

MARKET COMMENTARY MONDAY, JUNE 11, 2018

June 11, 2018

EXECUTIVE SUMMARY

Week in Review – We’d Love to Have “Capped” Gains Every Five Days

Media Pessimism – Byron Wien’s “Something Lurking Out There” vs. “No Recession Until 2021 at the Earliest”

Econ Outlook – OECD U.S. GDP Forecast

Secret to Success – Plenty of Scary Headlines the Past Couple of Years, But Stocks Have Soared

Value vs. Growth – Undervalued Stocks Still Running Second

Value Investors Face Existential Crisis after Long Market Rally – Our Response to *WSJ* Article

AFAM Capital 13-F Filing – 25 Largest Holdings

Stock News – Updates on TPR, KSS, DAL & DPSGY

Market Review

While I concede that these missives essentially say the same thing week after week – ignore the short-term gyrations and patiently stick with a broadly diversified portfolio of undervalued stocks, preferably of the dividend-paying variety, for their long-term appreciation potential – it is always interesting to read what the financial press comes up with to sum up short-term market movements.

For example, CNBC.com’s main market headline this weekend described last week’s action this way, “Stocks rise more than 1% this week, but gains capped by trade tensions.” The sub-headings of the article included:

- *For the week, the major averages all rose at least 1.2%. But their rise was kept in check amid increasing tensions between the U.S. and key trade partners*
- *On Friday, President Donald Trump arrived at the meeting, along with other world leaders – including those who currently govern nations that Trump has inflicted tariffs upon.*
- *“We are moving in the direction of a trade war. It’s really quite remarkable,” says Benn Steil of the Council on Foreign Relations.*

Incredibly, despite simmering, and dare we say boiling, trade worries, the S&P 500 advanced 1.66% and the Russell 3000 rose 1.65% over the last five sessions. While some may believe those one-week returns are pedestrian, we would all be ecstatic to make 135% or 134% for a full year...which is a return of 1.66% or 1.65% raised to the 52nd power! Where do we sign up to have our gains capped like that?


We suppose it shouldn’t be surprising that many stories are negatively biased these days, as the online media seemingly attracts more clicks with pessimistic headlines, which is a major positive from our contrarian way of thinking. Case in

point was a featured piece on Marketwatch.com the last couple of days that screamed, “Something lurking out there’ will upset the stock market, says Blackstone’s Wien!”

Despite the scary headline, the actual take for those who bothered to read the entire article related to legendary investment strategist Byron Wien was far more optimistic: “There will be 10% corrections along the way’ he told CNBC but said ‘generally, we are in a period of low volatility because there isn’t a recession in sight. My view is the earliest we’re gonna have a recession is 2021.”

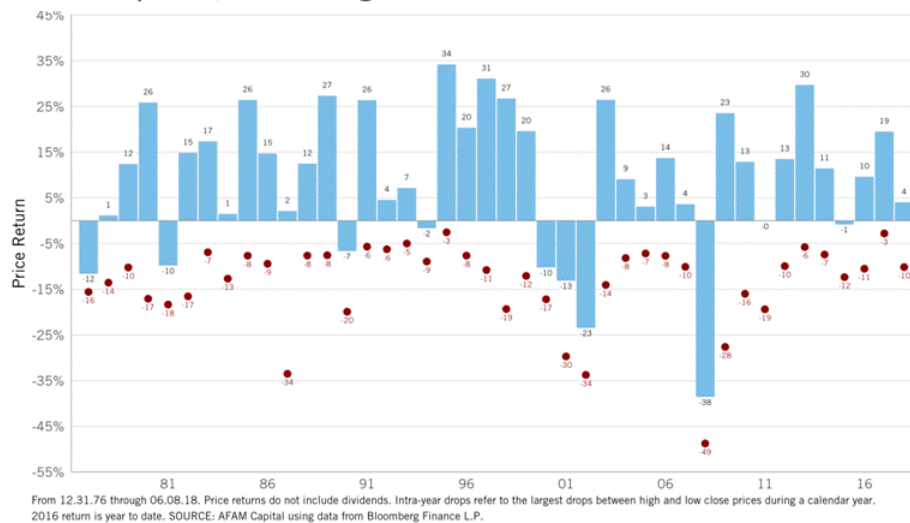
Sounds a lot like what we have long been saying as we are always braced for downside action. And, we might think a trip south could come as early as this week, given the wildcard that is the historic summit with North Korea’s Kim Jong Un scheduled for June 12 and *The Wall Street Journal* reporting this weekend, “President Donald Trump said Saturday the U.S. wouldn’t endorse the final communiqué of the Group of Seven industrial nations summit and threatened to impose auto tariffs in a statement on Twitter in which he insulted the Canadian prime minister.”

No doubt, volatility, including Mr. Wien’s potential 10% correction, is very much normal...



THE PRUDENT SPECULATOR A Big Selloff Happens Almost Every Year

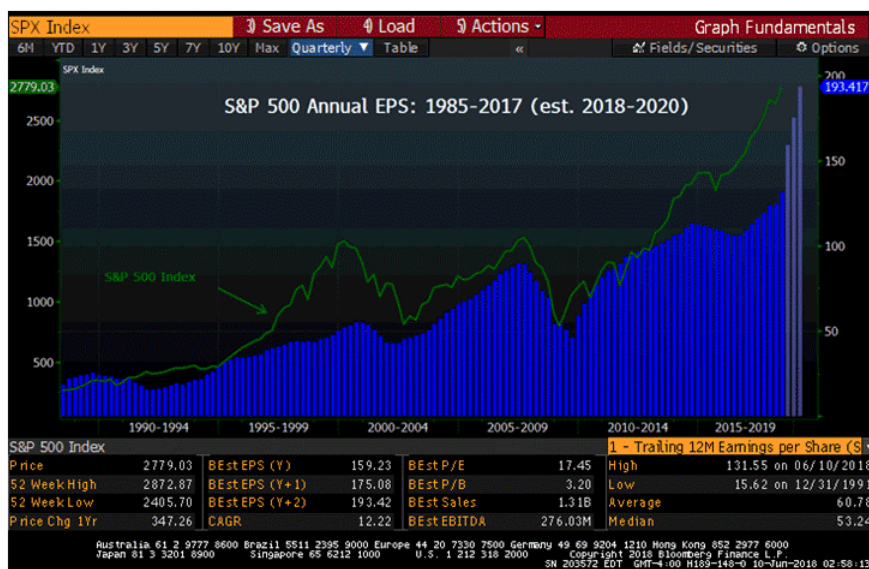
While the S&P 500 has enjoyed excellent long-term returns and endured a relatively small number of negative full years since the founding of *The Prudent Speculator* in 1977, there have been corrections of 10% or more in 25 of the 41 years, including the current one.



...but it is hard to believe from a review of market history that a long-lasting downturn in stocks will occur without a significant drop in corporate profits,...

THE PRUDENT SPECULATOR
Stock Prices Often Follow Earnings

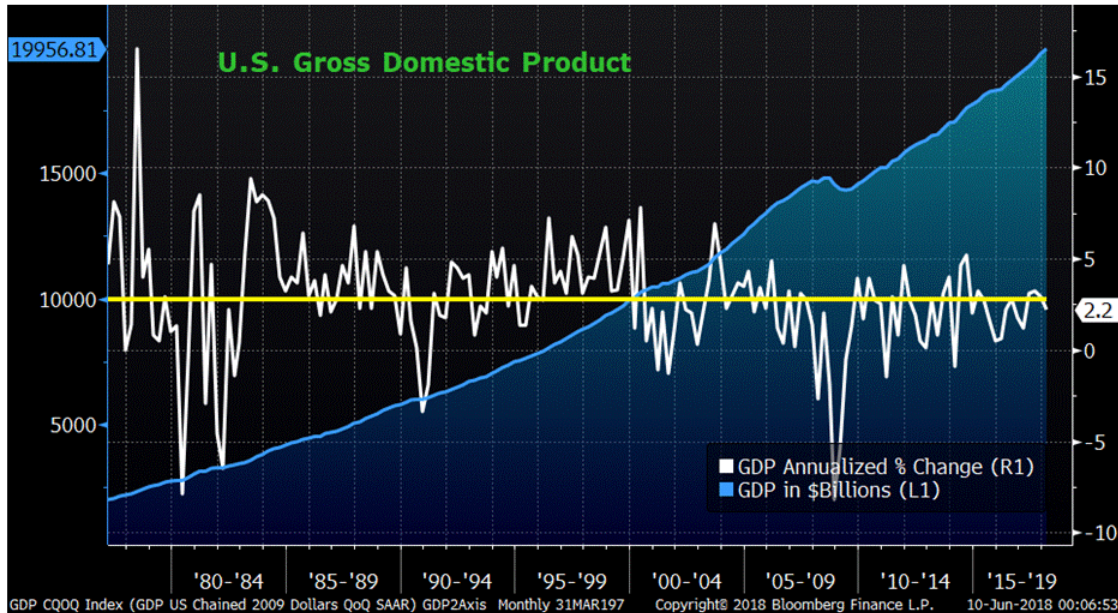
Market history shows that sustained market downturns usually coincide with a recession in corporate profits. No guarantees, of course, but the outlook for earnings, especially given the recent tax cuts, is favorable.



...which does not appear to be on the horizon given that earnings recessions often (naturally) go hand-in-hand with economic recessions,...

AFAM CAPITAL THE PRUDENT SPECULATOR
Solid U.S. Economic Growth

While GDP growth has its ups and downs, with stock prices often suffering during recessions, the long-term trend for the economy is up.



...which does not appear to be in the cards, with the Organisation for Economic Co-operation and Development stating last week: “The latest Economic Survey of the United States presents a robust near-term outlook: private consumption remains solid, driven by a strong job market and high levels of consumer confidence. Against this backdrop, GDP growth is set to increase by 2.9% in 2018, and 2.8% in 2019. The Survey notes that the recent U.S. tax reform – combined with higher public spending ceilings in 2018 and 2019 – will provide a fiscal stimulus of around 1% of GDP in both years, representing a sizeable short-term boost to growth. Plans to reduce regulatory burdens should also help foster business dynamism.”

Certainly, we aren’t declaring an all-clear signal because OECD calls for solid growth this year and next, while Mr. Wien doesn’t foresee an economic recession in the U.S. until 2021. This is especially true as the former added, “However, risks to the outlook remain sizable. Elevated leverage ratios in the corporate sector will need careful monitoring, while emerging interest rate differentials between the U.S. and other major currencies may contribute to an appreciation of the dollar. Rising trade tensions with key partners also threaten to disrupt global supply chains and dent growth. And long-term fiscal sustainability remains a concern.”

Nevertheless, despite the ups and downs of the economy and the financial markets, equities generally have proved very rewarding for those who remember that the secret to success in stocks is not to get scared out of them.

The last couple of years vividly illustrate the point. As we wrote in the January edition of *The Prudent Speculator*...

As Auld Lang Syne was warming up to welcome in 2018, it was fascinating to hear all of the negativity from folks bidding good riddance to the year just ended. To be sure, 2017 had its share of disconcerting headlines, with the Year in Review section of The Wall Street Journal offering Sexual Misconduct Rocks Media, Politics and Election Probe Rattles White House and Shootings Stun Las Vegas, Tiny Texas Town and A Year of Costly Disasters (Hurricanes Harvey, Irma & Maria, Severe Storms and Wildfires) and North Korea Raises Tensions.

Clearly, we understand that the political climate is also extremely polarized, but at the risk of sounding insensitive, bad news happens every year. For example, 12 months ago in this space we wrote: "No doubt, there was no shortage of concerns in 2016 (as has been the case every year), starting almost from day one as the worst first week in history (the Dow Jones Industrial Average skidded 6.2%, or more than 1,000 points) supposedly portended an ugly year for equities. Worries were hardly alleviated over the ensuing five weeks, with the percentage losses hitting double-digits in February on fears that a Chinese economic slowdown would kill global growth, while here at home, many were spooked by sub-par GDP growth, uncertainty in regard to Federal Reserve monetary policy and question marks about the health of corporate profits. And that was all before the shocking Brexit vote and the unexpected Trump victory, both of which were widely thought to be black-swan events that would lead to massive stock market losses."

And, it isn't as if 2018 has been free of drama, yet equities have delivered terrific returns over the past two+ years, even as the kinds of stocks that we have long favored have finished runner-up in the recent performance derbies.



THE PRUDENT SPECULATOR

Value Lags Growth, But Trounces Bonds

Returns Race					
2018 YTD	2017	2016	Since 10-Yr	Bloomberg	
Return %	Return %	Return %	Yield Low	Symbol	Index
			(7.8.16) %		
Stock Indexes					
3.50	28.11	16.50	46.19	INDU Index	Dow Jones Industrial Average
11.30	29.73	8.97	57.79	CCMP Index	NASDAQ Composite Index
5.06	21.68	12.04	35.92	RIY Index	Russell 1000 Index
9.48	14.63	21.28	45.65	RTY Index	Russell 2000 Index
5.40	21.12	12.72	36.64	RAY Index	Russell 3000 Index
4.84	21.82	11.95	35.60	SPX Index	S&P 500 Index
9.51	30.21	7.07	47.38	RLG Index	Russell 1000 Growth Index
0.52	13.64	17.33	24.89	RLV Index	Russell 1000 Value Index
11.51	22.14	11.28	49.87	RUO Index	Russell 2000 Growth Index
7.30	7.82	31.72	41.29	RUJ Index	Russell 2000 Value Index
9.66	29.58	7.38	47.57	RAG Index	Russell 3000 Growth Index
1.02	13.17	18.38	26.07	RAV Index	Russell 3000 Value Index
9.76	27.43	6.89	44.20	SGX Index	S&P 500 Growth Index
-0.33	15.35	17.39	25.78	SVX Index	S&P 500 Value Index
Largest Bond Funds					
-2.07	3.57	0.79	-2.24	VBIX Equity	Vanguard Tot Bd Mkt Idx-Inst
-2.14	3.53	0.75	-2.37	VBIX Equity	Vanguard Tot Bnd Mkt II-Inv
-1.27	8.17	0.82	10.80	PONAX Equity	Pimco Income Fund-A
-1.83	3.09	0.75	-1.54	MWTRX Equity	Mtrpltn Wst Ttl Rtrn Bnd-M
-2.15	5.13	0.73	0.41	PTTRX Equity	Pimco Total Return Fund-Inst
-0.51	2.02	-0.01	0.94	VFSTX Equity	Vanguard S/T Invest Grd-Inv
-1.48	4.36	0.63	2.52	DODIX Equity	Dodge & Cox Income
-0.68	3.79	0.51	1.75	DBLTX Equity	Doubleline Ttl Rtrn Bnd-I
0.24	2.30	0.19	3.26	LALDX Equity	Lord Abbett Shrt Dur Inc-A
-0.58	2.35	-1.43	10.47	TPINX Equity	Templeton Global Bond-A
-2.21	3.27	0.71	-2.52	FBIDX Equity	Fidelity Us Bond Index-I

Source: Bloomberg. As of 6.8.18. 10-Year Treasury Yield Low (1.36%) was July 8, 2016.

While Value strategies won the performance spoils by a wide margin in 2016, it has been an entirely different story since, as high-flying Growth stocks like Amazon, Facebook, Netflix and Tesla captured the fancy of investors. Of course, given that the yield on the 10-Year U.S. Treasury has more than doubled since July 8, 2016, the real “risk” in the financial markets has been in bonds, not stocks!

No doubt, the fact that the performance of Value strategies (hard to complain about a 26.1% return on the Russell 3000 Value index since the yield on the 10-Year U.S. Treasury bottomed at 1.36% on July 8, 2016) has trailed that of Growth has caused some consternation for many investors. Indeed, the subject was addressed last week via a widely-read column ([“Value Investors Face Existential Crisis after Long Market Rally”](#)) in *The Wall Street Journal*

Here is our response to the piece...

The writer seems to have covered his bases!

He opens with the assertion that those Value managers who have evolved their strategies may be taking big risks, “Hunting for cheap stocks has been out of favor for so long that some self-proclaimed ‘value’ investors are embracing a broader mandate, a potentially costly move in the later stages of an economic cycle.”

But, the rest of the piece discusses how arguably successful Value managers have evolved their approaches for the current environment, with nary a mention of anyone who is still embracing a narrow definition of Value. After all, his concluding quotation reads, “Anybody who is surviving in this world as a value investor has had to run outside the value benchmarks.”

Happily, we believe, we also cover those same bases as we never forget that Value has won the long-term performance race by a wide margin,...



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THE PRUDENT SPECULATOR Value Stocks Have the Best LT Returns

LONG-TERM RETURNS

	Annualized Return	Standard Deviation
Value Stocks	13.4%	25.9%
Growth Stocks	9.5%	21.4%
Dividend Paying Stocks	10.5%	18.0%
Non-Dividend Paying Stocks	8.8%	29.6%
Long-Term Corporate Bonds	6.0%	7.5%
Long-Term Gov't Bonds	5.4%	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 04.30.18. 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: AFAM Capital using data from Professors Eugene F. Fama and Kenneth R. French and Ibbotson Associates

...with our portfolios very much continuing to sport inexpensive valuation metrics that are more attractive than the even most of the Value indexes.



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THE PRUDENT SPECULATOR AFAM Capital Portfolio 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	16.2	13.2	1.2	1.9	2.7
Select Value	16.7	13.3	1.3	2.0	2.3
Select Dividend	16.2	13.2	1.1	2.1	3.0
Select Focused Dividend	14.8	12.4	1.0	2.2	3.2
Select Focused Value	15.0	12.9	1.3	2.3	2.6
Select SMID Dividend	17.9	14.0	0.7	1.7	2.5
Russell 3000	22.6	18.2	2.1	3.2	1.8
Russell 3000 Growth	27.4	21.8	2.9	6.7	1.2
Russell 3000 Value	19.0	15.4	1.6	2.0	2.4
Russell 2000	46.8	27.1	1.4	2.5	1.2
Russell 2000 Growth	71.2	35.4	1.8	4.5	0.6
Russell 2000 Value	33.9	21.4	1.1	1.7	1.9
Russell 1000	21.7	17.7	2.2	3.3	1.8
Russell 1000 Growth	26.0	21.1	3.0	7.0	1.2
Russell 1000 Value	18.3	15.0	1.6	2.1	2.5
S&P 500 Index	21.1	17.5	2.2	3.4	1.9
S&P 500 Growth Index	25.3	20.6	3.7	6.2	1.3
S&P 500 Value Index	17.7	14.8	1.5	2.2	2.6
S&P 500 Pure Value Index	15.4	12.6	0.7	1.5	3.2

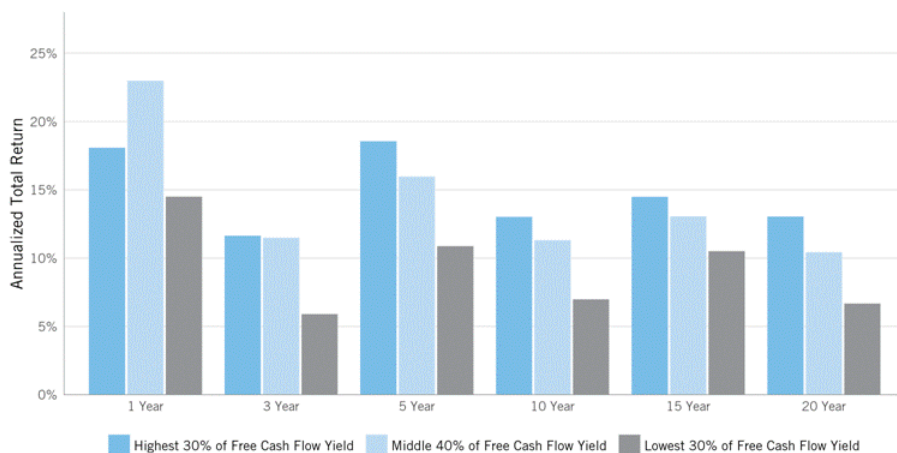
As of 06.10.18. Weights based on model portfolios. Harmonic mean used to calculate the portfolio price metrics. Companies with negative earnings are excluded from the P/E and Estimated P/E calculations. SOURCE: AFAM Capital using data from Bloomberg Finance L.P.

Yet, we are always evolving in our analytics, having more recently added Free Cash Flow Yield...



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THE PRUDENT SPECULATOR In House # Crunching: FCF Yield

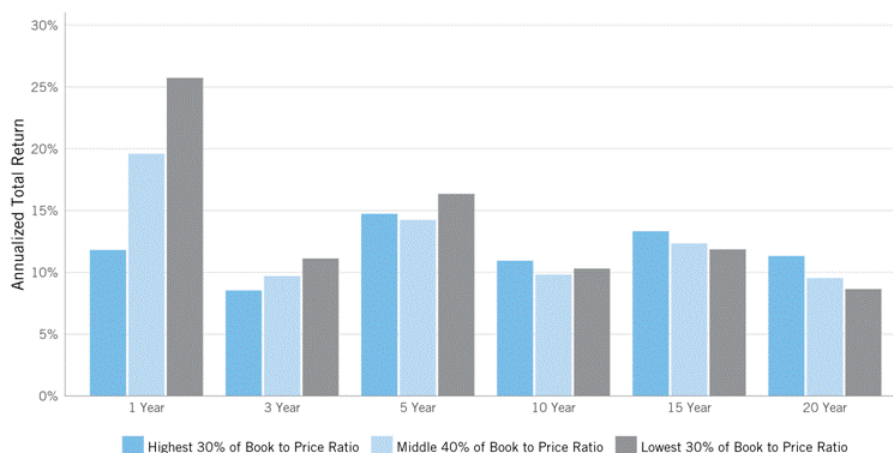


From 12.31.96 through 12.31.17, Portfolios are formed using the Russell 1000 ranked by decile on Free Cash Flow Yield at the end of each year. Stocks that cease trading mid-year are given the risk-free return for the balance of the year. Rebalanced annually. SOURCE: AFAM Capital using data from Bloomberg Finance L.P.

Free Cash Flow Yield (FCFY): Free cash flow yield is calculated as free cash flow per share divided by the market price. Free cash flow is the actual amount of cash a company receives in a period, less the amount it paid out. While income metrics like earnings per share are susceptible to accounting manipulation, free cash flow is more difficult to alter because it is directly related to the amount of cash a company moves. We view a higher free cash flow yield as better, all else equal, and believe it's a good way to measure the sustainability of a company's operations.

...to our analytical mix, as this metric has generally performed well over the long-term AND has also done better over the near-term than a traditional Value metric like Book Value to Price.

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In House # Crunching: BV to Price



From 12.31.96 through 12.31.17. Portfolios are formed using the Russell 1000 ranked by decile on Book to Price Ratio at the end of each year. Stocks that cease trading mid-year are given the risk-free return for the balance of the year. Rebalanced annually. SOURCE: AFAM Capital using data from Bloomberg Finance L.P.

Book Value (BV): Assets minus liabilities; book value is the total amount that common shareholders would theoretically expect to get if a company filed for bankruptcy and had to sell all of the company's assets. Book value per share is calculated and then divided by price to produce a BV/P (the inverse of the P/BV calc) ratio. We prefer companies with a high book value to price because we are paying less for the net assets on the books.

Of course, we also think that our three step approach to Stock Selection keeps us fishing in the Value pond, so to speak,...

...with our picks scoring favorably on a review of backward-looking factors that traditionally have been good indicators of future outperformance,...

...and our qualitative focus hopefully allowing us to avoid owning too many Value Traps, namely stocks that go on to prove to be cheap for good reason,...

...while our forward looking Valuation Engine helps to ensure that the companies in which we choose to invest have significant long-term total return potential (capital appreciation and dividend income), relative to the risk associated with the holding.

No doubt, we are constantly striving to improve our methodology, all while doing our best not to kill the goose that has laid the golden eggs,...



THE PRUDENT SPECULATOR

Staying the Course Has Rewards

Despite enduring two-dozen market pullbacks of at least 12% since its launch in 1977, *The Prudent Speculator* tops the Hulbert rankings.

Start Date		End Date		Price Return %		Start Date		End Date		Price Return %	
11.03.15	to	02.11.16	-13.3	03.24.00	to	04.04.01	-27.8				
05.21.15	to	08.25.15	-12.4	07.16.99	to	10.15.99	-12.1				
04.29.11	to	10.03.11	-19.4	07.17.98	to	08.31.98	-19.3				
04.23.10	to	07.02.10	-16.0	07.16.90	to	10.11.90	-19.9				
01.06.09	to	03.09.09	-27.6	10.21.87	to	12.04.87	-13.3				
11.04.08	to	11.20.08	-25.2	08.25.87	to	10.19.87	-33.2				
05.19.08	to	10.27.08	-40.5	10.10.83	to	07.24.84	-14.4				
10.09.07	to	03.10.08	-18.6	11.30.81	to	08.12.82	-18.9				
11.27.02	to	03.11.03	-14.7	11.28.80	to	09.25.81	-19.7				
08.22.02	to	10.09.02	-19.3	02.13.80	to	03.27.80	-17.1				
01.04.02	to	07.23.02	-32.0	09.12.78	to	11.14.78	-13.6				
05.21.01	to	09.21.01	-26.4	12.31.76	to	03.06.78	-19.1				
AVERAGE										-20.6	

Down Markets for the S&P 500 Price Return index are defined as periods where the index fell more than 12% without an intervening 12% advance. SOURCE: Al Frank using data from Bloomberg

Hulbert Rankings	
30-Year Performance Scorecard	
Newsletter Averages	
Newsletter	Annualized
Prudent Speculator, The	14.71
Investment Reporter, The	12.17
Fidelity Monitor & Insight	12.05
Turnaround Letter, The	11.77
NoLoad FundX	11.71
Investment Quality Trends	11.53
Bob Brinker's Marketimer	10.89
PaulMerriman.com	7.18
S&P 500 Total Return	10.47

As of 3.31.18. Source: <http://hulbertratings.com/30-year-scoreboard/>

...while we note that our eclectic Value approach has uncovered plenty of stocks that have terrific Growth potential, as evidenced by the top holdings (in order) of our managed account clients from our latest 13-F regulatory filing.



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THE PRUDENT SPECULATOR AFAM Capital Q1 2018 13-F Filing Top 25

AFAM CAPITAL Q1 2018 13-F LARGEST COMMON STOCK HOLDINGS													
Symbol	Common Stock	6.8.18 Price	Target Price	Sector	P/E	P/S	P/TBV	EV/ EBITDA	FCF Yld	Debt/ TE (%)	Div Yld	Mkt Cap	
MSFT	Microsoft	101.63	108.06	Software & Services	29.0	7.4	22.2	17.1	4.3	209%	1.7%	780,843	
AAPL	Apple	191.70	207.56	Technology Hardware	17.7	3.8	7.9	10.4	5.5	85%	1.5%	942,232	
INTC	Intel	55.05	59.21	Semiconductors	15.0	4.0	7.5	9.5	4.6	72%	2.2%	256,533	
AET	Aetna	180.81	201.76	Health Care Equip/Services	17.5	1.0	12.7	9.3	2.6	167%	1.1%	59,143	
JPM	JPMorgan Chase	111.11	129.66	Banks	14.8	nmf	2.1	nmf	nmf	nmf	2.0%	378,305	
CSCO	Cisco Systems	43.48	50.77	Technology Hardware	17.3	4.2	16.6	12.5	5.9	165%	3.0%	204,481	
DIS	Walt Disney	103.98	142.19	Media	16.3	2.7	22.6	10.6	6.7	274%	1.6%	154,592	
GLW	Corning	28.75	39.87	Technology Hardware	17.4	2.3	2.5	10.9	0.1	50%	2.5%	23,873	
CE	Celanese	117.11	136.89	Materials	13.8	2.4	8.8	14.3	2.9	185%	1.8%	15,910	
AMGN	Amgen	184.30	218.56	Pharmaceuticals, Biotech	14.3	5.3	nmf	10.4	8.2	nmf	2.9%	121,952	
RCL	Royal Caribbean Cruises	103.48	146.57	Consumer Services	13.6	2.5	2.1	11.4	3.7	74%	2.3%	21,912	
HFC	HollyFrontier	77.19	82.04	Energy	23.6	0.9	4.7	9.0	7.7	82%	1.7%	13,627	
DE	Deere & Co	157.12	186.27	Capital Goods	20.1	1.5	9.2	7.7	-3.0	475%	1.8%	50,952	
NSC	Norfolk Southern	154.23	173.00	Transportation	22.2	4.1	2.7	11.2	3.5	59%	1.9%	43,576	
TPR	Tapestry	46.24	56.99	Consumer Durables & Apparel	18.3	2.4	nmf	14.9	4.8	nmf	2.9%	13,309	
ETN	Eaton Corp PLC	80.35	91.32	Capital Goods	16.7	1.7	nmf	12.0	5.6	nmf	3.3%	35,137	
PRU	Prudential Financial	100.55	140.52	Insurance	9.3	nmf	0.8	nmf	nmf	nmf	3.6%	42,231	
CMCSA	Comcast	32.08	50.37	Media	14.9	1.7	nmf	7.5	7.8	nmf	2.4%	147,621	
CAT	Caterpillar	155.32	180.87	Capital Goods	18.4	1.9	13.9	10.5	2.7	347%	2.0%	92,874	
PNC	PNC Financial Services	148.85	167.41	Banks	16.6	nmf	2.1	nmf	nmf	nmf	2.0%	69,885	
ABT	Abbott Laboratories	63.27	69.33	Health Care Equip/Services	24.2	3.9	nmf	19.7	4.5	nmf	1.8%	110,924	
BAC	Bank of America	30.01	38.02	Banks	14.6	nmf	1.8	nmf	nmf	nmf	1.6%	304,282	
STX	Seagate Technology PLC	55.98	67.91	Technology Hardware	12.3	1.5	nmf	9.2	9.4	nmf	4.5%	16,070	
JNJ	Johnson & Johnson	124.06	152.18	Pharmaceuticals, Biotech	16.5	4.2	nmf	13.8	5.5	nmf	2.9%	332,748	
MDC	MDC Holdings	32.70	50.96	Consumer Durables & Apparel	11.8	0.7	1.3	12.1	-5.3	76%	3.7%	1,839	

Holdings as of 3.31.18. Other data as of 6.8.18. 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

Stock Updates

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

As the dreadful news that legendary fashion designer Katherine Noel Brosnahan, known professionally as Kate Spade, took her own life raced around the world on Tuesday, shares of Kate Spade New York owner **Tapestry** (TPR - \$46.24) momentarily dipped, as traders (or algorithms, more likely) responded to the news with dread that the brand lost a key part of its design team.



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THE PRUDENT SPECULATOR TPR – Efficient Markets at Work

We do not overreact to short-term price moves as setbacks of undervalued stocks are often overcome in the fullness of time...or in the case of Tapestry (TPR), within a few seconds! Incredibly, shares of the specialty retailer dropped 4% on news of the suicide of Kate Spade, only to immediately rebound as folks realized that the legendary designer has had nothing to do with her namesake company since 2007.



Trades placed under that assumption would have been in error, though, as Mrs. Brosnahan has not been associated with Kate Spade since 2007, when she stepped away completely from her namesake company. Tapestry, formerly Coach, Inc., acquired the current Kate Spade & Company 11 months ago, then stating, “The combination creates a leading luxury lifestyle company with a more diverse multi-brand portfolio supported by significant expertise in handbag design, merchandising, supply chain and retail operations as well as solid financial acumen. Coach’s history and heritage, multi-channel, international distribution model, and seasoned leadership team uniquely position it to drive long-term sustainable growth for Kate Spade.”

Our Target Price for TPR remains \$57, though we suspect that sales of Kate Spade merchandise may see a short-term spike, given the fond memories of the designer and her products from many a celebrity last week.

Shares of family-oriented department store operator **Kohl’s** (KSS – \$77.76) jumped more than 13% last week eclipsing the updated Target Price we set just two weeks ago (\$76). Kohl’s stock now has a year-to-date total return of 44.5%. Coming off a strong quarterly earnings release and solid outlook for the full-year, KSS further built momentum with investors during its sell-side analyst event in New York last week. Following the confab, an onslaught of positive investor comments and analyst upgrades ensued.

Along with others, we believe that Kohl's has begun to strategically benefit from store closures by Sears, Bon-Ton and even Toys "R" Us in certain areas. And last week, management outlined the game-plan to continue to "redefine" Kohl's, with a multi-year combination of core business initiatives (active/speed/beauty) as well as growth drivers (digital/loyalty/partnerships). Furthermore, management expressed confidence in near-term trends noting that Q2 has been strong, supported by an improvement in underlying business fundamentals, and stating that they believe this will carry over to the second half of the year with growth initiatives set to accelerate and persist into fiscal 2019 and 2020.

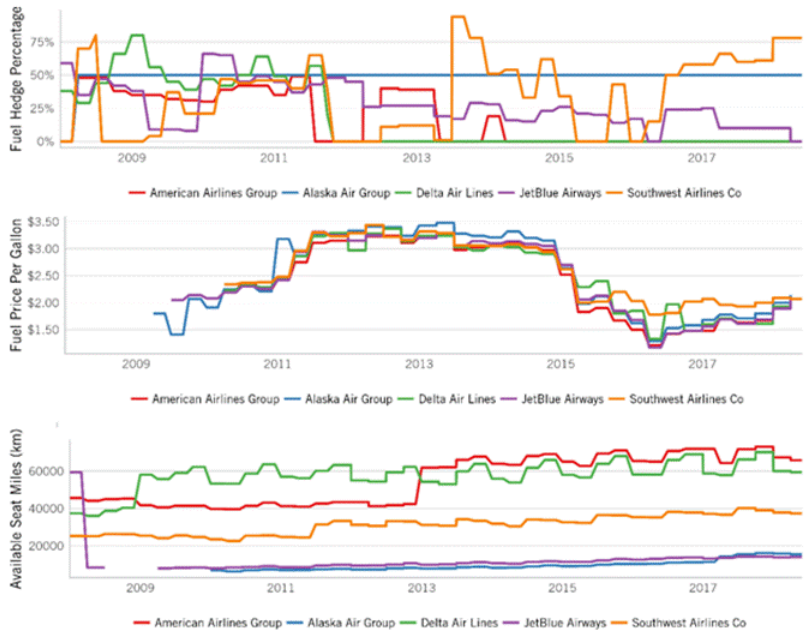
We continue to like what Kohl's has been doing to overcome, evolve and thrive in the highly competitive retail environment, including trying partnerships with competitors like Amazon (for package drop off and pick up, plus a trial of an Amazon Smart Home Experience in 10 stores in Chicago and Los Angeles), initiating a strategic relationship with Under Armour and focusing on beauty offerings, all in efforts to increase foot and online traffic as well as drive larger per-customer tickets.

All that said, we are keeping a close eye on KSS shares as we want to ensure that the valuation remains reasonable, especially as the trailing P/E is now 17.5, on the high end of its historical range. We have lifted our Target Price to \$81, and at this point would be leaning hard towards selling some or all of our KSS stake at this level, even as we are very fond of the 3.1% dividend yield.

In our 596th issue of *The Prudent Speculator* in June 2016, we recommended **Delta Air Lines** (DAL - \$54.09) to our readers, explaining, "DAL faced some significant hurdles after its merger with Northwest Airlines in 2007, especially related to fleet integration, union contracts (Delta was non-union, Northwest union) and differing organizational cultures. Although work remains to be done, Delta has mostly overcome the issues. Using low fuel prices and low cost of debt to its advantage, Delta has placed orders for more than a hundred new planes to replace aging aircraft in the current fleet. It seems the likely case that most will be delivered as fuel prices increase, such that savings from new planes' lower fuel and maintenance expenses will more than offset the higher lease costs."

It seems that higher fuel prices have finally arrived. As is presented in the chart below, fuel price has been gradually climbing over the past year, and the airlines have noticed. Despite the hundreds of fuel-efficient airplanes that have been delivered in the last few years, airlines have been opting to keep older planes in service longer or order more newer planes than are required for pure replacement, resulting in growing industry-wide capacity. The capacity increases are good for travelers, but not great for margins. And striking the right balance is crucial—and elusive. We think that longer-term capacity changes and newer airplanes will help keep DAL's fuel costs in check.

AFAM CAPITAL THE PRUDENT SPECULATOR
DAL – Fuel Cost & Capacity Worries



As of 06.08.18. SOURCE: AFAM Capital using data from Bloomberg Finance L.P.

While each airline is different, and we note that fuel hedging is generally an endeavor most profitable for the traders, some airlines are feeling the pinch more than others. Delta no longer hedges fuel, though it does own a refinery. And shares of DAL tumbled on Wednesday after the company’s presentation at the Deutsche Bank Global Industrials and Materials Summit revealed that, “Decisions on Fall 2018 capacity plans [are] expected to be made over the next month through the lens of strong demand and volatile fuel. Market fuel prices [are] up ~50% year over year and ~12% since beginning of quarter. [DAL] remains focused on recapturing fuel through revenue – fuel prices are highly correlated over long-term with 6-12 month lag.” As a result, Delta revised its Q2 EPS guidance downward from \$1.80 to \$2.00 per share to \$1.65 to \$1.75 per share.

With the capacity growth outlook modest (DAL still sees capacity growth of 3% to 4% this year) and orders on the books for more than three hundred new planes, we think that DAL is in a solid position to push fare prices higher, while benefitting from still-low fuel, maintenance and interest costs. Our Target Price is presently \$76.

Shares of German mail and package carrier **Deutsche Post AG** (DPSGY – \$36.76) fell more than 4% on Friday. The company reported a reduced adjusted EBIT (earnings before interest and taxes) estimate of \$3.78 billion for fiscal 2018, compared with the earlier estimate of \$4.98 billion, because of one-off expenses.

“We are fully focused on achieving our strategic and financial targets for 2020 and on positioning our business divisions for success in future years. In order to deliver long-term sustainable growth, we are now consciously accepting short-term negative effects on our earnings,” said Frank Appel, CEO Deutsche Post DHL Group.

The press release stated, “The structural shift from Post to Parcel resulted in a number of challenges in 2018. In Parcel Germany, the division sees unchanged structural volume growth, but costs inflated with more FTEs and transport capacities needed in unusually tight labor and transport markets. The challenge for Post is the unchanged structural volume decline with stable stamp prices since January 2016 and a high fixed cost base. Additionally, the structural shift with mail decline and parcel growth is currently not adequately reflected in the overhead cost of the division, and the investment into the further development of operations in PeP (Post – eCommerce – Parcel) Germany has not been sufficient over the last years.”

We continue to believe that DPSGY (which sports a net yield of 3.7%) can benefit from the Amazon-style online shopping that hasn’t taken over Europe yet, as well as its leading position in more profitable European express and parcel mail (most other carriers haven’t diversified yet in Europe). While online shopping might not reach the level it has in the U.S., primarily because of different consumer behavior, a global marketplace of goods available at the click of a button is incredibly enticing. The stock now trades for an inexpensive 14.5 times estimated earnings and for just 65% of sales. Still, the near-term operational issues have compelled us to trim our Target Price for DPSGY to \$56.