# MARKET COMMENTARY MONDAY, JANUARY 21, 2019

January 21, 2019

**EXECUTIVE SUMMARY**

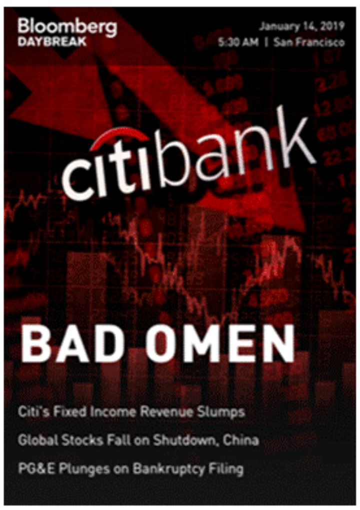
Media Remains Negative – Fourth Straight Week of Gains
Corporate Profits – Good Start to Q4 Reporting Season; Growth in 2019 and 2020 Expected
Investor Sentiment – Happily, Folks Remain Pessimistic
Volatility Cuts Both Ways – S&P 500 Up More Than 13% Since Christmas Eve
Reasons for Optimism – Reasonable Valuations & Solid Economic View
Target Prices – New Listing Posted
Stock Updates – TAK, GT, NEM, SCGLY, C, CMA, KEY, BAC, JPM, GS & SLB

**Market Review**

While eyeball seeking editors on *CNN.com* proclaimed this past weekend, "President Trump will start his third year in office with the longest government shutdown in US history and a stock market in turmoil," equities rebounded for a fourth consecutive week. To be sure, there have been no shortage of disconcerting headlines,…

# THE PRUDENT SPECULATOR
## If Only We Could See the Future

The headlines on Monday morning (1.14.19) were hardly inspiring for those who were long equities, but the "Bad Omen" of Citi's revenue miss, along with news that Global Stocks were falling on worries about the Government Shutdown and China, gave way to an 11% gain on the week for Citigroup's stock and a handsome rally for the S&P 500.





...but apparent progress on the trade front and a solid batch of Q4 earnings reports led to a very good five-day trading span. Indeed, the S&P 500 gained 2.90% on a total return basis and the Russell 3000 index advanced 2.86%, while the race between Value and Growth was close, with the Russell 3000 Value index returning 2.77% versus 2.96% for the Russell 3000 Growth index.

As to corporate profits, *CNBC* stated, "So far in fourth quarter reporting season, with 11 percent of the results reported for the S&P 500, three-quarters of companies have actually surprised Wall Street's forecasters with better than expected profit and a little more than half have reported better than expected revenue."

Companies generally Beat the Street on their bottom lines, on average, so the 75% positive surprise number is not unusual, but it does offer comfort to those worried about the misleading warnings from some market pundits that earnings have peaked. True, profit *growth* has likely hit an apex after the massive tax-cut-juiced increase in 2018, but an actual earnings recession in 2019 or 2020 seems very unlikely.

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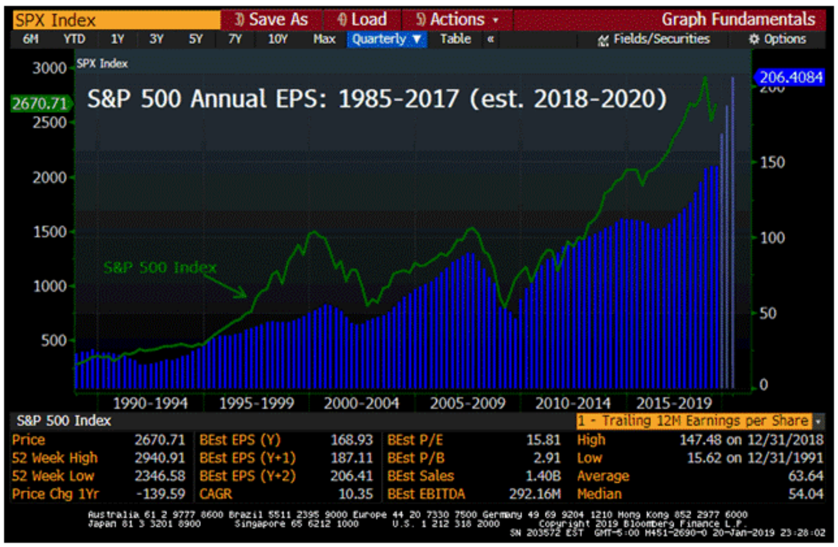
# THE PRUDENT SPECULATOR
## Growing Black Ink for Corporate America

Certainly, we understand that analysts are often overly optimistic in their projections, but sizable year-over-year earnings expansion is expected in 2019, with further growth likely in 2020.




**S&P 500 Earnings Per Share**

| Quanter Ended | Bottom Up Operating EPS 3 Month | Bottom Up Operating EPS 12 Month |
|---|---|---|
| **ESTIMATES** | | |
| 12/31/2019 | $44.71 | $169.61 |
| 9/30/2019 | $43.90 | $165.22 |
| 6/30/2019 | $42.02 | $162.70 |
| 3/31/2019 | $38.98 | $159.33 |
| 12/31/2018 | $40.32 | $156.89 |
| | | |
| **ACTUAL** | | |
| 9/30/2018 | $41.38 | $150.42 |
| 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 1.17.19*

Of course, the benefit of all of the fear-mongering in the financial press is that investor sentiment remains a long way from optimistic,...

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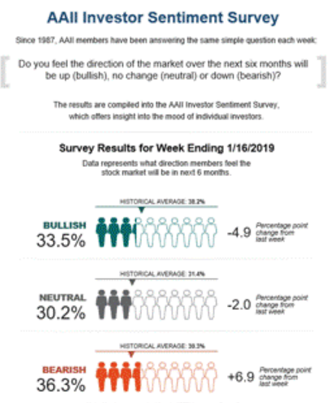
# THE PRUDENT SPECULATOR
## AAII Sentiment – Contrarian Buy Signal

Certainly, there is no guarantee that past is prologue, but it is nice to see more pessimists than optimists in the latest sentiment survey from the American Association of Individual Investors. This is very much true, following the big rally off of the Christmas lows, when the number of Bears hit a 5-year high), given that AAII numbers and subsequent equity performance suggest that folks should be greedy when others are fearful, especially for those with longer-term time horizons!



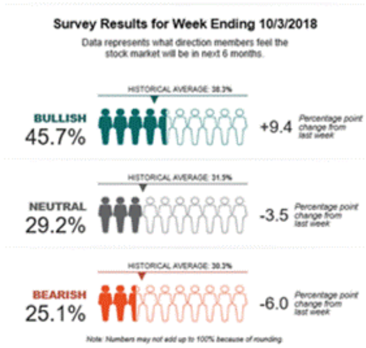

**AAII Bull-Bear Spread**

| Decile | Low Reading of the Range | High Reading of the Range | Count | R3K Next 1-Week Arithmetic Average TR | R3K Next 1-Week Geometric Average TR | R3K Next 1-Month Arithmetic Average TR | R3K Next 1-Month Geometric Average TR | R3K Next 3-Month Arithmetic Average TR | R3K Next 3-Month Geometric Average TR | R3K Next 6-Month Arithmetic Average TR | R3K Next 6-Month Geometric Average TR |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Below & Above Median Bull Bear Spread = 8.5 | | | | | | | | | | |
| BELOW | -54.00 | 8.48 | 817 | 0.24% | 0.21% | 1.18% | 1.05% | 3.28% | 2.90% | 6.59% | 5.84% |
| ABOVE | 8.49 | 62.86 | 797 | 0.17% | 0.15% | 0.49% | 0.41% | 2.07% | 1.83% | 4.63% | 4.14% |
| | Ten Groupings of 1614 Data Points | | | | | | | | | | |
| 1 | -54.0 | -14.3 | 160 | 0.34% | 0.28% | 1.23% | 0.99% | 4.04% | 3.42% | 8.06% | 6.65% |
| 2 | -14.3 | -7.0 | 165 | 0.40% | 0.37% | 1.34% | 1.21% | 4.00% | 3.67% | 7.25% | 6.65% |
| 3 | -6.8 | -0.9 | 161 | 0.30% | 0.26% | 1.66% | 1.57% | 3.36% | 2.96% | 6.90% | 6.19% |
| 4 | -0.7 | 3.4 | 156 | 0.16% | 0.14% | 1.20% | 1.13% | 2.67% | 2.36% | 6.08% | 5.65% |
| 5 | 3.4 | 8.0 | 164 | 0.00% | -0.03% | 0.50% | 0.40% | 2.60% | 2.35% | 5.01% | 4.46% |
| 6 | 8.1 | 12.4 | 154 | 0.14% | 0.12% | 0.44% | 0.35% | 1.82% | 1.60% | 4.75% | 4.23% |
| 7 | 12.5 | 17.0 | 175 | 0.15% | 0.13% | 0.88% | 0.80% | 2.78% | 2.59% | 5.77% | 5.36% |
| 8 | 17.0 | 22.6 | 151 | 0.27% | 0.25% | 0.68% | 0.60% | 2.14% | 1.86% | 5.67% | 5.18% |
| 9 | 22.7 | 30.0 | 163 | 0.10% | 0.08% | 0.27% | 0.18% | 2.10% | 1.84% | 4.52% | 3.92% |
| 10 | 30.5 | 62.9 | 165 | 0.20% | 0.18% | 0.20% | 0.13% | 1.24% | 1.01% | 2.25% | 1.82% |

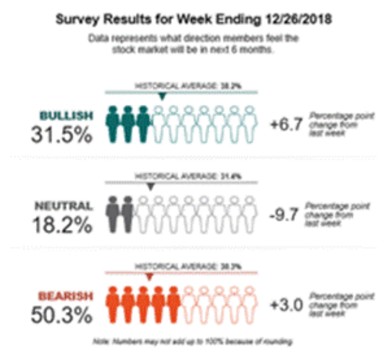
*From 07.31.87 through 1.17.19. Unannualized. SOURCE: Kovitz Investment Group using data from American Association of Individual Investors and Bloomberg*

…with the recent evidence illustrating yet again why the only problem with market timing is getting the timing right. Sadly, far more folks seem to buy high and sell low,…

# THE PRUDENT SPECULATOR
## AAII Sentiment Readings are Fascinating




Form doesn't always hold, of course, but the last three+ months have illustrated why the AAII Sentiment Survey is widely viewed as a contrarian indicator.






...as evidenced by Peter Crawford, CFO of Charles Schwab, stating that the giant brokerage firm saw a surge in cash allocations in December, with cash representing 12.8% of client assets, up 2 percentage points compared with a year earlier.

Incredibly (though hardly surprisingly, given that volatility is very much a normal part of the investment process), the S&P 500 is now up 13.6% from its closing low set on December 24,...

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# 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% | 43.6% | 330 | 71 | 1.3 | 12/24/2018 | 1/18/2019 |
| 10.0% | 34.8% | 246 | 105 | 0.9 | 12/24/2018 | 1/18/2019 |
| 7.5% | 23.3% | 146 | 154 | 0.6 | 12/24/2018 | 1/18/2019 |
| 5.0% | 14.7% | 72 | 298 | 0.3 | 12/24/2018 | 1/18/2019 |

**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% | -30.3% | 222 | 37 | 2.4 | 9/20/2018 | 12/24/2018 |
| -15.0% | -28.3% | 192 | 43 | 2.1 | 9/20/2018 | 12/24/2018 |
| -12.5% | -22.6% | 140 | 70 | 1.3 | 9/20/2018 | 12/24/2018 |
| -10.0% | -19.3% | 102 | 104 | 0.9 | 9/20/2018 | 12/24/2018 |
| -7.5% | -15.4% | 65 | 153 | 0.6 | 9/20/2018 | 12/24/2018 |
| -5.0% | -10.9% | 37 | 297 | 0.4 | 12/3/2018 | 12/24/2018 |

From 02.20.28 through 1.18.19. 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: Kovitz Investment Group using data from Bloomberg, Morningstar and Ibbotson Associates

**LONG-TERM RETURNS**

| | Annualized Return | Standard Deviation |
|---|---|---|
| Value Stocks | 13.3% | 25.9% |
| Growth Stocks | 9.5% | 21.4% |
| Dividend Paying Stocks | 10.5% | 18.0% |
| Non-Dividend Paying Stocks | 8.8% | 29.5% |
| Long-Term Corporate Bonds | 5.9% | 7.5% |
| Long-Term Gov't Bonds | 5.4% | 8.5% |
| Intermediate Gov't Bonds | 5.0% | 4.4% |
| Treasury Bills | 3.3% | 0.9% |
| Inflation | 2.9% | 1.8% |

From 06.30.27 through 11.30.18. 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: Kovitz Investment Group using data from Professors Eugene F. Fama and Kenneth R. French and Ibbotson Associates

…bouncing back from a three-month Bear Market (for many indexes and the average stock, even as the S&P 500 didn't quite make it…on a closing basis anyway) that began on Sept 20, 2018.

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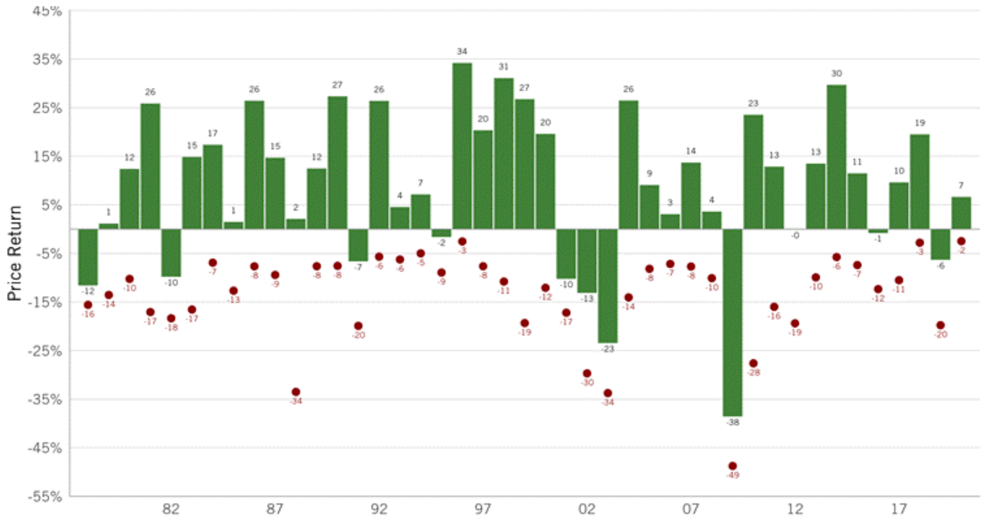
# THE PRUDENT SPECULATOR
## A Big Selloff Happens Almost Every Year

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 a 19.8% one (on a closing basis) last year.



From 12.31.76 through 01.18.19. Price returns do not include dividends. Intra-year drops refer to the largest drops between high and low close prices during a calendar year. 2019 return is year to date. SOURCE: Kovitz Investment Group using data from Bloomberg Finance L.P.

As the Holiday-shortened week gets underway tomorrow, it looks like equities will again face early pressure, given weak Chinese economic data and the lack of much progress on resolving the Government Shutdown, but we continue to think that stocks are attractively valued,...

# 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 5.51%.


...especially given a decent outlook for the U.S. economy. On that point, we note commentary from a *Wall Street Journal* article out on Jan. 17:

*"The data on the real economy is very strong and continues to look strong," said Randal Quarles, the Fed's vice chairman for bank supervision, at a gathering held by the Insurance Information Institute in New York.*

*Mr. Quarles said job creation is solid in an environment where inflation pressures remain well contained. The central banker acknowledged that financial market participants appear to have taken on a different view on the economic outlook, and their focus on slowing global growth has left traders and investors focused on the negative risks that could come the economy's way.*

*Mr. Quarles also acknowledged signs of slowing global growth but said it remains entirely possible that the weakness won't last. He added, "the core base case remains very strong."*

**Stock Updates**

Despite our enthusiasm for the long-term prospects of our broadly diversified portfolios, we continue to be braced for additional near-term volatility, especially with earnings reporting season kicking into higher gear this week. We have posted updated Target Prices to our website, theprudentspeculator.com, though one of our holdings is noticeably absent from that listing…

We know that many readers have had questions about the **Takeda Pharmaceuticals** (TAK – $19.78) acquisition of biotech giant **Shire PLC** (SHPG). Term of the transaction are: For each SHPG share, holders will receive $90.99 in cash and 5.034 TAK shares. Of course, this deal is a slow one to finalize and we believe that we will receive the $90.99 in cash by the end of this week. As this is a foreign deal, most brokerage firms have been showing an Escrow security along with the TAK shares. Happily, the value of the TAK shares received is north of $99 per SHPG share, so adding in the cash that will be coming shortly, the combined consideration of more than $190 looks pretty good, given that the last trade on SHPG was $179.20 on Jan. 4.

While we cannot provide tax advice, it looks as if this deal will be handled like the Aetna/CVS merger late last year in which the entire value of the consideration received (cash and stock) will be the effective "sale" price of SHPG.

We don't yet have enough financial information on the combined entity to decide whether to sell, hold or buy more Takeda shares, so we are simply maintaining our current position until such time as we can make an informed decision. Of course, we had long thought Shire was undervalued, so we do think that the price Takeda paid was not overly rich. This doesn't mean that we will keep our TAK shares, but it does give us enough comfort to hold for the time being.

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

Shares of **Goodyear Tire and Rubber** (GT – $20.58), a maker of tires for trucks, passenger vehicles, aircraft and heavy equipment, plunged 13% on Tuesday after management warned in an SEC filing and analyst presentation that preliminary 2018 performance numbers would be below expectations. The filing stated, "As part of those presentations, the company will announce that fourth quarter of 2018 tire unit volumes declined by approximately 3% due to (1) continued weakening of the OE environment in China and India, (2) declines in the winter tire market in Europe late in the quarter, and (3) supply constraints on volume for high-value-added consumer and commercial truck tires in the United States. Price/mix was positive during the fourth quarter of 2018 but was less than anticipated due to weaker mix, partially as a result of the supply constraints referred to above. In addition, earnings fell in other tire-related businesses, including with respect to the company's U.S. chemical operations. As a result of these factors, for the full year of 2018, Goodyear net income is expected to be adversely affected and the company's total segment operating income is expected to be slightly below the company's previous guidance of approximately $1.3 billion."

Given that the stock regained a sizable chunk of what it lost on Tuesday to end the week down only 3.2%, upon further review, GT's presentation (available here: https://corporate.goodyear.com/documents/events-presentations/global-auto-industry-conference-2019.pdf) ended up not nearly as bad as investors initially interpreted. Goodyear CFO Darren Wells explained, "We've got the positives here on volume and on our mix. We also had some positives in other parts of the business. We continue to ramp-up a new factory in San Luis Potosi, which serves our Americas business, and that ramp-up is giving us new supply of some of our best tires. And the continued advancement that we have, including technology we're applying for electric vehicles, that continued advancement in tire technology, very positive story for us in 2018."

Mr. Wells noted that there are headwinds, "We see a lot of the macro factors that have been a consistent theme for us through 2018. The one that's been added to the bottom though, these supply constraints, this is something that is a little bit of a new factor, and in fact, one that had an increasing impact for us as volumes improved. So you can imagine that factory supply constraints, you see those mostly – you don't see those when volumes are down, because you have lots of capacity. You see it when volumes come back up, and we had volumes recovering very strongly through the second and third quarter this year in North America, and that put us in a position where our manufacturing constraints in the U.S. became a very real factor for us."

Mr. Wells said that GT is declining to give guidance on the year-end call on Feb. 8 due to the variability of the headwinds GT is seeing, but the challenges have been expected (sans the supply constraints noted above) and are incorporated into the company's longer-term direction. The company believes that achieving 2014-2016 peak earnings is something that is not an "if" but a "when." In 2016, GT earned $4.00 per share, while the analyst consensus is to earn $2.59 in 2018 and $2.92 in 2019.


Despite the challenges, we still believe that GT can deliver long-term returns for investors and that the concerns are more than priced into the stock, considering the beating that has been issued over the past year. We think that continued strong employment, rising wages and solid consumer sentiment are conducive to keeping new car demand solid, as well as folks traveling more and thereby creating more wear and tear on tires (spurring replacements). We think that Goodyear also should gain from higher long-term demand in emerging markets. We are also constructive on management's continued focused on controlling expenses, improving cash flow and strengthening the balance sheet. Our Target Price for GT, which trades for 7.4 times trailing-12-month earnings and yields 3.1%, is $35.

**Newmont Mining** (NEM – $31.77) announced this past Monday plans to buy Goldcorp, a deal that would create the world's largest gold miner. Newmont said the stock-for-stock transaction is worth about $10 billion and would give 0.3280 NEM shares for each Goldcorp share. Despite paying just 17% above Goldcorp's trailing 20-day moving average,  and a price well below where the stock began 2018, shares of NEM slid 9% for the week.

“This combination will create the world’s leading gold business with the best assets, people, prospects and value-creation opportunities,” said Gary Goldberg, Newmont’s Chief Executive Officer. “We have a proven strategy and disciplined implementation plan to realize the full value of the combination, including an exceptional pool of talented mining professionals, stable and profitable gold production of six to seven million ounces over a decades-long time horizon, the sector’s largest gold Reserve and Resource base, and a leading project and exploration pipeline. Our cultures are well aligned, with strong commitments to zero harm, inclusion and diversity, and industry-leading environmental, social and governance performance. We expect to generate up to $100 million in annual pre-tax synergies, with additional cost and efficiency opportunities that will be pursued through our proven Full Potential continuous improvement program. The combination is expected to be immediately accretive to Newmont’s net asset value and cash flow per share. We constantly review opportunities to raise our performance, and this combination represents the most promising path to deliver superior and sustainable value for our shareholders, employees, host countries and communities.”

Though our gold miners have not treated us well as the price of the precious yellow has been subdued for quite some time, we continue to like NEM shares and the exposure to gold it gives our broadly diversified portfolios. We think that the Goldcorp acquisition is interesting, but we want to see significant operational improvements to make the transaction worthwhile. Still, we like Newmont’s continued focus on cutting and keeping costs low, and we think that there is sizable upside in the stock if gold prices jump in the future. Our Target Price for NEM, which actually sports a decent dividend yield of 1.8%, is now $40.

Paris-based **Societe Generale SA** (SCGLY – $6.50) warned of disappointing Q4 performance, sending the already-beaten-down shares steeply lower. Via press release, SocGen said, “Q4 18 Group performance was affected by IFRS 5 accounting of disposals and a challenging environment in global capital markets. The Board of Directors of Societe Generale intends to propose a stable dividend for 2018 (EUR 2.20 per share) and has decided to propose to shareholders the option of a dividend payment in shares. In addition, the pro forma Group CET1 ratio expected between 11.4% and 11.6% as of Q4 18.”

Compared with Q4 2017, SCGLY expects a 20% drop in global markets revenue for Q4 2018, which is a result of challenging global capital markets, although the bank said that it expects retail banking to be “solid.” The IFRS 5 accounting changes are related to non-current assets held for sale and discontinued operations, related to Societe Generale Serbia and a stake in La Banque Postale Financement. The one-time charge will be 240 million euros.

When we added SCGLY to our portfolios, we noted that some analysts had cautioned that the transition may be slow and painful, and we thought that the strengthening European macroeconomic environment would serve as a tailwind for the bank. Alas, 2018 was not a banner year for Europe generally and the immigration and Brexit debates that rage on have done little to help stabilize the political environment on the Continent. While we think that SCGLY management has not acted quickly enough to help their own cause, we aren't ready to throw in the towel, as SCGLY's dirt-cheap metrics (like a 6.3 times forward P/E ratio) and rumored structural changes like shutting its prop trading desk (thereby lowering the bank's overall risk) leave us thinking that the 2020 strategic plan may yet be accomplishable. Our Target Price has been trimmed to $12.

Diversified bank **Citigroup** (C – $63.12) earned $1.61 per share in fiscal Q4 2018 (vs. $1.55 est.). Shares soared in the days following the announcement, bringing the C rally to more than 28% since Christmas Eve. Of course, as mentioned above, even though the stock jumped, C reported lower-than-expected revenue due to a difficult December and lower bond trading.

Citigroup CEO Mike Corbat said, "Our net income for the year totaled $18 billion, or $6.65 per share, a 25% increase from 2017. During 2018, we made solid progress towards the 2020 targets, as we had committed. Our return on tangible common equity reached 10.9%, exceeding the 10.5% we targeted for the year and despite the market conditions we experienced throughout the fourth quarter, we still improved our operating efficiency to 57% for the year. In addition, we grew loans and deposits in constant dollars by 4% and 7% respectively, improved our return on assets to 93 basis points and managed our effective tax rate down to the 23% range, a little better than we had forecast. We had positive operating leverage and our EBIT was up 5% on an underlying basis."

Mr. Corbat added, "As 2019 begins, we find ourselves operating in a more uncertain macro environment. From what we see, economic growth is stronger and more resilient than recent market volatility would indicate. That said, we're prepared to make adjustments if we get the sense economic conditions are changing. We remain committed to our 2020 financial targets and this year we've targeted increasing our return on Tangible Common Equity to 12% and further improving our efficiency ratio. We continue to utilize technology to improve the client experience and lower our cost to serve, whether it's by automating processes or enhancing our mobile channels, and we'll continue to roll out new digital capabilities throughout the year. As I mentioned before, we have levers we can pull if revenues come in lower, but we're very cognizant of the need to invest for the long term, so that we can serve our clients with distinction."

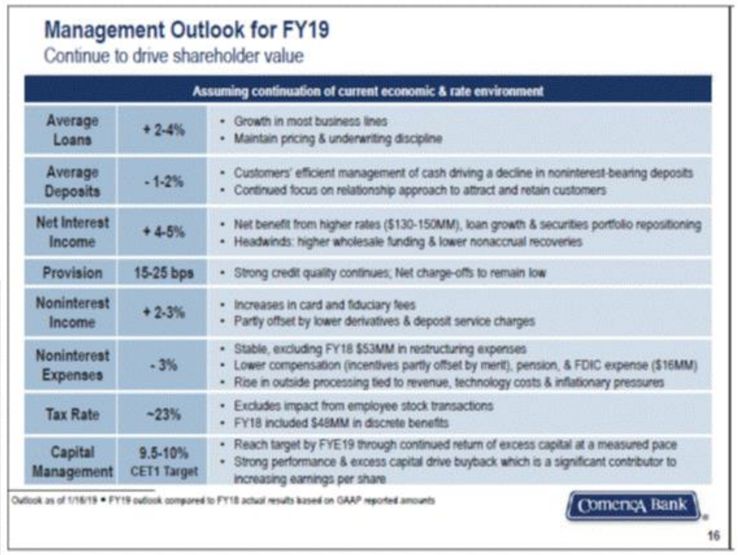
Even with improving operational execution, a domestic rising rate environment and faster growth markets around the globe (vs. its U.S. business), we believe that Citi shares trade far from their fair value. C is priced at just 8.4 times NTM adjusted EPS expectations and 84% of book value. We continue to see a more focused and recapitalized Citigroup as prepared to reward investors over the long-term. We like that C has good leverage towards the strong U.S. economy, while also having the potential to show outsized benefits versus its peers from growth in Asia, Latin America and other emerging economies. Even though the company faces plenty of operational headwinds in different segments of its business, we think the bank is on its way to achieving its low-50s efficiency-ratio target by 2020. Additionally, the current dividend yield now stands at 2.9%, and the bank continues to consistently buy back its stock. Our Target Price for C has been hiked to $106.

One of our newer recommendations, financial services company **Comerica** (CMA – $81.19) earned $1.95 per share in fiscal Q4 2018 (vs. $1.88 est.). In addition to strong year-over-year EPS growth, the company reported a return on equity north of 16%, a 1.74% return on assets, 11 basis points of net charge-offs and reduced excess capital. Shares rose 5.5% following the announcement.

CEO Ralph Babb commented, “Assuming continuation of the current economic environment, we expect average loans to grow approximately 2% to 4% in 2019 relative to 2018. We anticipate growth in most business lines, which is supported by positive trends in December and the increasing commitments we have seen over the past three quarters. We will maintain our relationship focus as well as loan pricing and credit discipline. Economic conditions are good, yet customers remain somewhat cautious given economic uncertainty, market volatility and lingering trade talks. As far as deposits, we expect the current trend to continue with average deposits declining about 1% to 2% as customers use cash in their businesses and more efficiently manage their cash position in this higher rate environment. We believe we will have some seasonality through the year. Our goal is to offer superior products and services, along with the appropriate pricing to attract and retain long-term customer relationships.”

# CMA – Favorable '18 & '19 Looking Good






In addition to being helped by a reduced tax bill, Comerica also lowered its share count by 6.3 million shares, while credit metrics remained strong. CMA also expects interest income to grow by $130 million to $150 million in 2019, while non-interest income is expected to grow in the 2% to 3% range. CMA is no longer considered a Systemically Important Financial Institution by the Federal Reserve, but still seemingly trades like one, though it has more balance sheet flexibility now to drive future EPS growth and return capital to shareholders. Despite having one of the most attractive deposit franchises, CMA trades for just 9.9 times NTM adjusted EPS estimates and yields 3.0%. Our Target Price has been boosted to $108.

Regional bank **KeyCorp** (KEY – $16.85) earned $0.48 per share in fiscal Q4 2018 (vs. $0.47 est.). Shares dipped 2.5% following the announcement, but recouped that loss on Friday. In Q4, the bank benefited from expense management, strong credit quality, an improvement in non-performing loans and disciplined capital management. Return on tangible common equity improved to 17.5% and the company expects to return a significant amount of cash to shareholders through dividends and repurchases.

CEO Beth Mooney commented, "We believe that our steadfast commitment to maintaining our moderate risk profile will continue to serve us well. In terms of capital management, we have consistently delivered on our stated priorities of supporting organic growth, growing dividends and prudently using share repurchases. And consistent with our 2018 capital plan, we increased our common stock dividend by 62% in 2018 and our dividend yield now stands at over 4%. We also repurchased over $1.1 billion of common shares throughout the year. Key's common equity tier 1 ratio ended the quarter at 9.92%. Again, it was a strong finish to the year. We had broad-based growth across our franchise with record annual revenue and well-managed expenses that drove meaningful improvement in both efficiency and returns. And we maintained our moderate risk profile and continued to return capital to our shareholders."

"Over the past several years, we have spent significant time, developing a distinctive partner capability. In that process, we have interacted with many different FinTech teams and other potential partners. And to-date, we have not yet found a business model or a management team with whom we are this closely aligned, which was a critical factor in our desire to engage in this transaction (with Laurel Road Bank), as well as the alignment with our relationship strategy targeted in an attractive and complementary client segment," Ms. Mooney concluded.

We continue to like Keycorp and think that the acquisition of Laurel Road Banks' digital lending business is interesting. Ms. Mooney said, "70% of the clients are doctors and dentists with another 20% being lawyers and MBAs. And the overall demographics of this target client base is extremely attractive, an average age of 33, average FICOs of 760, and income of approximately $185,000." We also believe that the bank's efficiency can continue to improve as it benefits from the full integration of its recent acquisitions. Shares currently trade at 9.1 times NTM adjusted earnings expectations and carry a 4.0% dividend yield. Our Target Price now stands at $27.

Diversified financial firm **Bank of America** (BAC – $29.30) reported earnings per share of $0.71, versus the $0.63 estimate, in fiscal Q4 2018. Shares moved up 7.2% the day of the announcement, boosted by bullish comments from CEO Brian Moynihan and strong performance for the company's retail banking franchise.

## Fourth Quarter 2018 Highlights

(% comparisons are to 4Q17 adjusted for enactment of Tax Act)

**Earnings**

- Diluted earnings per share of $0.70, up 49% [1]
- Record net income of $7.3B, up 39% [1]
- Pretax income of $8.7B, up 22% [1]
- Total revenue of $22.7B, up 6% [1]
- Noninterest expense of $13.1B, down 1%
- Net charge-off ratio of 0.39%, down 14 bps

**Returns and Efficiency**

- Return on average assets of 1.24% improved 34 bps [1]
- Return on average common shareholders' equity of 11.6% increased 373 bps [1]
- Return on average tangible common shareholders' equity of 16.3% improved 543 bps [1,2]
- Efficiency ratio of 58% improved 432 bps [1]

**Client Balances**

- Average loans and leases in business segments grew 3%
  - Consumer up 4% and commercial up 2%
- Average deposits increased 4%
- Full year Merrill Edge client flows of $25B
- Full year total client balance flows within Global Wealth & Investment Management of $56B

**Capital and Liquidity**

- $167B of Common Equity Tier 1 Capital (CET1) and CET1 ratio of 11.6% [3]
- $544B of average Global Liquidity Sources [4]
- Capital returned to shareholders
  - Repurchased $20.1B of common shares and paid $5.4B in common dividends in 2018; returned 96% of net income available to common shareholders

[1] Represent non-GAAP financial measures which exclude 4Q17 charge for enactment of the Tax Act. See slide 31 for important presentation information. In addition, for the non-GAAP financial measures under the "Earnings" section, see slide 8 for the percentages calculated using GAAP financial measures along with reconciliations. For the non-GAAP financial measures under "Returns and Efficiency", see slide 8 for the percentages calculated using GAAP financial measures and note A on slide 28 for reconciliations.
[2] Return on average tangible common shareholders' equity is a non-GAAP financial measure. See slide 8 for additional information.
[3] Regulatory capital ratios at December 31, 2018 are preliminary. The Company reports regulatory capital ratios under both the Standardized and Advanced approaches. The approach that yields the lower ratio is used to assess capital adequacy, which for CET1 is the Standardized approach for 4Q18.
[4] See note B on slide 28 for definition of Global Liquidity Sources.

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Mr. Moynihan said, "Looking at the full-year results, we reported record earnings for our company of $28 billion after tax, or $2.61 per share. Revenue grew a little better than GDP at 3% and when discussing the growth rate over 2017, we were increasing 2017 baseline as shown to add back the charges taken to the Tax Act last year. Our client base has expanded and in our key business, our market leadership positions continued to improve. Deposits and loans within our business segments grew a little better than the economy."

"The United States economy, the largest in the world, grew at the highest rate in a decade, the long recovery in 2018. We still have low inflation, rising wages, low unemployment. And despite the increases in rates, interest rates remain at all-time lows. Our research team predicts economic growth to be lower in 2019 than it was in 2018, as do the general economic community. However, it is true, these estimates still point to solid growth. For 2019, our research team has global GDP growth at 3.5%, and the research team has the U.S. GDP growth at 2.5%, which is higher than any but one year in the last seven. Trade wars, government shutdown, China slowdown, EU slowdown, Brexit, you name it, both here and abroad, impact people's economic growth outlook. We are mindful of those potential impacts, but we see in the U.S. strong indications of continued growth due to the denizens we have here in our economy. So, given the slowdown predicted, it does not enervate us, it invigorates us. We look forward to continue to produce strong results in 2019 by driving responsible growth," Mr. Moynihan concluded.

Despite many of the problems of the past decade seemingly now in the rear-view mirror and solid business performance in 2018, BAC seems in a solid position for the future. We think investors unduly discarded shares at the end of last year and that BAC has numerous opportunities upon which to capitalize, from its large deposit base and consumer lending franchise to its "thundering herd" of Merrill Lynch's financial advisors and wealth managers. Credit quality remains solid and the stock is trading for just 10.2 times NTM estimated EPS. BAC is also actively buying back its stock and the dividend yield now stands at 2.0%. Our Target Prices has been increased to $40.

Banking giant **JPMorgan Chase & Co** (JPM – $104.59) posted earnings per share of $1.98, versus the $2.21 estimate, in fiscal Q4 2018. Despite the big EPS miss, JPM shares actually gained nearly 5% last week, no doubt thanks to CEO Jamie Dimon's smooth handling of analyst questions and suggestion that some of the near-term challenges are due to the political deadlock in Washington.

Asked about the business climate at the end of the year and his role in the Business Roundtable, Mr. Dimon said, "December is terrible, but if you look at January, you have half of it back generally in spreads and markets and stuff like that. And as BRT, I don't do anything to benefit JPMorgan. That's about public policy, that's good for the growth of America in total. We want more innovation. We'd like to reduce regulations at the local and federal level to stop small business formation. So you look at the BRT, there are 10 verticals around it, and we try to do things that are good for the growth of America. And bad policy can slow down the growth of America. As I've pointed out over and over, it takes 12 years to get the permits to build a bridge, and it took eight years to put a man on the moon. It is time that we reform ourselves and not blame anybody else for our own lack of that we don't have kids getting out of school with educations, whether you get jobs that – whether innovations slow down, the government R&D spending is down, I always think you have to look at yourself and what can you do better and there's plenty in this country to do better self-growth over the long run. It's not about helping it next quarter."

CFO Marianne Lake noted that the macro trends are positive and, "They are creating tailwinds. But it's also true, we talked about the fact that if you go back to 2014, 2015 that we had expanded our credit box, we'd expanded it intentionally at higher risk-adjusted margins. But over the course of the last couple of years, as we've experienced outperformance, we've done surgical risk pullbacks and we've amended our collection strategy, all of which have led to a charge-off rate for the fourth quarter in 2018 that's down slightly year-on-year."

Mr. Dimon has never been shy about his political opinions and the relationship of the political environment to JPM's businesses. He discussed some of the usual Wall of Worry items like a trade war, the Government Shutdown and U.S. global influence on the earnings call, and thereby seemed to avoid some other questions about the challenges in Q4. Perhaps, though, it just serves to illustrate the long view Mr. Dimon traditionally takes. And when it comes to the long term, we think that JPM continues to execute well, while we remain quite fond of the fortress balance sheet. JPM shares are currently trading for just 10.5 times NTM projections, while carrying a dividend yield of 3.1%. With the continued progress and momentum, we believe that the financial titan is well-positioned for the next few years. Our Target Price for JPM has been bumped up to $138.

Investment banking and brokerage firm **Goldman Sachs Group** (GS – $202.54) posted earnings per share of $4.83, versus the $4.53 estimate, in fiscal Q4 2018. Shares rose 9.5% the day of the announcement, propelled by growth in Goldman's Advisory and Investment Banking businesses and a number-one rank in global M&A with more than 400 deals in 2018 worth $1.2 trillion.

CEO Dave Solomon remarked, "A few observations on the operating environment: Recently, there has been quite a disconnect between the weak market sentiment and the optimism we continue to see in corporate board rooms. The fourth quarter, particularly December, was characterized by a decline in investor sentiment with respect to the global growth outlook. A concern that central banks would continue to tighten into a slowing growth environment caused weakness in equity and credit markets and resulted in an increase in volatility of many macro assets. While this has created challenges for many of our institutional investing clients, it is also driving potential future opportunities for active managers to add value. In addition for now the absolute level of activity in the real economy remains fairly robust, and this is reflected in broad CEO sentiment and our Investment Banking transaction backlog. Despite the global uncertainties, including U.S.-China trade policy, Brexit, the planned removal of monetary policy stimulus in Europe and the recent yield curve flattening, our economists still see global growth of 3.5% next year, including 2.4% in the U.S., 1.6% in the Eurozone, over 6% in China and an acceleration to 2% in Latin America. Notwithstanding the mixed market and macro backdrop, we remain actively engaged with our clients across our franchise. Corporations continue to seek advice for strategic transactions and there's a need for both equity and debt financing. Financial markets are open and investors continue to need execution services, intellectual capital, hedging and liquidity solutions. Clients continue to need comprehensive asset wealth management advice and individuals need simple and transparent financial services that add value."

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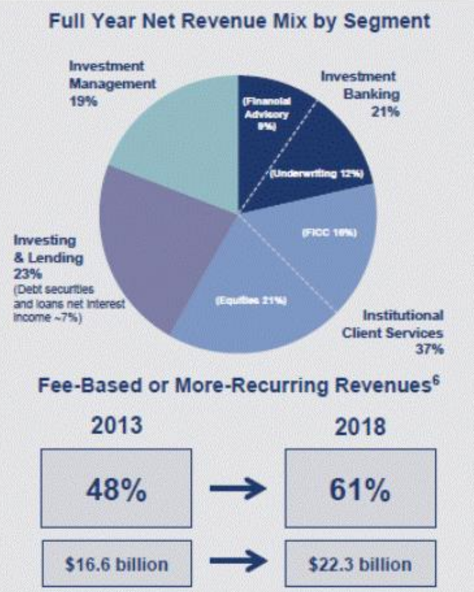
# THE PRUDENT SPECULATOR
# GS – Record 2018

## Financial Overview

### Financial Results

| $ in millions, except per share amounts | 4Q18 | vs. 3Q18 | vs. 4Q17 | 2018 | vs. 2017 |
|---|---|---|---|---|---|
| Investment Banking | $ 2,044 | 3% | -5% | $ 7,862 | 7% |
| FICC | 822 | -37% | -18% | 5,882 | 11% |
| Equities | 1,604 | -11% | 17% | 7,600 | 15% |
| Institutional Client Services | 2,426 | -22% | 2% | 13,482 | 13% |
| Investing & Lending | 1,906 | -6% | -2% | 8,250 | 14% |
| Investment Management | 1,704 | — | 2% | 7,022 | 13% |
| **Net revenues[3]** | $ 8,080 | -8% | -1% | $36,616 | 12% |
| Provision for credit losses[3] | 222 | 28% | -23% | 674 | 3% |
| Operating expenses | 5,150 | -8% | 9% | 23,461 | 12% |
| **Pre-tax earnings** | 2,708 | -12% | -13% | 12,481 | 12% |
| Provision for taxes[4] | 170 | -69% | -97% | 2,022 | -70% |
| Net earnings | 2,538 | 1% | N.M. | 10,459 | 144% |
| **Net earnings to common** | $ 2,322 | -5% | N.M. | $ 9,860 | 168% |
| **Diluted EPS[4]** | $ 6.04 | -4% | N.M. | $ 25.27 | 180% |
| ROE[4,5] | 12.1% | -1.0pp | N.M. | 13.3% | 8.4pp |
| ROTE[4,5] | 12.8% | -1.0pp | N.M. | 14.1% | 8.9pp |

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We were impressed with Goldman's quarter and think that the speedy partial recovery since the end of December is an encouraging sign. We continue to be long-term fans of GS and are constructive on the name given the prospects for stronger revenue growth, operating leverage, potential de-regulatory policies and a possible higher earnings multiple than the current forward P/E of 8.2. Additionally, we think that the Malaysian 1MDB scandal will blow over (despite the many negative headlines related to Goldman's involvement) and expect its reputation with clients will recover. Our Target Price has been elevated to $295.

Oilfield services firm **Schlumberger Ltd** (SLB – $44.73) reported earnings per share of $0.36, versus the $0.36 estimate, in fiscal Q4 2018. SLB had sales of $8.2 billion (vs. $8.0 billion est.). Shares rose 8.2% following the announcement, lifted by a one-time gain on its divestiture of WesternGeco and increased activity in Latin America and the Middle East.

CEO Paal Kibsgaard said, "Starting off with the industry macro view, the significant drop in oil prices in the fourth quarter was driven largely by the U.S. shale production surprising to the upside as a result of the surge in activity earlier in the year, and by geopolitics negatively impacting global supply and demand balance sentiments. The combination of these factors, together with the large sell-off in the equity markets due to concerns around global growth and increasing U.S. interest rates, created a near perfect storm to close out 2018. Looking forward to 2019, we expect the supply and demand balance sentiment and the oil prices to improve over the course of the year, as the OPEC and Russia cuts take full effect, the lower activity in North America land in the second half of 2018 impacts production growth, the dispensations from the Iran export sanctions expire and are not renewed, and as the U.S. and China continue to work towards a solution to their ongoing trade dispute. So far in January, Brentoil prices are already up around $10, supporting this improving outlook."

Looking forward, Mr. Kibsgaard said, "We still expect solid year-over-year revenue growth in the international markets in 2019, starting off in the mid-single digits for the first half of the year as our customers take a conservative approach due to the recent oil price volatility. Growth rates will be led by Africa, Asia and Latin America as new investment programs are kicked off in these regions, while we continue to see solid, but more nominal growth rates in the North Sea, Russia and the Middle East as existing activity on projects continue to expand. It is also worth noting that with the continued growth in U.S. shale production, an increasing percentage of the new wells drilled are being consumed to offset the steep decline from the existing production base. Third-party analysis shows that in 2018 this number was 54% of total CapEx and is expected to increase to 75% in 2021, clearly demonstrating the unavoidable treadmill effect of shale oil production."

We like management's attitude about evolving for the future and we see SLB not only surviving the turbulence in the oil patch but thriving from a sustained upturn in the historically cyclical industry. We think its global income diversification is a positive and think SLB is the clear technology leader with an important reputation for consistent execution. We are fond of the firm's ability to generate solid free cash flow and the handsome 4.5% dividend yield the shares currently offer. Our Target Price for SLB is now $91.