EXECUTIVE SUMMARY

Forbes Danube Cruise Around the Corner - Memories of Australia
September Rebound Continues - Value Beats Growth
Rising Rates and Stocks - Busting Another Market Myth
Government Bonds Can Be Risky - Sizable Losses on 10-Year and 30-Year Treasuries Since August 2016
Sentiment - Only Problem with Market Timing is Getting the Timing Right
Staying the Course - Reasonable Valuations and Dividend Yields Relative to Bond Yields
Company News - Updates on ORCL, FDX & MU

Market Review

Your Editor will be leaving at the end of the week to speak on the *Forbes Danube Cruise*. We know that several of our readers and managed account clients will be taking part and we wanted folks to be aware that there is another *Forbes Cruise*, this one to South America, coming up in January. The *MoneyShow* is presently running a special promotion, whereby there is a $400 per person savings off the cabin price if booked by October 31. Click here for more details…https://cruises.moneyshow.com/the-31st-forbes-cruise-for-investors/?scode=046375.

Hopefully, the trip down the Danube won't be as "interesting" for investors as was this past February's Australian Cruise, when the Dow Jones Industrial Average had two separate quadruple-point drubbings in the span of four days. Back then, we expressed our usual optimism in times of market turmoil, writing in a Special Market Commentary on Feb. 8:

The reason that we remain so sanguine about the prospects for stocks is that the supposed causes of the plunge, namely fears of rising interest rates and inflation, are very much overdone in our view. After all, interest rates have been climbing on the back of healthier economic data, with New York Fed President William Dudley stating on Thursday afternoon, "There are so many things now on the side of the economy being stronger than expected that I think [a slowdown] is not that likely. We have above-trend growth, we have buoyant financial conditions, we still have an easy monetary policy, and this is all taking place with a very large tax cut that is going to provide additional stimulus." Mr. Dudley concluded, "The little decline that we've had in the equity market today has virtually no implications for the economic outlook," and we remain of the mind that a healthy business climate is likely to lead to improved corporate profits, which is ultimately what drives stock prices.

Our advice that fateful day, "Not to minimize the recent ugliness, but we have endured far worse in our 40 years of publishing *The Prudent Speculator* and we have no reason to change our belief that the secret to success in stocks is not to get scared out of them," has proved "valuable," with the major market averages quickly rebounding from the February trauma and hitting all-time highs last week.

Indeed, despite having to contend with drama related to tariffs (with renewed concern thereof again pushing the equity futures into the red as trading resumes this week), it was a terrific five days of trading in the week just completed. This is especially true as Value stocks rallied smartly

while Growth stocks ended slightly in the red. When all was said and done, the S&P 500 and Russell 3000 last week gained 0.86% and 0.60%, respectively, while the Russell 3000 Value index advanced 1.35%, versus a 0.15% decline for the Russell 3000 Growth index.

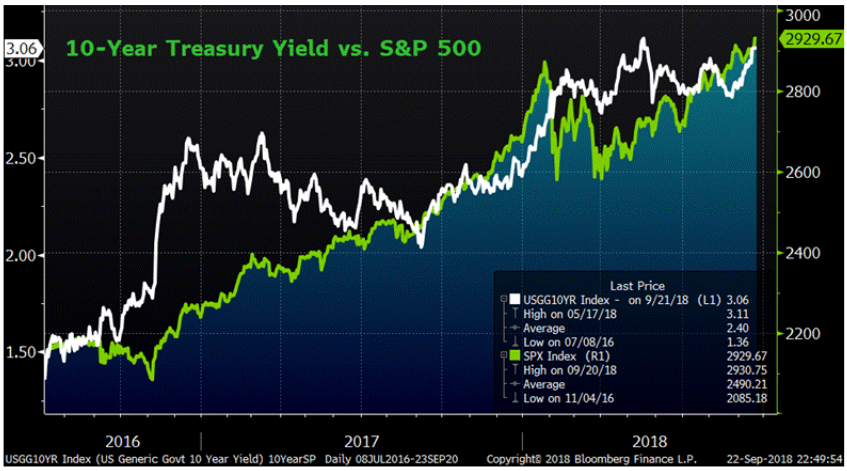
And, the rally came even as interest rates moved sharply higher, with the yield on the 10-year Treasury eclipsing 3%, a level that is actually well above the 2.75% or so that seemed to spook investors back in February. Of course, the yield on the 10-year was 1.36% on July 8, 2016, when the S&P 500 was at 2130, so we suspect that more are realizing that that the oft-expressed assertion of supposed market experts that rising rates are bad for stocks might make some sense in theory, but it often is not true in practice,…

AFAM CAPITAL

THE PRUDENT SPECULATOR

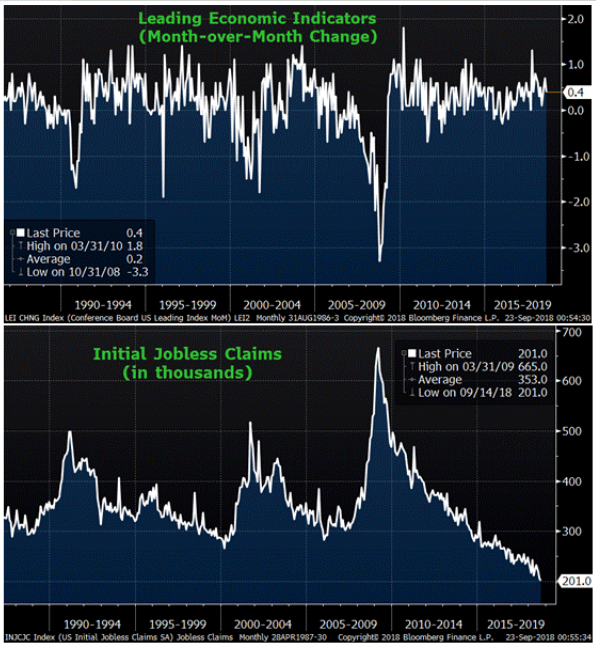
Rising Rates are Bad for Stocks?

The major market averages hit all-time highs last week, even as the 10-Year U.S. Treasury yield pushed well above 3%, continuing a rally that has seen the S&P 500 soar from 2130 on July 8, 2016, despite a more-than-doubling in the 10-Year yield over the same period.



…especially when the increase in bond yields is due to a strengthening economy that is not showing signs of overheating.

THE PRUDENT SPECULATOR
Healthy Economic Data

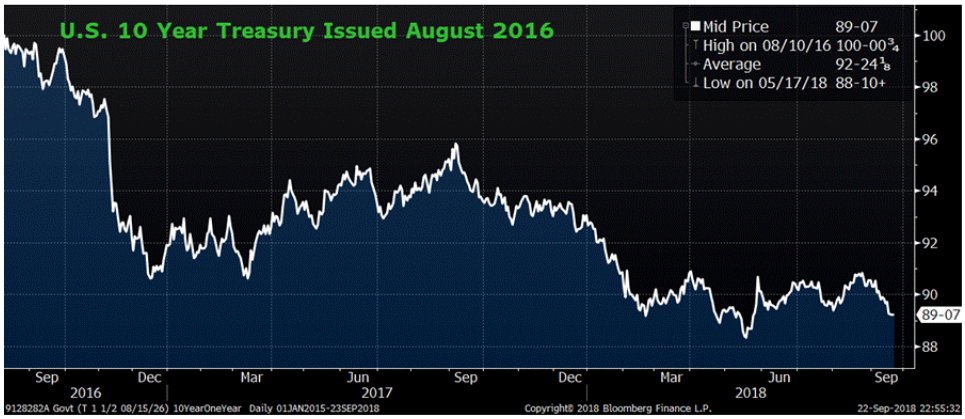


Though many are of the mind that economic growth will soon ease, the forward-looking Index of Leading Economic Indicators came in at a solid 0.4% growth rate in August, above its historic average, suggesting that a recession is not on the immediate horizon. Meanwhile, first-time filings for unemployment benefits fell in the latest week to 201,000, the lowest tally in some 50 years.

To be sure, about the only thing we can say with certainty is that rising interest rates are bad for bonds, supposedly a less-risky asset class, with long-term government bonds proving to be awful investments over the past two years or so. Incredibly, in the past 25 months, the 10-year Treasury has suffered a greater than 7% loss on a total return basis,…

THE PRUDENT SPECULATOR
"Safe" 10-Year Treasuries Can Be Risky

We respect that those able to hold government bonds to maturity face no loss of principal (though inflation impacts purchasing power) and the 10-Year U.S. Treasury issuance in August 2016 offered a 1.50% annual coupon, but folks unwilling or unable to hold until 2026 will have endured a total return of -7.67% in 25 months if they sell today.



…while the 30-year Treasury has skidded more than 12%,…

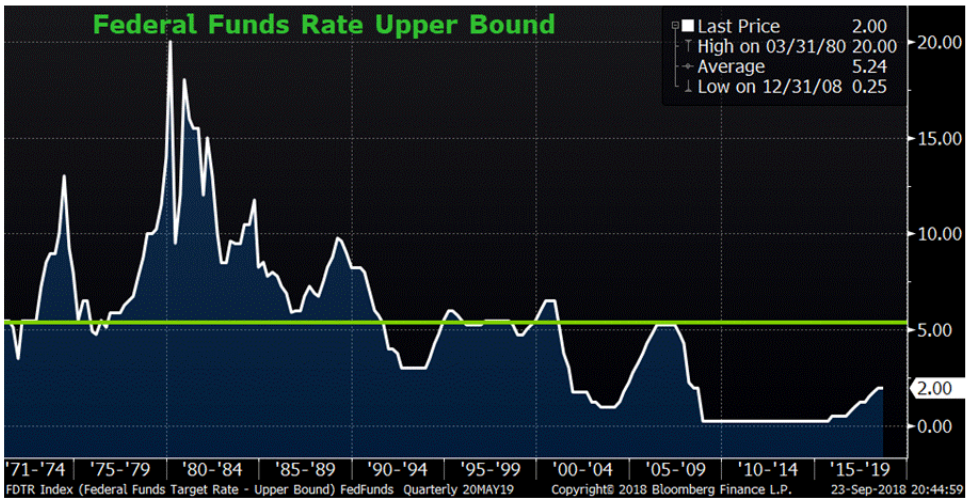
THE PRUDENT SPECULATOR
Lousy Returns for 30-Year Treasuries

We respect that those able to hold government bonds to maturity face no loss of principal (though inflation impacts purchasing power) and the 30-Year U.S. Treasury issuance in August 2016 offered a 2.25% annual coupon, but folks unwilling or unable to hold until 2046 will have endured a total return of -12.25% in 25 months if they sell today.

…and interest rates actually remain extraordinarily low by historical standards,…

THE PRUDENT SPECULATOR
Lots Of Hikes Needed To Reach "Normal"

Folks should not be too worried about additional interest rate hikes, given that Jerome Powell & Co. now project that the long-run target for the Fed Funds rate is 2.9%, well below the long-term 5.25% average.



…though the futures market suggests that there is a 97.9% chance that the Federal Reserve will boost the Fed Funds rate by another 25 basis points at the FOMC Meeting on Wednesday. No guarantee that government bond prices will continue to head south again should Jerome Powell & Co. hike rates, but we struggle to see the attraction in fixed income, which has been the destination of quite a few dollars from those disenchanted with equities, with the exodus from stocks picking up in September, just in time for the Dow Jones Industrial Average to post its best two week stretch…since February!

THE PRUDENT SPECULATOR
All-Time Highs and Hardly Any Optimism

AAII Investor Sentiment Survey

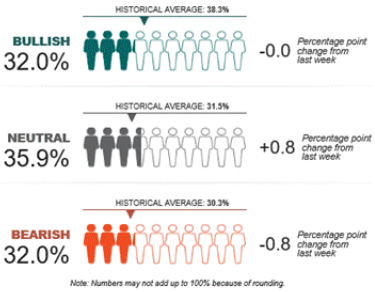
Since 1987, AAII members have been answering the same simple question each week:

Do you feel the direction of the market over the next six months will be up (bullish), no change (neutral) or down (bearish)?

The results are compiled into the AAII Investor Sentiment Survey, which offers insight into the mood of individual investors.

Survey Results for Week Ending 9/19/2018

Data represents what direction members feel the stock market will be in next 6 months.



Note: Numbers may not add up to 100% because of rounding.

The AAII Investor Sentiment Survey has become a widely followed measure of the mood of individual investors. The weekly survey results are published in financial publications including Barron's and Bloomberg and are widely followed by market strategists, investment newsletter writers and other financial professionals.

Folks fled U.S. equities during the first two weeks of September, as evidenced by the massive outflows from mutual funds and ETFs, while Bullishness in the latest AAII Sentiment Survey remained well below normal, and, perhaps not surprisingly, stocks moved nicely higher.

Combined Estimated Long-Term Fund Flows and ETF Net Issuance
Millions of dollars

Week Ended	9/12/2018	9/5/2018	8/29/2018	8/22/2018	8/15/2018
Total Equity	-3,371	-5,551	-570	3,028	778
Domestic	-3,830	-7,011	-413	1,415	11
World	459	1,461	-158	1,613	767
Hybrid	-1,691	-1,762	-1,362	-1,485	-1,475
Total Bond	7,206	3,519	4,414	4,597	1,675
Taxable	7,177	3,515	4,141	4,066	1,013
Municipal	30	4	273	531	662
Commodity	-57	-411	-388	-532	-674
Total	2,088	-4,204	2,094	5,607	305

Source: Investment Company Institute

After all, stocks compare quite well on an earnings yield perspective,…

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 rich earnings yield of 4.73%.

…while an argument also can be made that dividend yields are very much respectable,…

THE PRUDENT SPECULATOR
Dividends Have Grown Over Time

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

COUNT OF S&P 500 DIVIDEND ACTIONS	INCREASES	INITIATIONS	DECREASES	CESSATIONS
2018 YTD	283	3	2	0
2017	351	5	9	2
2016	344	7	19	2
2015	344	7	16	3
2014	375	8	8	0
2013	366	15	12	0
2012	333	15	11	1
2011	320	22	5	0
2010	243	13	4	1
2009	151	6	68	10
2008	236	5	40	22
2007	287	11	8	4
2006	299	6	7	3
2005	306	10	9	2

Source: Standard & Poor's. As of 9.20.18

S&P 500 DIVIDENDS PER SHARE	
2019 (Est.)	$58.29
2018 (Est.)	$54.01
2017	$50.47
2016	$46.73
2015	$43.49
2014	$39.44
2013	$34.99
2012	$31.25
2011	$26.43
2010	$22.73
2009	$22.41
2008	$28.39
2007	$27.73
2006	$24.88
2005	$22.22

Source: Bloomberg. As of 9.21.18

…especially on Value-oriented portfolios.

THE PRUDENT SPECULATOR
Newsletter Ports & 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	15.5	12.8	1.2	2.1	2.7
Buckingham	16.0	12.9	1.2	2.1	2.6
Milennium	16.4	13.2	1.1	2.0	2.6
PruFolio	16.2	13.1	1.1	2.1	2.6
Russell 3000	22.5	18.9	2.1	3.4	1.8
Russell 3000 Growth	28.4	23.7	3.1	7.6	1.2
Russell 3000 Value	18.6	15.7	1.6	2.2	2.3
Russell 2000	38.1	27.3	1.3	2.4	1.3
Russell 2000 Growth	99.2	46.0	1.8	4.8	0.6
Russell 2000 Value	23.1	19.0	1.0	1.6	2.0
Russell 1000	21.8	18.5	2.2	3.5	1.8
Russell 1000 Growth	26.8	22.8	3.3	8.0	1.2
Russell 1000 Value	18.3	15.5	1.7	2.2	2.4
S&P 500 Index	21.2	18.1	2.3	3.5	1.8
S&P 500 Growth Index	25.3	21.5	3.8	6.6	1.2
S&P 500 Value Index	17.7	15.3	1.6	2.3	2.5
S&P 500 Pure Value Index	15.1	12.7	0.7	1.6	2.4

As of 09.21.18. 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.

Of course, we realize that stocks are a volatile asset class and we are always braced for downside surprises, especially as September and October have often been scary months, but for those who share our long-term time horizon, our advice remains the same today as it did when yours truly was sailing the Great Australian Bight: Buy and patiently hold/harvest a broadly diversified portfolio of undervalued stocks for their long-term appreciation potential, ignoring and/or taking advantage of short-term market fluctuations.

Stock Updates

Speaking of short-term fluctuations, Chris Quigley takes a look at developments at three of our holdings that saw quite a bit of share-price volatility in response to quarterly earnings reports last week.

System software firm **Oracle** (ORCL - $51.10) earned $0.71 per share in fiscal Q1 2019 (vs. $0.68 est.). ORCL had sales of $9.2 billion (vs. $9.3 billion est.). Although shares were volatile in extended hours trading, they closed the week up nearly 4%. Oracle benefitted from growing market share, as customers opt to buy the Oracle Fusion ERP (Enterprise Resource Planning Cloud), rather than competing SAP and Workday systems.

Co-CEO Safra Catz said, "Total Cloud Services and License Support revenues for the quarter were $6.6 billion, up 4% in constant currency. This accounted for 72% of total company revenue, and the bulk of it is recurring revenues. In terms of ecosystems, GAAP applications total revenues were $2.8 billion, up 7%, and GAAP platform and infrastructure total revenues were $4.7billion, up 2%. Operating cash flow over the last four quarters was a record $15.5 billion. Over the same four quarters, capital expenditures were $1.6 billion and free cash flow was $13.9 billion, up 10%, in USD. We have more than $60 billion in cash and marketable securities; the short-term deferred revenue balance is $10.3 billion and was up 4% in constant currency. The remaining performance obligation of what I will refer to as contrast backlog which will be in the Q from now going forward is now $31.3 billion, of which approximately 64% will be recognized as revenue over the next 12 months."

Oracle founder Larry Ellison added, "Oracle has two strategic products that will determine our future. Our Cloud ERP product is the strategic key to our success in the SaaS applications layer of the Cloud. And our Autonomous Cloud Database is the strategic key to our success in the IaaS or Infrastructure layer of the Cloud. We think we have compelling advantages will allow us to compete very effectively against Amazon in the infrastructure business. Today, we may be behind Amazon in infrastructure market share, but we are way ahead of Amazon in cloud infrastructure technology. We think that will allow us to gain market share in infrastructure in the Cloud very, very rapidly."

We continue to be encouraged by the possibilities in the cloud business and we believe that ORCL has an experienced leadership team that will drive top-line growth to the bottom line. Oracle shares are again approaching all-time highs set in March, but we believe that the stock valuation is still very reasonable, based on our proprietary score and metrics like the 15x forward P/E ratio. ORCL also has the aforementioned mountain of cash, while the long-term debt gives

the company about $2 billion of net cash. Our Target Price has been bumped up to $59. ORCL currently yields 1.5%.

Air freight and logistics leader **FedEx** (FDX - $247.32) reported earnings per share of $3.46, versus the $3.80 estimate, in fiscal Q1 2019. FDX had sales of $17.1 billion, versus the $16.9 billion estimate. Shares nosedived 5.5% following the announcement. In a strange possible rule change from the Treasury Department, FedEx may have to reverse a $225 million benefit it recognized in 2018. The company wrote, "On August 1, 2018, the U.S. Treasury Department released proposed regulations covering the one-time transition tax on unrepatriated foreign earnings, which was enacted as part of the TCJA. Certain guidance included in these proposed regulations is inconsistent with our interpretation that led to the recognition of a $225 million ($0.94 per diluted share) benefit in 2018 (the '2018 Benefit'). This proposed guidance is not authoritative and is subject to change in the regulatory review process. However, if the proposed guidance is included in the final regulations as drafted, we may be required to reverse the 2018 Benefit in the quarter the regulations become final. We are still completing our accounting for the income tax effects of the TCJA. As of August 31, 2018, there were no changes to the provisional amounts recorded at May 31, 2018."

In regard to the Q1 numbers, CEO Fred Smith stated, "FedEx delivered higher earnings driven by a solid execution of our business plan and a strong U.S. economy. We believe we will continue to increase revenue, cash flows, earnings and returns in fiscal 2019and beyond. We're very optimistic about our prospects for profitable growth and remain confident we'll reach our goal to improve FedEx Express operating income by $1.2 billion to $1.5 billion in fiscal 2020 versus fiscal 2017."

Chief Marketing Officer Raj Subramaniam offered additional economic perspective, "We're seeing solid economic growth especially in the U.S. Growth in jobs and incomes are keeping confidence high and driving positive trends in the consumer spending and retail sales. The industrial sector continues to perform well and the outlook for business investment is strong. Internationally, we do not see a repeat of last year's synchronized global growth story as the Eurozone and China slow. However, we expect another Eurozone global growth as the economic cycle plays out. Global manufacturing and business investment continue to expand. Regarding trade matters, current tariffs impact a small portion of our volume coming out of China. However, the uncertainty surrounding the issue is not helping and thus has a broader impact on the market. It's important to note that our revenue on the China/U.S. lane bi-directionally represents 2% of our total FedEx revenues and the tariffs impact only a small portion of that. It's very difficult to predict the future course of tariff implementation. We're monitoring the situation very carefully and we'll adjust our strategies according to market conditions."

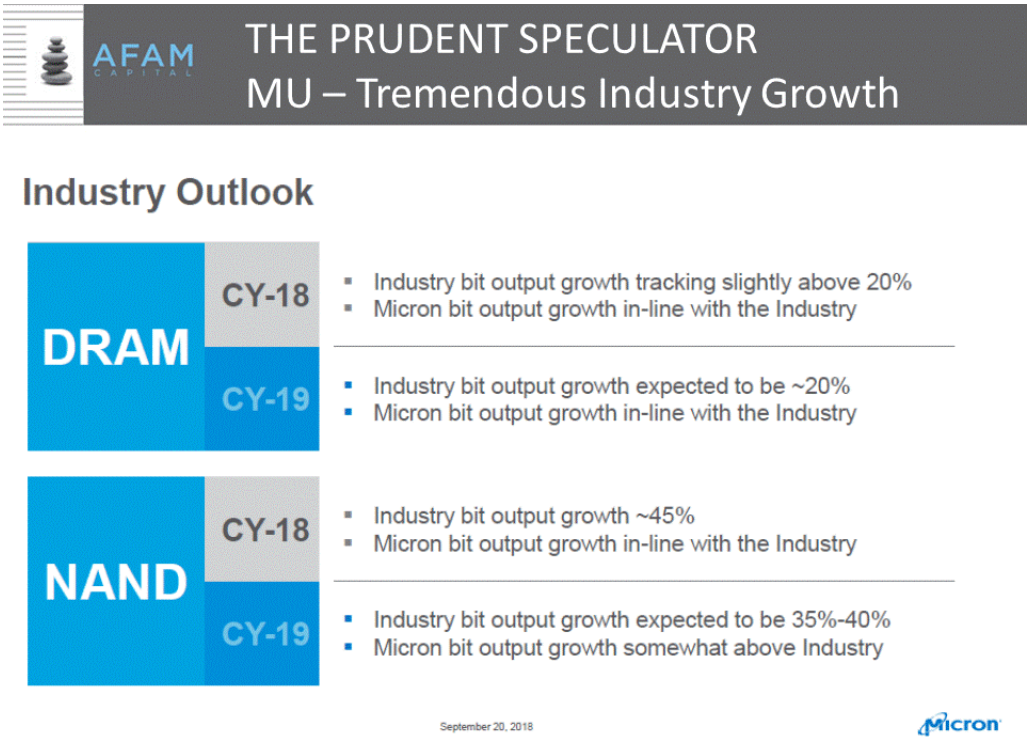
Mr. Subramaniam continued, "We're fast approaching the holiday peak season and preparations are well underway. We forecast another record year with four Mondays during peak expected to be among the busiest days in the history of FedEx. Once again, we are not applying a residential peak surcharge. FedEx delivers to millions of small and medium-sized businesses every day and we want to support these customers as e-commerce continues to grow and becomes a major part of their business. We continue to have excellent momentum with our small and medium customers segment."

FedEx also repurchased $625 million of stock in fiscal Q1 and increased the dividend for 2019 by 30%, resulting in a yield of 1.1%. FDX expects 9% revenue growth for 2019, resulting in an estimated EPS range of $17.20 to $17.80 per share (compared with last quarter's estimated range of $17.00 to $17.60). We are enthused by the guidance bump for fiscal 2019 and think that FedEx will ultimately be able to navigate around the trade issues. We think that the continued pressure on the U.S. Postal Service to restructure will help FedEx and we are pleased that the ongoing Amazon threat has not hampered FedEx's growth plan. We like FedEx's strong balance sheet, modest dividend yield and position as an industry leader. FDX trades at a reasonable 13.5 times NTM earnings. Our Target Price has been hiked to $334.

Memory maker **Micron Technology** (MU - $44.74) posted earnings per share of $3.53, versus the $3.33 estimate, in fiscal Q4 2018. MU had sales of $8.4 billion (vs. $8.3 billion est.). Shares slipped 2.9% following the announcement, though volatile extended hours trading saw the stock jump to nearly $49 and plunge below $43.

CEO Sanjay Mehrotra commented, "Our fourth quarter results contributed to a year of unprecedented success for the company. With record profitability and revenue over $30 billion, Micron ended fiscal 2018 as the second largest semiconductor company in the U.S. Over the last 12 months, we have sharpened our focus on improving our cost structure and on increasing the mix of high value solutions in our portfolio, all of which position us well for the future. Our technology roadmap and manufacturing execution is driving strong cost reductions for the company. Over the last year, we have increased production DRAM bits per wafer at a higher rate than the industry, reducing the cost gap with competitors."

Mr. Mehrotra continued, "Looking at the industry broadly, calendar 2018 has been a phenomenal year so far, with the total DRAM and NANDs TAM on track to reach record highs and total industry revenues forecasted to grow 29% year-over-year to $168 billion. As we discussed at our Investor Day event, we expect industry cyclicality to be more dampened than in the past as industry supply growth from nodes transitions slows structurally and supply growth requires higher levels of CapEx. In addition, we continue to see robust diversified demand drivers and are confident in the long-term outlook for our business. In fiscal 2019, we expect that DRAM profitability will remain strong as the market continues to benefit from long-term structural growth drivers and from structurally slowing supply growth."



Of course, traders are always focused most heavily on growth and we think it very important to consider additional comments from Mr. Mehrotra on the earnings call, “I think what's important to understand is the end market demand trends for DRAM as well as NAND continue to be strong. I mean, when you look at data center and cloud applications, AI is in the very, very early innings. And the whole cloud growth is in the very early innings as well. We see the DRAM requirements in enterprise and cloud data center application to be growing much faster than the total average DRAM industry demand growth, a CAGR over a course of a few years of about 30%. Similarly, in mobile applications, DRAM is growing nicely as well as machine learning kind of features as facial recognition, et cetera, get implemented in these phones. We are already starting to see 6 to 8 gigabytes even 10 gigabyte coming in smart and high-end smartphones now and days are not too far then you'll even see 12 gigabyte in smartphones. And similarly on the NAND front, when you look at average capacities increasing in smartphones, you are seeing now 512-gigabyte smartphones being offered, and again, days of terabyte smartphones are not far away. And certainly, with elasticity in NAND, average capacities in client computing applications as well as mobile devices will increase, as well as the attach rate of SSDs will increase. So, this is important when you look at these demand trends, we feel very confident about the long-term trajectory. One or two quarters here or there, there can certainly be ebb and flow in terms of demand or supply in the industry, but the long-term trend is positive.”

Not surprisingly then, given management’s long-term optimism, CFO David A. Zinsner addressed the new stock buyback program, “Now let me take a moment to provide an update on our share repurchase program. I'm pleased to report that our buyback has been in effect since the beginning of September. And for the fiscal first quarter, we are committed to spend at least $1.5 billion in programmatic repurchases with an additional amount allocated for opportunistic repurchases. Beyond the first fiscal quarter, we expect to be active buyers of our stock by

repurchasing Micron shares regularly. We are committed to deploying at least 50% of our ongoing free cash flow towards our $10 billion buyback program and, as Sanjay mentioned, we are assessing an accelerated rate of completion of this program. The total buyback program of $10 billion represents approximately 19% of the current equity value."

It's unlikely to surprise our readers that we still think that MU's valuation is far from expensive. Analysts expect the company to earn $10.65 in fiscal 2019 (ends Aug 2019), translating to a forward P/E ratio just above four. While we can certainly appreciate the historical aspect of memory and data storage volatility, and we respect that analysts now think the company will earn "only" $9.82 in fiscal 2020, we think that MU sits in a good spot for future growth and we believe that solid state storage is the way of the future for its size, performance and energy saving properties. Our Target Price for MU is now $96.