EXECUTIVE SUMMARY

Week in Review - Awful Start to December
China Trade Perspective - Hard to Say Things are Worse Today than on Nov. 30
Econ Update - Solid Numbers
Interest Rates - Fed Less Likely to Hike Multiple Times
Myth Busting - Yield Curve Inversion and Stock Returns
More Myth Busting - Recessions and Equity Performance
Corporate Profit Outlook - Handsome Growth Still Likely
Yields - Stocks Look Good on Earnings and Income Basis
Shopping List - December's Biggest Losers
Keeping the Faith - Buffett's Mr. Market Commentary
Company News - Updates on BASFY, KR & MRVL

Market Review

Though we all are very much aware that big swings in prices are not unusual in the equity markets,…

AFAM CAPITAL

THE PRUDENT SPECULATOR
Volatility is Normal: Stocks Win the Race

Selloffs, downturns, pullbacks, corrections and even Bear Markets are events that equity investors always have had to endure on their way to the best long-term performance of any of the financial asset classes.

Advancing Markets

Minimum Rise %	Average Gain	Average # Days	Count	Frequency (in Years)	Last Start	Last End
20.0%	107.9%	916	26	3.5	3/9/2009	9/20/2018
17.5%	67.6%	585	37	2.5	10/3/2011	9/20/2018
15.0%	67.2%	567	43	2.1	10/3/2011	9/20/2018
12.5%	44.1%	334	70	1.3	2/11/2016	9/20/2018
10.0%	35.0%	248	104	0.9	2/8/2018	9/20/2018
7.5%	23.4%	147	153	0.6	2/8/2018	9/20/2018
5.0%	14.7%	72	297	0.3	11/23/2018	12/3/2018

Declining Markets

Minimum Decline %	Average Loss	Average # Days	Count	Frequency (in Years)	Last Start	Last End
-20.0%	-34.3%	371	25	3.6	1/6/2009	3/9/2009
-17.5%	-30.6%	225	36	2.5	4/29/2011	10/3/2011
-15.0%	-28.5%	195	42	2.1	4/29/2011	10/3/2011
-12.5%	-22.7%	140	69	1.3	5/21/2015	2/11/2016
-10.0%	-19.2%	102	104	0.9	9/20/2018	11/23/2018
-7.5%	-15.3%	65	153	0.6	9/20/2018	11/23/2018
-5.0%	-10.9%	37	297	0.4	12/3/2018	12/7/2018

From 02.20.28 through 12.07.18. Price return series. We defined a Declining Market as an instance when stocks dropped the specified percentage or more without a recovery of equal magnitude, and an Advancing Market as in instance when stocks appreciated the specified percentage or more without a decline of equal magnitude. SOURCE: AFAM Capital using data from Bloomberg, Morningstar and Ibbotson Associates

LONG-TERM RETURNS

	Annualized Return	Standard Deviation
Value Stocks	13.4%	25.9%
Growth Stocks	9.6%	21.4%
Dividend Paying Stocks	10.6%	18.0%
Non-Dividend Paying Stocks	8.9%	29.5%
Long-Term Corporate Bonds	5.9%	7.5%
Long-Term Gov't Bonds	5.3%	8.5%
Intermediate Gov't Bonds	5.0%	4.4%
Treasury Bills	3.3%	0.9%
Inflation	3.0%	1.8%

From 06.30.27 through 09.30.18. 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

…the best week in seven years over the final five trading sessions of November was followed by one of the worst weeks (in the top 148 of all time) as December began, with the S&P 500 losing 4.55% on a total return basis (4.60% on a price basis) and the Russell 3000 skidding 4.60%.

THE PRUDENT SPECULATOR
Outsized Weekly S&P Moves

The week ended 12.07.18 was awful, but since 1927, there have been 148 times when the S&P 500 skidded 4.60%+ from a Friday to a Friday.

	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		9	3	1	0	2	2	1	2	2	22
Years Ending in 1		11	2	0	0	0	0	0	2	4	19
Years Ending in 2		13	1	0	3	0	0	0	3	0	20
Years Ending in 3		11	1	0	0	0	0	0	0	0	12
Years Ending in 4		4	0	0	0	7	0	0	0	0	11
Years Ending in 5		0	0	0	0	1	0	0	0	1	2
Years Ending in 6		1	2	0	0	0	1	0	0	1	5
Years Ending in 7		8	0	0	0	0	4	0	1	0	13
Years Ending in 8	1	9	1	0	0	1	1	3	6	3	25
Years Ending in 9	7	5	0	0	0	1	1	1	4		19
Totals	8	71	10	1	3	12	9	5	18	11	148

From 12.31.27 though 12.07.18. Weeks of index price return drops of more than 4.60%. 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		2	1	0	0	2	1	0	5	1	12
Years Ending in 1		9	0	0	0	1	1	3	3	5	22
Years Ending in 2		13	1	0	1	0	4	0	3	0	22
Years Ending in 3		13	0	0	1	0	0	0	1	0	15
Years Ending in 4		5	0	0	0	4	1	0	0	0	10
Years Ending in 5		2	0	0	0	2	0	0	0	0	4
Years Ending in 6		1	1	0	2	0	1	0	0	0	5
Years Ending in 7		1	0	0	0	1	3	1	0	0	6
Years Ending in 8	0	10	1	0	0	0	1	1	3	1	17
Years Ending in 9	4	2	0	0	0	0	0	2	6		14
Totals	4	58	4	0	4	10	12	7	21	7	127

From 12.31.27 though 12.07.18. Weeks of index price return gains of more than 4.60%. SOURCE: Al Frank using data from Bloomberg

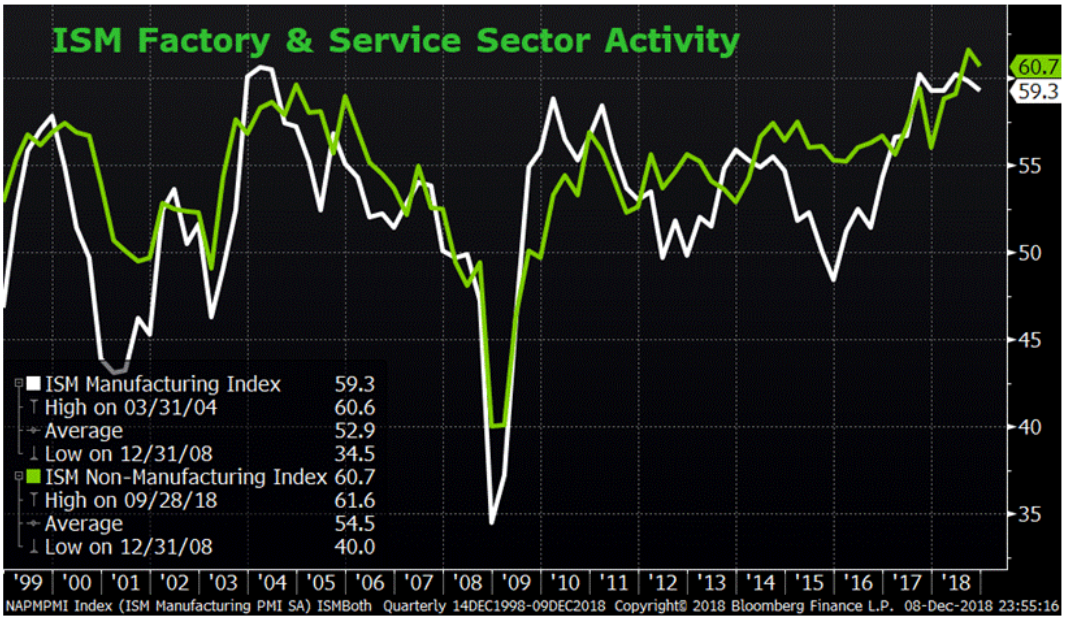
No doubt, investors were concerned about the uncertainty on the trade front with China, even as we are arguably better off today than where we were at the end of November. After all, President Trump tweeted on Dec. 6, "Statement from China: 'The teams of both sides are now having smooth communications and good cooperation with each other. We are full of confidence that an agreement can be reached within the next 90 days,'" and he added on Dec. 7, "China talks are going very well!"

To be sure, the arrest of Huawei CFO Meng Wanzhou adds another wrinkle to the negotiations, while the Trump Administration has not exactly presented a unified front in comments surrounding the ongoing talks. Still, an escalation of tariff hostilities on the U.S. side appears to be delayed by three months, meaning that we would not have been surprised if stocks had continued to rally last week.

Of course, we understand that the financial press and numerous talking heads on business television have become concerned that a recession is somehow on the horizon (more on this in a bit), even as the latest set of economic statistics provided compelling evidence otherwise. In addition to the University of Michigan's Consumer Sentiment figure for November at 97.5 coming in above expectations, and well above its 87.6 historical average, the Institute for Supply Management numbers on the health of the factory and service sectors remained very elevated. And, regarding its Manufacturing index, ISM stated, "The past relationship between the PMI and the overall economy indicates that the PMI for November (59.3) corresponds to a 4.9% increase in real gross domestic product (GDP) on an annualized basis."

Robust ISM Numbers: Healthy Businesses

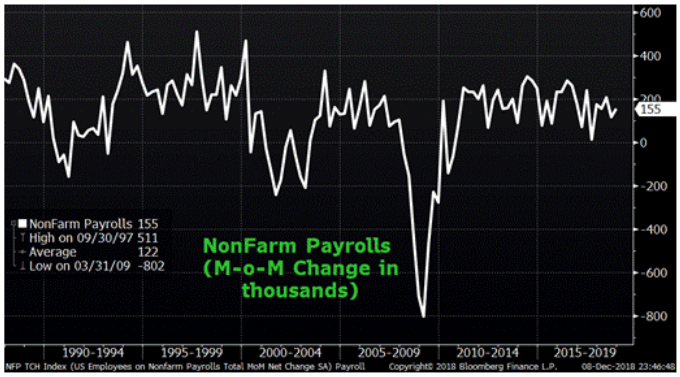
Though the ISM Manufacturing index has pulled back from recent highs, the 59.3 reading is robust, while the Non-Manufacturing index (60.7) came in well above expectations and is near a record high.



True, the monthly jobs figures were not as strong as expected, but the labor market remains in good shape,…

AFAM CAPITAL

THE PRUDENT SPECULATOR
Solid Employment Situation



The Labor Department said that the unemployment rate remained at 3.7% in November, the lowest level since 1969, though a lower-than-expected 155,000 new jobs were added, continuing a string of 98 straight months of employment gains. Wages last month grew at 3.1%, the highest increase since 2009, while first-time filings for jobless benefits rose to 231,000 in the latest week, with the figure still very low by historical standards.

…and the fact that the economy does not seem to be overheating suggests that the Federal Reserve likely does not have to be as aggressive in raising interest rates,…

Interest Rate Expectations

99) Export Data — World Interest Rate Probability

United States — Instrument: Futures: Fed Funds - Effective — Fed Effective Rate 2.18

1) Overview | 2) Future Implied Probability

Current Implied Probabilities — 3) Add/Remove Rates

Dates: Meeting / Calculation — Calculated 09/20/2018 — Based on rate 1.75-2.00

Meeting	Hike Prob	Cut Prob	1.75-2	2-2.25	2.25-2.5	2.5-2.75	2.75-3	3-3.25	3.25-3.5	Fwd Rate
09/26/2018	100.0%	0.0%	0.0%	97.9%	2.1%	0.0%	0.0%	0.0%	0.0%	2.17
11/08/2018	100.0%	0.0%	0.0%	95.2%	4.7%	0.1%	0.0%	0.0%	0.0%	2.18
12/19/2018	100.0%	0.0%	0.0%	23.2%	73.2%	3.6%	0.0%	0.0%	0.0%	2.37
01/30/2019	100.0%	0.0%	0.0%	21.8%	70.1%	7.9%	0.3%	0.0%	0.0%	2.39
03/20/2019	100.0%	0.0%	0.0%	8.3%	40.1%	46.4%	5.0%	0.2%	0.0%	2.55
05/01/2019	100.0%	0.0%	0.0%	7.2%	36.2%	45.7%	10.1%	0.8%	0.0%	2.58
06/19/2019	100.0%	0.0%	0.0%	3.8%	22.3%	41.1%	27.2%	5.3%	0.4%	2.70
07/31/2019	100.0%	0.0%	0.0%	3.4%	20.6%	39.4%	28.4%	7.2%	0.8%	2.72
09/18/2019	100.0%	0.0%	0.0%	2.4%	15.5%	33.8%	31.7%	13.6%	2.7%	2.80

99) Export — World Interest Rate Probability

United States — Instrument: Futures: Fed Funds - Effective — Fed Effective Rate 2.20

1) Overview | 2) Future Implied Probability

Current Implied Probabilities — 3) Add/Remove Rates

Dates: Meeting / Calculation — Calculated 12/07/2018 — Based on rate 2.00-2.25

Meeting	Hike Prob	Cut Prob	1.75-2	2-2.25	2.25-2.5	2.5-2.75	2.75-3	3-3.25	3.25-3.5	Fwd Rate
12/19/2018	67.4%	0.0%	0.0%	32.6%	67.4%	0.0%	0.0%	0.0%	0.0%	2.37
01/30/2019	69.1%	0.0%	0.0%	30.9%	65.6%	3.5%	0.0%	0.0%	0.0%	2.38
03/20/2019	78.6%	0.0%	0.0%	21.4%	54.9%	22.6%	1.1%	0.0%	0.0%	2.46
05/01/2019	80.8%	0.0%	0.0%	19.2%	51.5%	26.0%	3.3%	0.1%	0.0%	2.47
06/19/2019	84.9%	0.0%	0.0%	15.1%	44.6%	31.4%	8.1%	0.8%	0.0%	2.53
07/31/2019	85.6%	0.0%	0.0%	14.4%	43.3%	32.0%	9.1%	1.1%	0.1%	2.54
09/18/2019	87.1%	0.0%	0.0%	12.9%	40.2%	33.2%	11.6%	2.0%	0.2%	2.56
10/30/2019	87.2%	0.0%	0.0%	12.8%	40.1%	33.2%	11.7%	2.0%	0.2%	2.56
12/11/2019	87.5%	0.0%	0.0%	12.5%	39.5%	33.4%	12.2%	2.2%	0.2%	2.57

Source: Bloomberg

While the plunge in equities at times has been blamed on fears of rising interest rates, the odds (per the futures market) of a 2.75%-3.00% or higher Fed Funds rate by June 2019 are sharply lower today (8.9%) than at the Sept. 20 (32.9%) stock market peak!

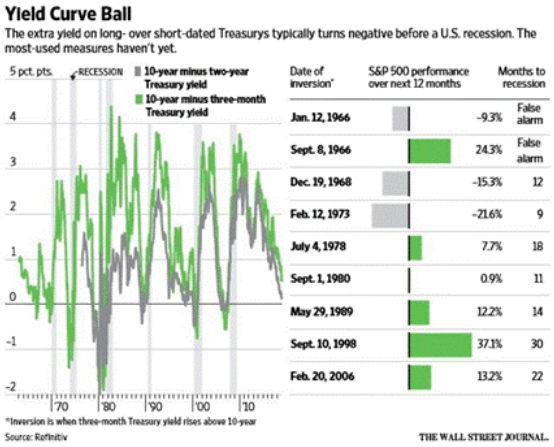
…even as Fed Chair Jerome Powell said on Dec. 6, "Our economy is currently performing very well overall, with strong job creation and gradually rising wages. In fact, by many national-level measures, our labor market is very strong."

Of course, interest rates seem to have many folks spooked these days, given the hullabaloo about an inverted yield curve. Certainly, we respect that recessions have in the past been signaled by such an event, but the fact that the two-year Treasury was yielding more than the 5-year Treasury last week is an occurrence that has not been shown to have any predictive power.

Further, given the unprecedented Quantitative Easing program by the Federal Reserve in which a massive amount of longer-term Treasuries were purchased, it is hard to draw concrete conclusions about the current yield curve. Yes, rates on the long end have contracted, but there is still room to go before a true inversion in the most germane rate spread (the 10-Year / 3-Month) would actually occur. And, perhaps more importantly, history shows that even that supposedly scary event would hardly be cause for folks to bail out of stocks,…

THE PRUDENT SPECULATOR
Myth Busting - Yield Curve Inversions

While pundits have scared folks out of stocks with dire warnings that a recession is imminent if the U.S. Treasury yield curve inverts, the spread between the ten-year and three-month yields has the best predictive power of economic contraction, per the San Francisco Fed. Yet, today, said spread (+44 basis points) is still a ways from inverting and stocks have performed just fine, on average, after previous 10Y/3M inversions.



S&P 500 Total Return Post 10-Year/3-Month Yield-Curve Inversion

Inversion Date	1 Year S&P 500 TR	3 Year S&P 500 TR	5 Year S&P 500 TR	10 Year S&P 500 TR	To Present S&P 500 TR
1/12/1966	-6.8%	19.3%	17.6%	46.2%	13675%
9/8/1966	28.4%	34.2%	58.3%	97.0%	16513%
12/19/1968	-11.8%	4.3%	4.8%	30.6%	10881%
2/12/1973	-19.1%	-2.6%	-4.4%	105.0%	8694%
7/4/1978	13.3%	58.4%	131.5%	352.6%	8420%
9/1/1980	5.6%	56.7%	96.8%	300.3%	5787%
5/29/1989	16.0%	42.6%	66.2%	423.5%	1439%
9/10/1998	39.8%	15.7%	10.7%	48.2%	294%
1/20/2006	15.5%	-36.2%	16.0%	84.3%	168%
S&P Total Return	**9.0%**	**21.4%**	**44.2%**	**165.3%**	**7319%**

Source: Al Frank using data from Bloomberg and Refinitiv via The Wall Street Journal

…while recessions themselves, even if they could be predicted with certainty, have also proven to be a virtual non-event for those who maintain a long-term investment time horizon, though one would want to be a Value investor before and following periods of negative economic growth!

As the saying goes, the stock market (and economists) has predicted nine of the last five recessions, but the 14 prior instances of actual negative economic growth illustrate that long-term-oriented investors (on average) should stay invested (in Value, preferably) no matter what.

U.S. Recession Commencement (per NBER) & Equity Returns
S&P 500 and Fama/French Value Performance

Year Prior S&P 500 TR	Year Prior FF Value TR	Recession Start Date	1 Year S&P 500 TR	1 Year FF Value TR	3 Year S&P 500 TR	3 Year FF Value TR	5 Year S&P 500 TR	5 Year FF Value TR	10 Year S&P 500 TR	10 Year FF Value TR	To Present S&P 500 TR	To Present FF Value TR
51.9%	30.8%	August 1929	-32.6%	-32.0%	-73.5%	-64.9%	-71.1%	-61.4%	-58.0%	-47.7%	187017%	5370487%
18.2%	42.6%	May 1937	-39.3%	-55.8%	-33.2%	-55.1%	-32.5%	-44.3%	53.7%	142.7%	338507%	5016720%
26.3%	54.4%	February 1945	26.0%	42.2%	12.0%	28.5%	64.3%	75.7%	379.2%	468.6%	243960%	2420978%
4.0%	4.6%	November 1948	19.2%	12.4%	101.8%	108.9%	145.2%	130.7%	542.0%	584.7%	198148%	1755736%
3.1%	4.7%	July 1953	31.9%	25.6%	128.9%	118.0%	136.5%	138.2%	308.5%	381.9%	81847%	736507%
-1.2%	-0.4%	August 1957	10.0%	16.4%	40.2%	55.0%	55.1%	77.9%	188.9%	418.4%	37562%	348290%
-2.4%	-6.4%	April 1960	24.2%	29.0%	41.7%	51.5%	92.4%	131.0%	107.7%	268.9%	28277%	236000%
-8.4%	-20.9%	December 1969	3.9%	8.7%	41.4%	40.3%	-11.3%	-7.3%	77.0%	267.9%	12149%	59954%
-15.2%	-19.4%	November 1973	-23.8%	-14.8%	20.8%	77.1%	23.7%	142.4%	182.3%	719.9%	10258%	52248%
20.6%	31.3%	January 1980	19.5%	12.3%	49.5%	80.4%	102.4%	183.5%	342.4%	480.7%	6416%	14985%
13.0%	22.9%	July 1981	-13.3%	-0.8%	34.0%	78.6%	127.9%	217.1%	343.4%	408.6%	5162%	11768%
6.5%	-6.9%	July 1990	12.7%	9.9%	38.2%	76.0%	83.2%	129.3%	407.0%	424.9%	1237%	2465%
-21.7%	17.0%	March 2001	0.2%	14.6%	1.9%	33.8%	21.4%	83.4%	38.3%	96.0%	223%	317%
9.0%	-5.7%	December 2007	-40.4%	-36.2%	-13.0%	-6.6%	5.3%	5.7%	117.4%	119.5%	121%	113%
7.4%	**10.6%**	**Averages**	**-0.1%**	**2.3%**	**27.9%**	**44.4%**	**53.0%**	**85.8%**	**216.4%**	**338.2%**	**82206%**	**1144755%**

Source: Al Frank using data from Bloomberg, Professors Eugene F. Fama & Kenneth R. French and the National Bureau of Economic Research

Obviously, anything can happen in the stock markets and the equity futures were again pointing to a continuation of the selling when trading resumes this morning, but we continue to think that the outlook for earnings is favorable, even as profit projections have been reined in a bit.

AFAM CAPITAL

THE PRUDENT SPECULATOR
Significant EPS Growth Estimated

S&P 500 Earnings Per Share		
Quanter Ended	Bottom Up Operating EPS 3 Month	Bottom Up Operating EPS 12 Month
ESTIMATES		
12/31/2019	$45.88	$174.02
9/30/2019	$44.82	$169.10
6/30/2019	$43.09	$165.65
3/31/2019	$40.23	$161.21
12/31/2018	$40.96	$157.52
9/30/2018	$41.37	$150.41
ACTUAL		
6/30/2018	$38.65	$140.37
3/31/2018	$36.54	$132.23
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 12.06.18

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 rosy. Happily, the number of companies (76.3%) exceeding expectations thus far for Q3 2018 is far better than the average beat-rate over the prior 5 years.

S&P 500 Quarterly Earnings Comparisons							
	BEAT	MISSED	MET		BEAT	MISSED	MET
Q2 2018	80.0%	14.8%	5.2%	Q3 2015	67.9%	23.0%	9.0%
Q1 2018	77.0%	17.2%	5.8%	Q2 2015	69.8%	22.0%	8.3%
Q4 2017	75.0%	16.4%	8.6%	Q1 2015	67.7%	22.9%	9.4%
Q3 2017	72.6%	19.1%	8.3%	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%	AVERAGE	70.2%	20.9%	9.0%

Source: Standard & Poor's

And the reduction in interest rates of late has added to the relative attractiveness of stocks from an earnings perspective and even in regard to the income they generate,…

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 5.56%.

…especially when one considers that yields on fixed income are generally fixed, while dividend payments historically have moved higher over time,…

AFAM CAPITAL

THE PRUDENT SPECULATOR
Dividends Have Grown Over Time

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

COUNT OF S&P 500 DIVIDEND ACTIONS	INCREASES	INITIATIONS	DECREASES	CESSATIONS
2018 YTD	355	5	3	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 12.06.18

S&P 500 DIVIDENDS PER SHARE	
2019 (Est.)	$58.62
2018 (Est.)	$54.60
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 12.7.18

…and our managed account portfolios of what we believe to be undervalued stocks are presently showing payment streams of 2.6% to 3.6%.

AFAM CAPITAL

THE PRUDENT SPECULATOR
Portfolio & 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	12.9	11.1	1.0	1.7	3.1
Select Value	13.1	11.2	1.1	1.7	2.6
Select Dividend	13.2	11.3	0.9	1.9	3.5
Select Focused Dividend	12.0	10.7	0.8	2.1	3.6
Select Focused Value	13.1	11.7	1.2	2.2	3.0
Select SMID Dividend	13.3	11.6	0.6	1.5	3.0
Russell 3000	19.1	16.7	1.8	3.0	2.0
Russell 3000 Growth	24.0	20.2	2.6	6.4	1.4
Russell 3000 Value	16.0	14.3	1.4	1.9	2.6
Russell 1000	18.4	16.3	2.0	3.1	2.1
Russell 1000 Growth	22.2	19.5	2.8	6.8	1.5
Russell 1000 Value	15.8	14.1	1.5	2.0	2.6
S&P 500 Index	18.0	16.1	2.0	3.1	2.0
S&P 500 Growth Index	21.3	18.7	3.3	5.7	1.4
S&P 500 Value Index	15.2	13.8	1.4	2.1	2.8
S&P 500 Pure Value Index	12.1	11.1	0.6	1.4	2.8

As of 12.09.18. 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.

All that said, we are braced for additional downside action, but we certainly think the selling is more than overdone and that those with cash on the sidelines looking to do a little shopping might want to take a look at a list of the biggest losers last week.

UNDERVALUED RECIPIENTS OF LUMPS OF COAL THUS FAR IN DECEMBER

Symbol	Common Stock	December TR %	12.07.18 Price	Target Price	Sector	P/E	P/S	P/TBV	EV/ EBITDA	FCF Yld	Debt/ TE (%)	Div Yld	Mkt Cap
COHU	Cohu Inc	-14.4	16.78	25.18	Semiconductors	10.6	1.9	3.0	11.5	8.6	2%	1.4%	700
BHF	Brighthouse Financial	-14.4	34.47	77.30	Insurance	2.4	nmf	0.3	nmf	nmf	nmf	0.0%	4,239
DSW	DSW Inc	-12.7	24.21	34.07	Retailing	13.1	0.7	2.2	9.4	9.9	0%	4.0%	2,006
FDX	FedEx	-11.8	201.39	336.85	Transportation	12.4	0.8	4.3	8.5	-1.9	124%	1.2%	56,150
LRCX	Lam Research	-11.4	138.03	231.44	Semiconductors	7.5	2.0	6.0	5.9	10.2	52%	3.1%	22,048
ALK	Alaska Air Group	-11.4	64.94	97.08	Transportation	14.3	1.0	4.7	7.5	5.5	98%	1.9%	8,293
FLR	Fluor Corp	-10.3	36.53	56.74	Capital Goods	13.9	0.3	2.1	6.9	-3.4	67%	2.2%	5,292
BASFY	BASF SE	-10.1	16.38	29.80	Materials	9.5	0.9	3.0	6.2	7.0	88%	3.8%	63,889
BAC	Bank of America	-9.9	25.43	39.46	Banks	10.6	nmf	1.5	nmf	nmf	nmf	2.3%	255,169
C	Citigroup	-9.9	58.35	105.36	Banks	9.4	nmf	0.9	nmf	nmf	nmf	3.0%	145,283
MAN	ManpowerGroup	-9.9	73.16	138.23	Comm/Pro Services	8.5	0.2	3.9	5.5	7.5	90%	2.7%	4,649
CE	Celanese	-9.6	91.26	147.07	Materials	8.6	1.7	5.7	8.2	12.0	148%	2.3%	12,700
HFC	HollyFrontier	-9.0	56.85	82.95	Energy	11.6	0.6	3.0	5.3	10.1	73%	2.2%	10,244
MET	MetLife	-9.0	40.63	73.24	Insurance	8.7	nmf	1.0	nmf	nmf	nmf	4.1%	40,791
CAT	Caterpillar	-8.9	123.55	186.47	Capital Goods	11.4	1.4	9.5	7.1	3.0	333%	2.7%	74,855
KEY	KeyCorp	-8.8	16.73	26.98	Banks	10.2	nmf	1.5	nmf	nmf	nmf	4.0%	17,773
MU	Micron Technology	-8.4	35.31	78.61	Semiconductors	3.1	1.3	1.3	1.9	20.9	12%	0.0%	40,839
PRU	Prudential Financial	-8.4	85.87	137.69	Insurance	7.2	nmf	0.8	nmf	nmf	nmf	4.1%	36,113
TPR	Tapestry	-8.4	35.34	59.04	Consumer Durables	13.1	1.7	nmf	9.7	8.0	nmf	3.7%	10,586
FITB	Fifth Third Bancorp	-8.4	25.59	39.32	Banks	10.8	nmf	1.4	nmf	nmf	nmf	2.7%	17,171
CMI	Cummins Inc	-8.2	138.60	200.54	Capital Goods	10.8	1.0	4.3	7.4	7.1	30%	3.2%	22,747
AXAHY	AXA SA	-8.2	22.36	42.32	Insurance	7.5	nmf	1.2	nmf	nmf	nmf	5.5%	54,946
AMGN	Amgen	-8.1	191.44	227.63	Pharmaceuticals, Biotech	13.8	5.2	nmf	10.5	8.0	nmf	3.0%	123,710
NSC	Norfolk Southern	-8.1	156.99	190.75	Transportation	18.2	3.8	2.8	10.7	4.4	69%	2.0%	44,017
COF	Capital One Financial	-7.8	82.67	125.53	Diversified Financials	7.8	nmf	1.2	nmf	nmf	nmf	1.9%	39,877

As of 12.7.18. 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

And, for those struggling to keep the faith these days, we offer lengthy words of wisdom from legendary investor Warren Buffett. Believe it or not, these comments were not penned last week…they appeared in the *1987 Berkshire Hathaway Letter to Shareholders*!

Ben Graham, my friend and teacher, long ago described the mental attitude toward market fluctuations that I believe to be most conducive to investment success. He said that you should imagine market quotations as coming from a remarkably accommodating fellow named Mr. Market who is your partner in a private business. Without fail, Mr. Market appears daily and names a price at which he will either buy your interest or sell you his.

Even though the business that the two of you own may have economic characteristics that are stable, Mr. Market's quotations will be anything but. For, sad to say, the poor fellow has incurable emotional problems. At times he feels euphoric and can see only the favorable factors affecting the business. When in that mood, he names a very high buy-sell price because he fears that you will snap up his interest and rob him of imminent gains. At other times he is depressed and can see nothing but trouble ahead for both the business and the world. On these occasions he will name a very low p/rice, since he is terrified that you will unload your interest on him.

Mr. Market has another endearing characteristic: He doesn't mind being ignored. If his quotation is uninteresting to you today, he will be back with a new one tomorrow. Transactions are strictly at your option. Under these conditions, the more manic-depressive his behavior, the better for you.

But, like Cinderella at the ball, you must heed one warning or everything will turn into pumpkins and mice: Mr. Market is there to serve you, not to guide you. It is his pocketbook, not his wisdom, that you will find useful. If he shows up some day in a particularly foolish mood, you are free to either ignore him or to take advantage of him, but it will be disastrous if you fall under his influence. Indeed, if you aren't certain that you understand and can value your business far better than Mr. Market, you don't belong in the game. As they say in poker, "If you've been in the game 30 minutes and you don't know who the patsy is, you're the patsy."

Ben's Mr. Market allegory may seem out-of-date in today's investment world, in which most professionals and academicians talk of efficient markets, dynamic hedging and betas. Their interest in such matters is understandable, since techniques shrouded in mystery clearly have value to the purveyor of investment advice. After all, what witch doctor has ever achieved fame and fortune by simply advising "Take two aspirins"?

The value of market esoterica to the consumer of investment advice is a different story. In my opinion, investment success will not be produced by arcane formulae, computer programs or signals flashed by the price behavior of stocks and markets. Rather an investor will succeed by coupling good business judgment with an ability to insulate his thoughts and behavior from the super-contagious emotions that swirl about the marketplace. In my own efforts to stay insulated, I have found it highly useful to keep Ben's Mr. Market concept firmly in mind.

Following Ben's teachings, Charlie and I let our marketable equities tell us by their operating results - not by their daily, or even yearly, price quotations - whether our investments are successful. The market may ignore business success for a while, but eventually will confirm it. As Ben said: "In the short run, the market is a voting machine but in the long run it is a weighing machine." The speed at which a business's success is recognized, furthermore, is not that important as long as the company's intrinsic value is increasing at a satisfactory rate. In fact, delayed recognition can be an advantage: It may give us the chance to buy more of a good thing at a bargain price.

Stock Updates

Keeping in mind that all stocks are rated as “Buy” until such time as they are a “Sell,” a listing of all current recommendations is available for download via the following link: https://theprudentspeculator.com/dashboard/. Jason Clark and Chris Quigley offer updates on three of our stocks that had news last week that was of sufficient importance to trigger a review of their respective Target Prices…

Germany's **BASF SE** (BASFY - $16.37) announced that it was slashing its forecast for 2018 profits. The company said that the decline was mainly due to business headwinds in its chemicals segment, while low water levels on the Rhine River and weaker-than-expected automotive demand, especially in China, were also issues.

In its statement, BASF said it now expects earnings before interest and taxes before special items (EBIT) to decline by 15% to 20% from last year's 7.6 billion euros, compared to an earlier forecast of a 10% fall. BASF said its business with the automotive industry has continued to decline since the third quarter of 2018 and demand from customers in China slowed significantly. Not surprisingly, the company blamed the trade conflict between the U.S. and China as a main factor in the slowdown. Additionally, low water

levels on the Rhine following a summer drought have disrupted river traffic and were expected to lead to an earnings hit of 200 million euros in the fourth quarter, higher than originally forecast.

The newly announced profit warning comes just two weeks after CEO Martin Brudermuller, who took the helm in May, announced a cost-cutting drive to boost annual earnings by 2 billion euros by 2021 to counter slower profit growth, so we weren't exactly counting on stellar growth as rationale for our recent recommendation of the stock. Still, there is no doubt that we have had a disappointing start to our investment in BASFY. Though the near-term headwinds continue to mount, we think that the challenges can be overcome via stronger execution, cost controls and the company's acquisitions (including the seed and herbicide business from Bayer, global polyamide business from Solvay and waterproofing systems company Thermotek). In addition, we like BASF's strong free cash flow yield, strong score in our proprietary scoring framework and net yield of 4.0%. Given the latest hurdles, however, we have trimmed our Target Price to $30.

Shares of **Kroger** (KR – $29.17) fell with the equity markets last week, but the stock pared some of those losses after the grocer reported solid fiscal Q3 financial results. Sales for the period of $27.7 billion essentially matched consensus analyst expectations, while bottom-line results came in more than 10% above projections (adjusted EPS of $0.48 vs. estimates of $0.43). Identical store sales ex-fuel were up 1.6% and the continued investment in online sales saw a 60% surge in digital business.

CEO Rodney McMullen commented, "Kroger is transforming our business model. We're moving from a traditional grocer to a growth company with both a strong customer ecosystem that offers anything, anytime, anywhere, and asset-light, high-margin alternative partnerships and services. Restock Kroger is the blueprint for this transformation…We are strengthening the Kroger ecosystem by reducing costs and investing the savings in our associates, technology, and price to grow units, traffic and share. Leveraging our store, logistics and data assets in turn creates incremental new profit streams, which then further redefines the customer experience. In this way, our new growth model will be a virtuous cycle…We are doing all of this and remain committed to delivering on our 2020 Restock Kroger financial targets."

Those positives aside, we are keeping a close eye on Kroger's debt levels as leverage metrics continue to be a bit elevated. Kroger's net total debt to adjusted EBITDA ratio, on a 52-week basis, is 2.72. Management affirmed that its target range for this metric is 2.30 to 2.50. For the remainder of fiscal 2018, Kroger expects its leverage ratio to remain slightly above the target range, primarily due to increased borrowings to fund the company's merger with Home Chef and investments in Ocado. Management has stated on multiple occasions that it is committed to bringing the metric back into the target range or better.

While there is little doubt that competitive headwinds will continue to blow briskly as Kroger battles the likes of Amazon/Whole Foods, Walmart, Target, Aldi and numerous other grocers, we like the strides and operational momentum the company has been making and its focus on online services and investments designed to engage its customers on inventory and store offerings. We also are encouraged that like Walmart, Kroger's Click-and-Collect grocery services continue to score better in customer satisfaction surveys than grocery delivery (something that could help slow the Amazon threat, as Amazon itself only delivers, and its Whole Foods stores that can conduct Click-and-Collect do not have locations in a large number of Kroger's markets). KR shares trade at a very reasonable 12.8 times NTM adjusted EPS projections, while the stocks yields 1.9%. Our Target Price on KR has been bumped up to $38.

Semiconductor firm **Marvell Technology Group** (MRVL - $15.44) earned $0.33 per share in fiscal Q3 2019 (vs. $0.32 est.). MRVL had sales of $851.0 million (vs. $844.0 million est.). Shares fell a little more than 4% last week, which was something of a victory, given the carnage in the chip sector. MRVL had strong performance in the Networking and Storage businesses and made the planned Cavium-related inventory reduction of approximately $20 million. The company said that the integration of Cavium is proceeding smoothly and "the combined portfolios will drive long-term growth in a broad number of areas including 5G, Ethernet networking, enterprise and data center storage, ARM servers, cloud security, AI and automotive."

CEO Matt Murphy explained, "While we need to navigate through some short-term market headwinds in the storage business, we continued to benefit from positive trends in our other businesses. Ethernet switch and PHY business has maintained a double-digit year-on-year growth rate over several quarters, and we expect this to continue into the fourth quarter. We expect growth in the Cavium business, and at the midpoint of our guidance, we are projecting this business to grow double-digit sequentially to approximately $240 million of revenue in the fourth quarter. We have now fully integrated Cavium, and going forward, we will not be delineating revenue between Marvell and Cavium. 5G trials have started, which we believe will turn into larger deployments that will drive significant revenue growth from existing design wins and from ongoing engagements with additional Tier-1 base station OEMs. And despite anticipating lower revenue in the fourth quarter, we still expect to increase gross margins to 65%. We also project to continue increasing gross margins next year as we complete our planned $50 million of COGS-related integration synergies."

Mr. Murphy continued, "Looking ahead to the fourth quarter and similar to what you have heard from many of our storage customers, we are also forecasting weak demand. There are several factors hurting this market, including PC, CPU shortages, trade tensions, moderating cloud CapEx and large inventory increases at our customers. Given these headwinds, we expect storage revenue in the fourth quarter to sequentially decline by about 10%. However, we remain bullish on the long-term prospects of our Storage business. During the third quarter, we won several storage controller designs that will continue to diversify our Storage business by adding significant future revenue streams outside the PC market. We are also making strong progress in our new initiatives, including automotive, AI inference and cloud security with a very robust design-win funnel at several key customers. In summary, our networking business delivered a solid third quarter. Looking ahead, we expect low single-digit sequential revenue growth for this business in the fourth quarter, primarily from an increase in demand from the service provider market for our embedded and baseband processors."

CFO Jean Hu added, "We expect our revenue to be in the range of $790 million to $830 million. Our expected GAAP gross margin will be approximately 46% and our non-GAAP gross margin will be approximately 65%. Our operating expenses have a certain amount of seasonality and tend to increase in the Q1 of our fiscal year, driven primarily by employee payroll taxes, matching contribution and our annual merit process. We anticipate that these factors will drive our operating expense in the Q1 of fiscal 2020 to just above $300 million. We anticipate operating expense to then reduce as we progress into the rest of fiscal 2020 and exit the year at a quarterly run rate of $280 million. We expect our non-GAAP tax rate to be approximately 4% and the net interest expense to be $20 million. We expect GAAP loss per diluted share in the range of $0.05 to $0.01 and non-GAAP income per diluted share in the range of $0.30 to $0.34."

There’s no doubt in our minds that MRVL took a balance sheet hit to make the Cavium acquisition happen. However, we have been pleased with the speedy integration and think that the prolonged sell-off in MRVL shares is unwarranted (MRVL has beaten analyst consensus estimates every quarter but one since the beginning of 2017). With the bookkeeping review behind them and the acquisition complete, we believe that the future is bright for the discounted MRVL. Analysts estimate that the forward EPS will grow from $0.37 in fiscal 2016 to $1.71 by 2021. Our Target Price is $25.