates on MRVL, GM, DSW & AEO

Market Review

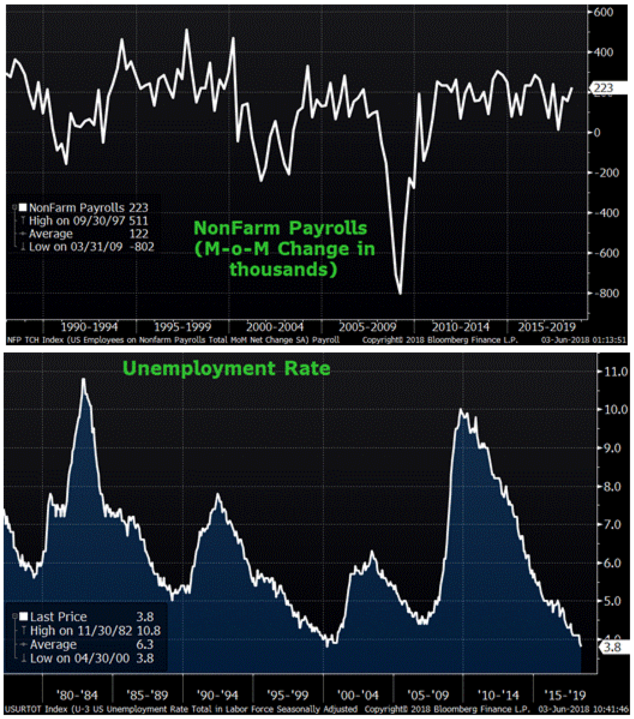
The June edition of *The Prudent Speculator* was emailed to subscribers on Friday afternoon, a day in which the Wall Street yo-yo headed in a favorable direction for equity holders, ending a fascinating week in which stocks fell on Tuesday on renewed concerns about Southern Europe, specifically Italy. Incredibly, those worries lasted about a day, as investors were buoyed by news that the competing factions in Rome were apparently hammering out a coalition government, with a so-called “government of change” ultimately sworn in on Friday.

Never mind that the new government is essentially an uneasy alliance between two populist parties, the anti-establishment 5-Star Movement, led by Luigi di Maio, and the anti-migrant, Euroskeptic League, led by Matteo Salvini. Perhaps traders realized on Wednesday that stocks have performed extremely well since the scary *Acropolis Now* magazine cover from *The Economist* back in the spring of 2010, even as Southern Europe has been problematic off and on for much of that time span.



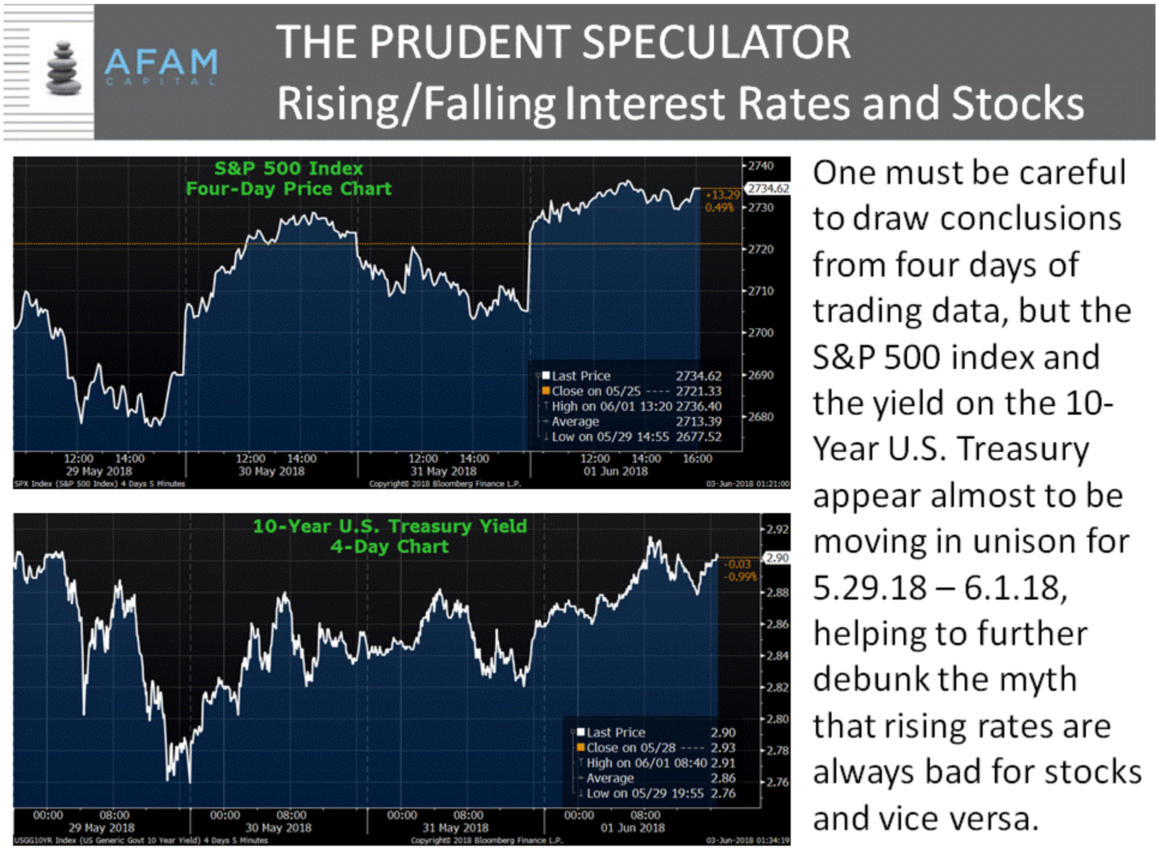
Of course, folks found new reasons to fret on Thursday when the Trump Administration announced that tariffs on steel (25%) and aluminum (10%) from Canada, Mexico and the European Union would take effect on Friday, prompting swift retaliatory responses from all three allies. Yet, despite more tough talk on trade involving China, stocks actually rallied on Friday, on the back of the North Korean summit in Singapore being back on and a better-than-expected U.S. employment report.

THE PRUDENT SPECULATOR
Solid Employment Situation



Uncle Sam said that the number of new jobs created during May jumped to 223,000, well above the consensus forecast of 190,000, while the unemployment rate matched the 18-year low of 3.8%, a tally that was last bettered in December 1969. The labor participation rate dipped to 62.7%, but average hourly earnings rose a greater-than-expected 0.3%, the latter somehow not fueling inflation fears this time around.

When all was said and done, both stocks and U.S. government bonds ended not too far from where they began the week, with the S&P 500 gaining 0.49% over the four days and yield on the 10-Year Treasury closing at 2.90%, down a bit from 2.93% a week ago. Interestingly, stock prices and Treasury yields seemed to move in unison, throwing more cold water on the argument made by many supposed experts that rising interest rates are bad and that falling rates are good for stocks.



To be fair, there was a "flight to safety" on Tuesday when stocks plunged and Treasuries soared, but last week was hardly the only instance when recent market history has defied the textbooks. No doubt, it makes sense that higher yields on bonds would make them more attractive versus stocks, all else equal, but all else is seldom equal, as evidenced by what has happened since the yield on the 10-Year Treasury hit its all-time low of 1.36% on July 8, 2016.

THE PRUDENT SPECULATOR
Interest Rates and Stocks

Despite a significant plunge in the 10-Year U.S. Treasury yield on 5.29.18, stock prices sank, while rising government bond yields over the balance of the week did not hold back a full equity market recovery. Of course, the disconnect between stocks and rates is nothing new!

Readers are undoubtedly aware that we like to debunk a lot of the myths that permeate Wall Street, especially as so many of them are hazardous to investor wealth in that they can frighten folks into abandoning their long-term investment plans, often at the worst possible time. Indeed, there are plenty of legitimate concerns (the federal deficit, a polarized electorate, trade skirmishes, terrorism and natural disasters, to name a few), so we do not mean to imply that stock prices will always move higher, but we live by the Vannevar Bush quotation, “Fear cannot be banished, but it can be calm and without panic; it can be mitigated by reason and evaluation.”

Obviously, nobody has a crystal ball…and even if we had information ahead of everyone else, or could decipher an early tweet from our Commander in Chief, there is no certainty that we would be able to predict the short-term market reaction,…

THE PRUDENT SPECULATOR
Nonfarm Payrolls Releases and Equities

Certainly, the White House should not be tweeting about important economic data like the jobs numbers prior to their 8:30 AM Eastern time release, but history suggests that it isn't necessarily easy for short-term equity traders to profit from knowing the information in advance!

Not Easy to Predict if Good/Bad News on Jobs is Good/Bad for Stocks

Employment Situation Report Date	Nonfarm Payrolls Median Estimate	Nonfarm Payrolls Actual	S&P Futures 8:29 AM	S&P 500 9:45 AM	S&P 500 4:00 PM	Full Day S&P 500 Change
1/5/2018	190,000	148,000	2719.00	2731.43	2743.15	0.70%
2/2/2018	180,000	200,000	2812.50	2802.90	2762.13	-2.12%
3/9/2018	205,000	313,000	2740.50	2753.42	2786.57	1.74%
4/6/2018	185,000	103,000	2642.00	2648.38	2604.47	-2.19%
5/4/2018	193,000	164,000	2622.25	2627.34	2663.42	1.28%
6/1/2018	190,000	223,000	2719.00	2727.42	2734.62	1.08%

Source: AFAM Capital using data from Bloomberg Finance L.P. All times Eastern

…so we simply remember the timeless advice of our founder Al Frank, "We think of ourselves as partners in great corporations, growing in wealth as they prevail, rather than traders of pieces of paper." And, with a favorable outlook for company profits going forward, we think that we and our corporations will continue to grow in wealth over time.

THE PRUDENT SPECULATOR
Significant EPS Growth Estimated

History shows that stock prices generally have followed earnings, so it is nice to see actual and projected EPS moving up, even as earnings forecasts often turn out to be too optimistic. Happily, the number of companies (76.3%) exceeding expectations in Q1 2018 was far better than the average beat-rate over the prior 5 years.

S&P 500 Earnings Per Share

Quarter Ended	Bottom Up Operating EPS 3 Month	Bottom Up Operating EPS 12 Month
ESTIMATES		
12/31/2019	$46.51	$174.51
9/30/2019	$44.55	$170.09
6/30/2019	$42.70	$165.86
3/31/2019	$40.75	$161.68
12/31/2018	$42.09	$157.30
9/30/2018	$40.32	$149.06
6/30/2018	$38.52	$140.07
3/31/2018	$36.37	$132.06
ACTUAL		
12/31/2017	$33.85	$124.51
9/30/2017	$31.33	$118.56
6/30/2017	$30.51	$115.92
3/31/2017	$28.82	$111.11
12/31/2016	$27.90	$106.26
9/30/2016	$28.69	$101.42
6/30/2016	$25.70	$98.17
3/31/2016	$23.97	$98.61
12/31/2015	$23.06	$100.45
9/30/2015	$25.44	$104.14
6/30/2015	$26.14	$108.30
3/31/2015	$25.81	$111.50
12/31/2014	$26.75	$113.01

Source: Standard & Poor's. As of 5.31.18

S&P 500 Quarterly Earnings Comparisons

	BEAT	MISSED	MET		BEAT	MISSED	MET
Q4 2017	73.5%	18.1%	8.4%	Q1 2015	67.7%	22.9%	9.4%
Q3 2017	72.4%	19.3%	8.2%	Q4 2014	68.6%	21.0%	10.4%
Q2 2017	70.2%	20.1%	9.7%	Q3 2014	73.7%	17.2%	9.0%
Q1 2017	74.0%	18.9%	7.2%	Q2 2014	65.7%	21.2%	13.0%
Q4 2016	67.3%	22.0%	10.8%	Q1 2014	67.1%	22.6%	10.2%
Q3 2016	70.5%	21.1%	8.4%	Q4 2013	63.9%	25.3%	10.8%
Q2 2016	70.2%	20.9%	8.9%	Q3 2013	66.1%	23.2%	10.6%
Q1 2016	72.3%	20.6%	7.0%	Q2 2013	65.4%	26.8%	7.8%
Q4 2015	68.8%	21.6%	9.7%	Q1 2013	65.9%	25.9%	8.2%
Q3 2015	67.9%	23.0%	9.0%	Q4 2012	64.8%	24.8%	10.4%
Q2 2015	69.8%	22.0%	8.3%	AVERAGE	68.9%	21.8%	9.3%

Source: Standard & Poor's and Bloomberg

Stock Updates

Chris Quigley and Jason Clark take a look at four of our stocks that were in the news last week…

Semiconductor firm **Marvell Technology Group** (MRVL – $22.17) earned $0.32 per share in fiscal Q1 2019 (vs. $0.31 est.). MRVL had revenue of $614.6 million, versus the $601.6 million estimate. Shares rose 3% on the news, with investors enthused about MRVL's solid core business growth and gains in operational efficiency.

CEO Matt Murphy commented, "Our storage business exceeded expectations growing 4% year over year. This growth was driven by two factors. First was record SSD revenue, which contributed more than 30% of total storage revenue. Second was the shifting mix of our HDD and SSD Storage Solutions as we expand in the enterprise and data center markets. The segment of our storage business grew 50% year over year and overall demand continues to grow. Marvell's connectivity business grew 19% year over year driven by our broad-based demand for our solutions across all of our targeted market end segments particularly performance client and enterprise access. Our success in this high-performance market segment is the result of a shift in our strategy over the past two years. We're focusing primarily on markets that value the differentiation we deliver through our system level solutions. In these high-performance end markets, we are able to offer solutions comprised of processor, RF, switch, PHY, security, and software IP, which together helps customers accelerate their time to market."

Mr. Murphy continued, "On March 16, Marvell and Cavium shareholders voted overwhelmingly in favor of the proposed merger. Second, the HSR antitrust process is complete and we recently obtained CFIUS approval. The final regulatory review approval we are waiting for is from China's State Administration for Market Regulation, SAMR, also known as the new MOFCOM. We continue to currently believe the transaction will close in mid-calendar year 2018. While the deal isn't closed yet, integration planning is going extremely well. This will enable us to hit the ground running once the transaction closes, and I'm confident in the synergies we projected, $150 million to $175 million within the first 18 months and expect to achieve $200 million over the long term. The strategic rationale of this combination is compelling. It's financially accretive, technically accretive from the addition of new product lines and IP, increases our scale, significantly diversifies Marvell, accelerates our presence in the cloud and data center market, and with synergy capture creates a best-in-class financial mode."

While the Cavium acquisition still requires MRVL to take on about $1.75 billion of debt, we think that the balance sheet hit is justified, given the diversification that the maker of highly integrated multi-core SoC products offers. We are pleased that the regulatory reviews are on schedule. With the synergies and Marvell firing on all cylinders, we are glad we kept the faith as the company worked through its accounting challenges. Our Target Price is now $28.

General Motors (GM – $43.20) gained more than 15% at the end of last week after the company announced that SoftBank Vision Fund will invest $2.25 billion with the automaker to develop commercial AV (Autonomous Vehicle) technology on a large scale. "Our Cruise and GM teams together have made tremendous progress over the last two years," said GM CEO Mary Barra. "Teaming up with SoftBank adds an additional strong partner as we pursue our vision of zero crashes, zero emissions and zero congestion."

"GM has made significant progress toward realizing the dream of completely automated driving to dramatically reduce fatalities, emissions and congestion," said Michael Ronen, managing partner, SoftBank Investment Advisers. "The GM Cruise approach of a fully integrated hardware and software stack gives it a unique competitive advantage. We are very impressed by the advances made by the Cruise and GM teams, and are thrilled to help them lead a historic transformation of the automobile industry."

"We're excited to be joining forces with a tech leader who shares our belief that AV technology will change the world," said GM President Dan Ammann. "We look forward to partnering with SoftBank as we work toward deploying this technology safely and in massive scale."

According to the press release, the investment will be made in two tranches, the first totaling $900 million. When the Cruise AVs are "ready for deployment," SoftBank will make the remaining $1.35 billion available. In the joint venture, SoftBank Vision Fund will hold a 19.6% equity stake and GM will be allowed to raise other external capital to the extent they deem necessary. The venture is expected to start in 2019.

While we think the partnership is a big vote of confidence for GMs self-driving development program, we know that AV programs in the industry have had varying levels of success, from Tesla doing broadly well with Auto Pilot to Uber shuttering its self-driving car program in

Arizona a few weeks ago. We believe that the road to truly independent self-driving cars is loaded with potholes and other challenges, both in practical and financial senses, so we are pleased to see the risks being mitigated by the external investment, while the involvement of Softbank provides added incentive to monetize the value of the AV venture down the road. We have hiked our Target Price for GM to $57 and we note that even with the price spike, the stock trades for less than 7 times estimated earnings and yields 3.5%.

Despite reporting fiscal Q1 2019 top and bottom-line results that were better than consensus analyst estimates, shares of **DSW Inc.** (DSW – $23.99) fell more than 5% last week, after suffering a few downgrades as the footwear retailer seemingly came up short of the gross margin "whisper number" for which some analysts were looking. That said, we thought the quarter was positive.

DSW posted revenue of $712 million, which was slightly better than forecasts calling for $682 million, while adjusted EPS for the period was $0.39, some 6% better than expectations. Comparable sales growth of 2.2%, supported by robust digital gains, and healthy traction in fashion footwear not only aided last quarter, but we think they set up operating momentum for the rest of calendar 2018.

CEO Roger Rawlins stated, "We are pleased this quarter to report our second consecutive positive comp for DSW Inc. and the fourth positive footwear comp in the DSW brand. With our solid first quarter results, we have delivered a 4% revenue increase and a 16% earnings increase over the last twelve months, marking an exciting return to growth for the DSW brand."

"Furthermore, we launched a new integrated and cross-channel loyalty program a few weeks ago, reaching an important milestone in DSW's history. We are pleased with the customer response to DSW VIP, which delivers a simpler points system and new benefits like shoe donations, free shipping and points gifting. We remain committed to innovating our customer experience with initiatives that will elevate Designer Shoe Warehouse and drive customer acquisition and loyalty for years to come," Mr. Rawlins added.

The company maintained its full-year outlook for adjusted earnings in the range of $1.52 to $1.67 per diluted share, and we continued to be pleased to see DSW's operational improvements and momentum. We understand that brick-and-mortar retail faces stiff operating headwinds from numerous directions, including titans Amazon and Walmart, but we believe that DSW still offers upside, despite a 49% total return over the last 12 months. The stock trades for 14.4 times NTM adjusted earnings, while the balance sheet contains $269 million of cash and short-term investments, with no outstanding long-term debt, though there are rent and lease obligations. The dividend yield now stands at 4.2%. Our Target Price for DSW is now $32.

Shares of **American Eagle Outfitters** (AEO – $22.56) fell a bit more than 1% last week, even as the apparel retailer turned in fiscal Q1 2019 financial results that beat both top and bottom-line expectations. The quarter included strong results from its Aerie unit (38% comparable sales improvement) and continued growth at American Eagle (4% comparable sales increase). Adjusted EPS for the period came in at $0.23 on revenue of $823 million (versus respective consensus projections of $0.22 and $812 million). Additionally, gross profit margins improved by 50 basis points, reflecting rent leverage and improved merchandise margins.

CEO Jay Schottenstein commented, “I'm very pleased to see our momentum continue. The first quarter marked our 13th consecutive quarter of positive comparable sales, leading to an increased operating margin and earnings growth, which exceeded our expectations. American Eagle leveraged strong brand equity and its dominant jeans business to deliver comparable sales gains across brick and mortar stores and e-commerce. After starting a body positivity movement, Aerie is posting record growth rates and striking a real emotional connection with its expanding customer base. We are highly focused on our strategic plan, centered on expanding American Eagle, accelerating Aerie’s growth, elevating the customer experience and delivering strong financial returns.”

AEO spent $45 million during the previous quarter repurchasing 2.3 million of its shares. The company ended the quarter with almost $310 million of cash with no long-term debt (equivalent to approximately $1.75 of net cash per outstanding share). And, based on an anticipated comparable sales increase in the mid-single digits, management expects Q2 adjusted EPS to be approximately $0.27 to $0.29. Last year’s second quarter saw adjusted EPS of $0.19.

While the retail environment continues to rapidly change and fashion trends are always very fickle, we have been pleased with AEO’s overall execution and that the stock is up 20% in 2018 and 100% over the last year. Given the continued progress and solid quarter, we have bumped up our Target Price to $25, though we are keeping a close eye on AEO shares as the valuation creeps closer to that level. AEO currently trades for 15 times forward earnings estimates and yields 2.4%.