MARKET COMMENTARY MONDAY, JANUARY 28, 2019

January 27, 2019

EXECUTIVE SUMMARY

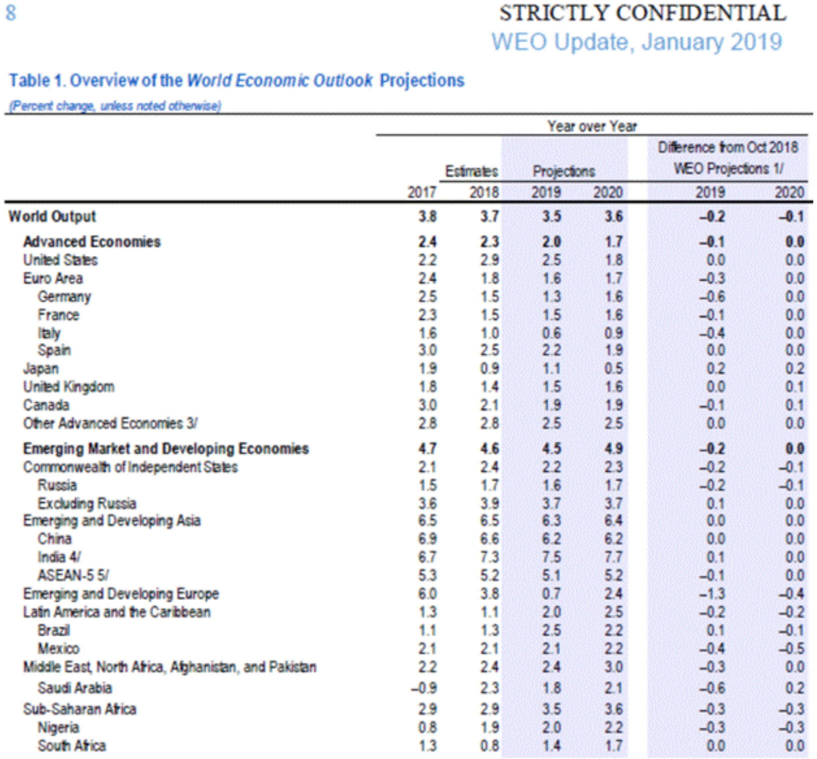
Forbes South America Cruise – Buckingham at Sea and Market Holding Up So Far
Econ Forecasts – IMF Joins the World Bank in Lowering Global GDP Outlook
Leading Economic Indicators – 2% U.S. GDP Growth in 2019
Government Shutdowns & Recessions – What Actually Happens with Stocks
Corporate Profits – Solid Growth in EPS Still Likely
Valuations – AFAM Portfolios vs. the Indexes
Stock Updates – CMCSA, ONB, COF, HAL, KMB, LRCX, SYF, INTC, AVX, ALK, NSC & IBM

Market Review

Greetings from the South Atlantic Ocean where the *Forbes South America Cruise* is now underway. Happily, and unlike with the *Australia* and *Danube Cruises* last year, your Editor's sailing thus far has not coincided with a big downturn in the equity markets. In fact, the two market days we have been aboard the Crystal Symphony were actually very good, helping to turn around a lousy start to the holiday-shortened trading week and leaving most of the major averages near the break-even mark for the four days.

Interestingly, Tuesday saw a sizable market pullback, with a prime catalyst being the modest downgrade of the global economic outlook by the International Monetary Fund.

IMF’s Weakening Global Expansion



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WEO Update, January 2019

Table 1. Overview of the *World Economic Outlook* Projections

(Percent change, unless noted otherwise)

	Year over Year					
		Estimates	Projections		Difference from Oct 2018 WEO Projections 1/	
	2017	2018	2019	2020	2019	2020
World Output	**3.8**	**3.7**	**3.5**	**3.6**	**–0.2**	**–0.1**
Advanced Economies	**2.4**	**2.3**	**2.0**	**1.7**	**–0.1**	**0.0**
United States	2.2	2.9	2.5	1.8	0.0	0.0
Euro Area	2.4	1.8	1.6	1.7	–0.3	0.0
Germany	2.5	1.5	1.3	1.6	–0.6	0.0
France	2.3	1.5	1.5	1.6	–0.1	0.0
Italy	1.6	1.0	0.6	0.9	–0.4	0.0
Spain	3.0	2.5	2.2	1.9	0.0	0.0
Japan	1.9	0.9	1.1	0.5	0.2	0.2
United Kingdom	1.8	1.4	1.5	1.6	0.0	0.1
Canada	3.0	2.1	1.9	1.9	–0.1	0.1
Other Advanced Economies 3/	2.8	2.8	2.5	2.5	0.0	0.0
Emerging Market and Developing Economies	**4.7**	**4.6**	**4.5**	**4.9**	**–0.2**	**0.0**
Commonwealth of Independent States	2.1	2.4	2.2	2.3	–0.2	–0.1
Russia	1.5	1.7	1.6	1.7	–0.2	–0.1
Excluding Russia	3.6	3.9	3.7	3.7	0.1	0.0
Emerging and Developing Asia	6.5	6.5	6.3	6.4	0.0	0.0
China	6.9	6.6	6.2	6.2	0.0	0.0
India 4/	6.7	7.3	7.5	7.7	0.1	0.0
ASEAN-5 5/	5.3	5.2	5.1	5.2	–0.1	0.0
Emerging and Developing Europe	6.0	3.8	0.7	2.4	–1.3	–0.4
Latin America and the Caribbean	1.3	1.1	2.0	2.5	–0.2	–0.2
Brazil	1.1	1.3	2.5	2.2	0.1	–0.1
Mexico	2.1	2.1	2.1	2.2	–0.4	–0.5
Middle East, North Africa, Afghanistan, and Pakistan	2.2	2.4	2.4	3.0	–0.3	0.0
Saudi Arabia	–0.9	2.3	1.8	2.1	–0.6	0.2
Sub-Saharan Africa	2.9	2.9	3.5	3.6	–0.3	–0.3
Nigeria	0.8	1.9	2.0	2.2	–0.3	–0.3
South Africa	1.3	0.8	1.4	1.7	0.0	0.0

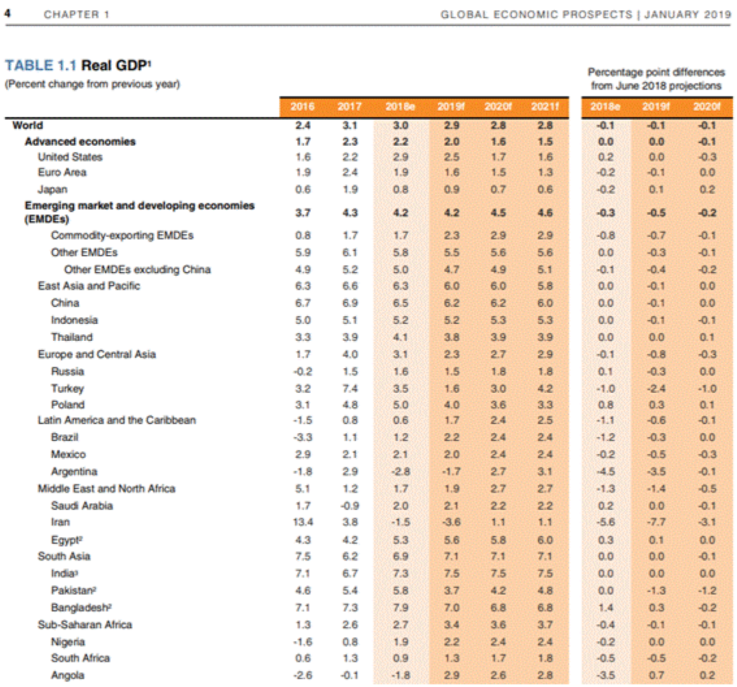
Stocks had a temporary tumble on 1.22.19, supposedly on renewed concerns for global economic growth, after the International Monetary Fund (IMF) lowered its 2019 and 2020 projections by 0.2% and 0.1%, respectively. Of course, the IMF still expects worldwide GDP growth of 3.5% in 2019 and 3.6% in 2020.

The IMF stated, “Risks to global growth tilt to the downside. An escalation of trade tensions beyond those already incorporated in the forecast remains a key source of risk to the outlook. Financial conditions have already tightened since the fall. A range of triggers beyond escalating trade tensions could spark a further deterioration in risk sentiment with adverse growth implications, especially given the high levels of public and private debt. These potential triggers include a ‘no-deal’ withdrawal of the United Kingdom from the European Union and a greater-than-envisaged slowdown in China.”

Sounds somewhat ominous, but the IMF’s worldwide growth estimates still are well above those recently provided by the World Bank,…

THE PRUDENT SPECULATOR

World Bank’s Darkening Skies: 0.1% Cut?



4 CHAPTER 1 GLOBAL ECONOMIC PROSPECTS | JANUARY 2019

TABLE 1.1 Real GDP[1]

(Percent change from previous year)

							Percentage point differences from June 2018 projections		
	2016	2017	2018e	2019f	2020f	2021f	2018e	2019f	2020f
World	**2.4**	**3.1**	**3.0**	**2.9**	**2.8**	**2.8**	**-0.1**	**-0.1**	**-0.1**
Advanced economies	**1.7**	**2.3**	**2.2**	**2.0**	**1.6**	**1.5**	**0.0**	**0.0**	**-0.1**
United States	1.6	2.2	2.9	2.5	1.7	1.6	0.2	0.0	-0.3
Euro Area	1.9	2.4	1.9	1.6	1.5	1.3	-0.2	-0.1	0.0
Japan	0.6	1.9	0.8	0.9	0.7	0.6	-0.2	0.1	0.2
Emerging market and developing economies (EMDEs)	**3.7**	**4.3**	**4.2**	**4.2**	**4.5**	**4.6**	**-0.3**	**-0.5**	**-0.2**
Commodity-exporting EMDEs	0.8	1.7	1.7	2.3	2.9	2.9	-0.8	-0.7	-0.1
Other EMDEs	5.9	6.1	5.8	5.5	5.6	5.6	0.0	-0.3	-0.1
Other EMDEs excluding China	4.9	5.2	5.0	4.7	4.9	5.1	-0.1	-0.4	-0.2
East Asia and Pacific	6.3	6.6	6.3	6.0	6.0	5.8	0.0	-0.1	0.0
China	6.7	6.9	6.5	6.2	6.2	6.0	0.0	-0.1	0.0
Indonesia	5.0	5.1	5.2	5.2	5.3	5.3	0.0	-0.1	-0.1
Thailand	3.3	3.9	4.1	3.8	3.9	3.9	0.0	0.0	0.1
Europe and Central Asia	1.7	4.0	3.1	2.3	2.7	2.9	-0.1	-0.8	-0.3
Russia	-0.2	1.5	1.6	1.5	1.8	1.8	0.1	-0.3	0.0
Turkey	3.2	7.4	3.5	1.6	3.0	4.2	-1.0	-2.4	-1.0
Poland	3.1	4.8	5.0	4.0	3.6	3.3	0.8	0.3	0.1
Latin America and the Caribbean	-1.5	0.8	0.6	1.7	2.4	2.5	-1.1	-0.6	-0.1
Brazil	-3.3	1.1	1.2	2.2	2.4	2.4	-1.2	-0.3	0.0
Mexico	2.9	2.1	2.1	2.0	2.4	2.4	-0.2	-0.5	-0.3
Argentina	-1.8	2.9	-2.8	-1.7	2.7	3.1	-4.5	-3.5	-0.1
Middle East and North Africa	5.1	1.2	1.7	1.9	2.7	2.7	-1.3	-1.4	-0.5
Saudi Arabia	1.7	-0.9	2.0	2.1	2.2	2.2	0.2	0.0	-0.1
Iran	13.4	3.8	-1.5	-3.6	1.1	1.1	-5.6	-7.7	-3.1
Egypt[2]	4.3	4.2	5.3	5.6	5.8	6.0	0.3	0.1	0.0
South Asia	7.5	6.2	6.9	7.1	7.1	7.1	0.0	0.0	-0.1
India[3]	7.1	6.7	7.3	7.5	7.5	7.5	0.0	0.0	0.0
Pakistan[2]	4.6	5.4	5.8	3.7	4.2	4.8	0.0	-1.3	-1.2
Bangladesh[2]	7.1	7.3	7.9	7.0	6.8	6.8	1.4	0.3	-0.2
Sub-Saharan Africa	1.3	2.6	2.7	3.4	3.6	3.7	-0.4	-0.1	-0.1
Nigeria	-1.6	0.8	1.9	2.2	2.4	2.4	-0.2	0.0	0.0
South Africa	0.6	1.3	0.9	1.3	1.7	1.8	-0.5	-0.5	-0.2
Angola	-2.6	-0.1	-1.8	2.9	2.6	2.8	-3.5	0.7	0.2

The good folks at the World Bank joined the sensationalistic media world by titling their latest Global Economic Prospects report, “Darkening Skies!” No doubt, the world economy faces headwinds, but the apparently ominous weather caused the Bank to lower its forecast for 2019 and 2020 global GDP growth by a whopping 0.1% in each year to 2.9% and 2.8%, respectively.

…with both entities suggesting that lackluster U.S. GDP growth is in the cards, an outlook that arguably was echoed by the latest index of leading economic indicators.

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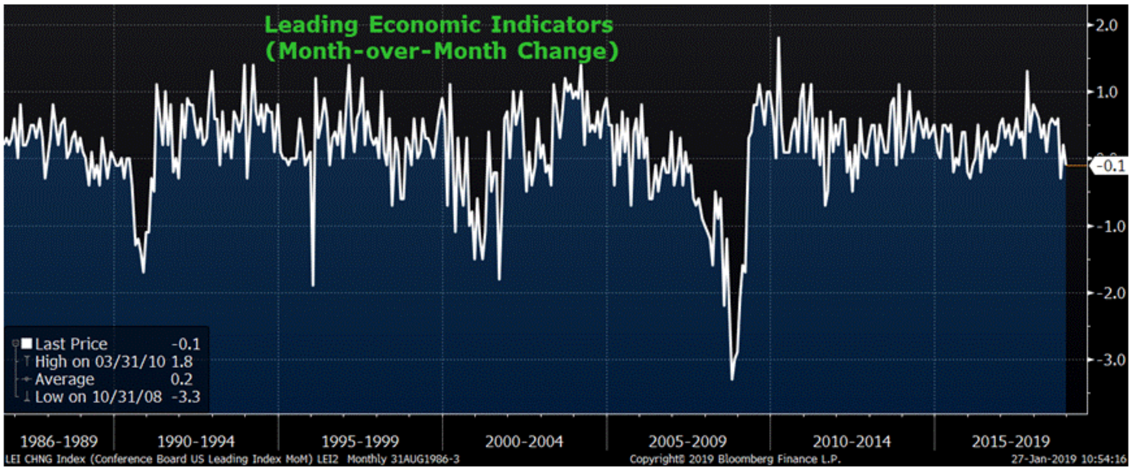
THE PRUDENT SPECULATOR
No Signs of an Imminent Recession

The forward-looking index of Leading Economic Indicators fell 0.1% in December, with the Conference Board stating, "The U.S. LEI declined slightly…and the recent moderation in the LEI suggests that the U.S. economic growth rate may slow down this year. While the effects of the government shutdown are not yet reflected here, the LEI suggests that the economy could decelerate towards 2% growth by the end of 2019."



To be sure, the Government Shutdown, which ended late Friday, for the time being anyway, won't help near-term economic numbers, but equities have performed just fine, on average, during prior periods when Washington was closed for business,…

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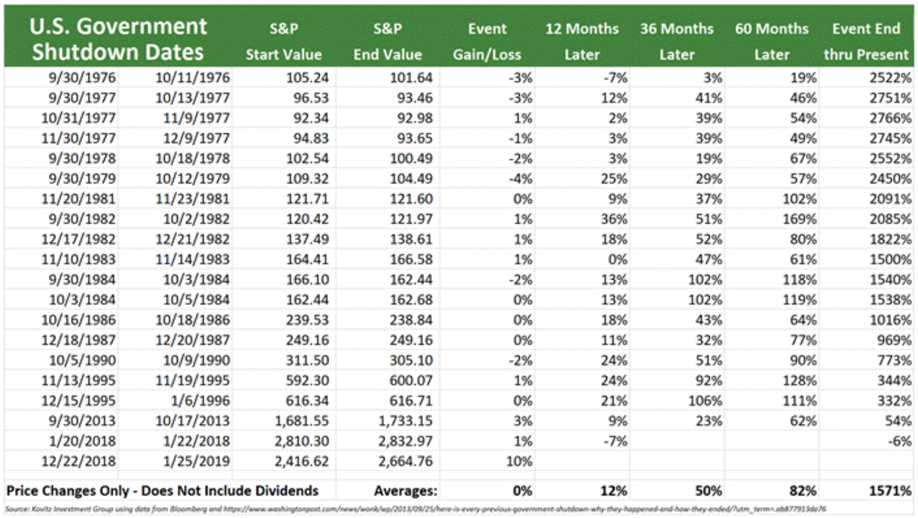
Gov't Shutdown Not a Problem for Stocks

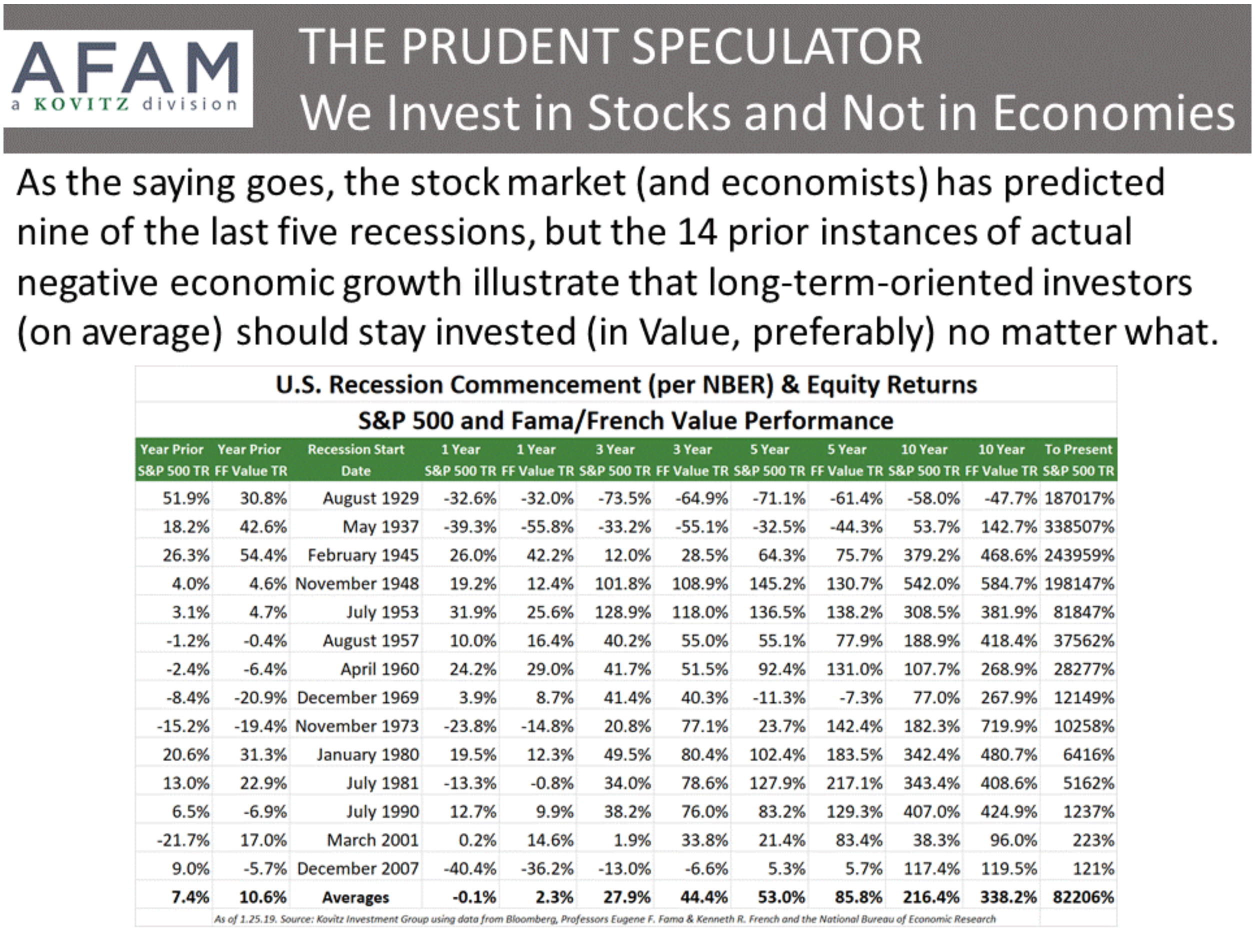
With funding for a wall along the U.S.-Mexico border the main sticking point, the U.S. government partially shut down on Dec. 22, before a temporary agreement was reached on Jan. 25. Incredibly, a Washington closure over market-trading days has now occurred 20 times since 1976, but equities generally have taken these events in stride.



U.S. Government Shutdown Dates		S&P Start Value	S&P End Value	Event Gain/Loss	12 Months Later	36 Months Later	60 Months Later	Event End thru Present
9/30/1976	10/11/1976	105.24	101.64	-3%	-7%	3%	19%	2522%
9/30/1977	10/13/1977	96.53	93.46	-3%	12%	41%	46%	2751%
10/31/1977	11/9/1977	92.34	92.98	1%	2%	39%	54%	2766%
11/30/1977	12/9/1977	94.83	93.65	-1%	3%	39%	49%	2745%
9/30/1978	10/18/1978	102.54	100.49	-2%	3%	19%	67%	2552%
9/30/1979	10/12/1979	109.32	104.49	-4%	25%	29%	57%	2450%
11/20/1981	11/23/1981	121.71	121.60	0%	9%	37%	102%	2091%
9/30/1982	10/2/1982	120.42	121.97	1%	36%	51%	169%	2085%
12/17/1982	12/21/1982	137.49	138.61	1%	18%	52%	80%	1822%
11/10/1983	11/14/1983	164.41	166.58	1%	0%	47%	61%	1500%
9/30/1984	10/3/1984	166.10	162.44	-2%	13%	102%	118%	1540%
10/3/1984	10/5/1984	162.44	162.68	0%	13%	102%	119%	1538%
10/16/1986	10/18/1986	239.53	238.84	0%	18%	43%	64%	1016%
12/18/1987	12/20/1987	249.16	249.16	0%	11%	32%	77%	969%
10/5/1990	10/9/1990	311.50	305.10	-2%	24%	51%	90%	773%
11/13/1995	11/19/1995	592.30	600.07	1%	24%	92%	128%	344%
12/15/1995	1/6/1996	616.34	616.71	0%	21%	106%	111%	332%
9/30/2013	10/17/2013	1,681.55	1,733.15	3%	9%	23%	62%	54%
1/20/2018	1/22/2018	2,810.30	2,832.97	1%	-7%			-6%
12/22/2018	1/25/2019	2,416.62	2,664.76	10%				
Price Changes Only - Does Not Include Dividends			**Averages:**	**0%**	**12%**	**50%**	**82%**	**1571%**

Source: Kovitz Investment Group using data from Bloomberg and https://www.washingtonpost.com/news/wonk/wp/2013/09/25/here-is-every-previous-government-shutdown-why-they-happened-and-how-they-ended/?utm_term=.ab877913da76

...while market history shows that Value stocks have been the place to be, for those with a long-term orientation, during and following recessionary periods.



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THE PRUDENT SPECULATOR
We Invest in Stocks and Not in Economies

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
51.9%	30.8%	August 1929	-32.6%	-32.0%	-73.5%	-64.9%	-71.1%	-61.4%	-58.0%	-47.7%	187017%
18.2%	42.6%	May 1937	-39.3%	-55.8%	-33.2%	-55.1%	-32.5%	-44.3%	53.7%	142.7%	338507%
26.3%	54.4%	February 1945	26.0%	42.2%	12.0%	28.5%	64.3%	75.7%	379.2%	468.6%	243959%
4.0%	4.6%	November 1948	19.2%	12.4%	101.8%	108.9%	145.2%	130.7%	542.0%	584.7%	198147%
3.1%	4.7%	July 1953	31.9%	25.6%	128.9%	118.0%	136.5%	138.2%	308.5%	381.9%	81847%
-1.2%	-0.4%	August 1957	10.0%	16.4%	40.2%	55.0%	55.1%	77.9%	188.9%	418.4%	37562%
-2.4%	-6.4%	April 1960	24.2%	29.0%	41.7%	51.5%	92.4%	131.0%	107.7%	268.9%	28277%
-8.4%	-20.9%	December 1969	3.9%	8.7%	41.4%	40.3%	-11.3%	-7.3%	77.0%	267.9%	12149%
-15.2%	-19.4%	November 1973	-23.8%	-14.8%	20.8%	77.1%	23.7%	142.4%	182.3%	719.9%	10258%
20.6%	31.3%	January 1980	19.5%	12.3%	49.5%	80.4%	102.4%	183.5%	342.4%	480.7%	6416%
13.0%	22.9%	July 1981	-13.3%	-0.8%	34.0%	78.6%	127.9%	217.1%	343.4%	408.6%	5162%
6.5%	-6.9%	July 1990	12.7%	9.9%	38.2%	76.0%	83.2%	129.3%	407.0%	424.9%	1237%
-21.7%	17.0%	March 2001	0.2%	14.6%	1.9%	33.8%	21.4%	83.4%	38.3%	96.0%	223%
9.0%	-5.7%	December 2007	-40.4%	-36.2%	-13.0%	-6.6%	5.3%	5.7%	117.4%	119.5%	121%
7.4%	**10.6%**	**Averages**	**-0.1%**	**2.3%**	**27.9%**	**44.4%**	**53.0%**	**85.8%**	**216.4%**	**338.2%**	**82206%**

As of 1.25.19. Source: Kovitz Investment Group using data from Bloomberg, Professors Eugene F. Fama & Kenneth R. French and the National Bureau of Economic Research

Of course, we do not think a recession in 2019 or 2020 is in the cards, so we look for solid corporate profit growth to continue,...

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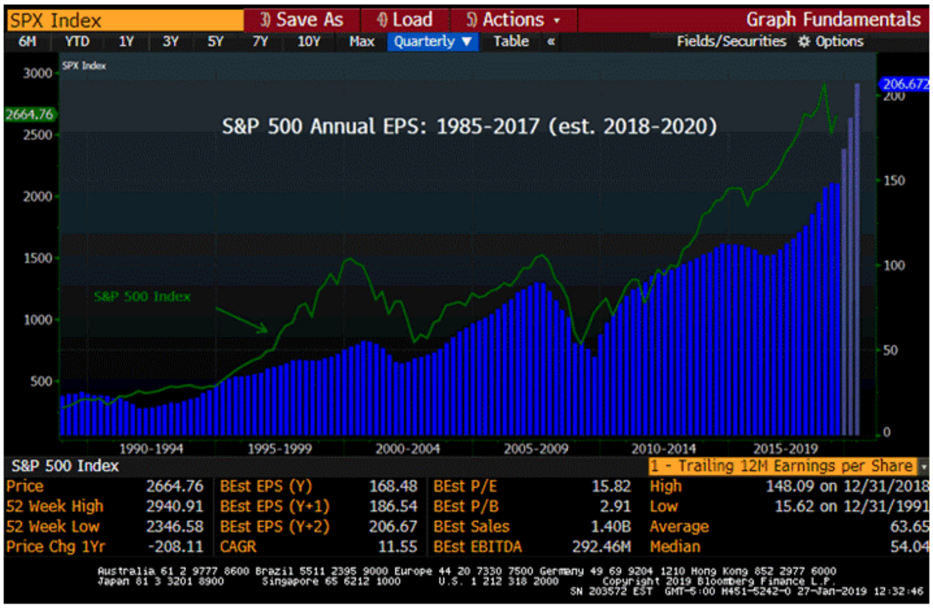
Stock Prices Often Follow Earnings

Market history shows that sustained market downturns usually coincide with a recession in corporate profits. No guarantees, of course, but the outlook for earnings, especially given the recent tax cuts, is favorable.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S&P 500 Index
1990-1994
1995-1999
2000-2004
2005-2009
2010-2014
2015-2019

S&P 500 Annual EPS: 1985-2017 (est. 2018-2020)

S&P 500 Index

1 - Trailing 12M Earnings per Share

Price	2664.76	BEst EPS (Y)	168.48	BEst P/E	15.82	High	148.09 on 12/31/2018
52 Week High	2940.91	BEst EPS (Y+1)	186.54	BEst P/B	2.91	Low	15.62 on 12/31/1991
52 Week Low	2346.58	BEst EPS (Y+2)	206.67	BEst Sales	1.40B	Average	63.65
Price Chg 1Yr	-208.11	CAGR	11.55	BEst EBITDA	292.46M	Median	54.04

Australia 61 2 9777 8600 Brazil 5511 2395 9000 Europe 44 20 7330 7500 Germany 49 69 9204 1210 Hong Kong 852 2977 6000
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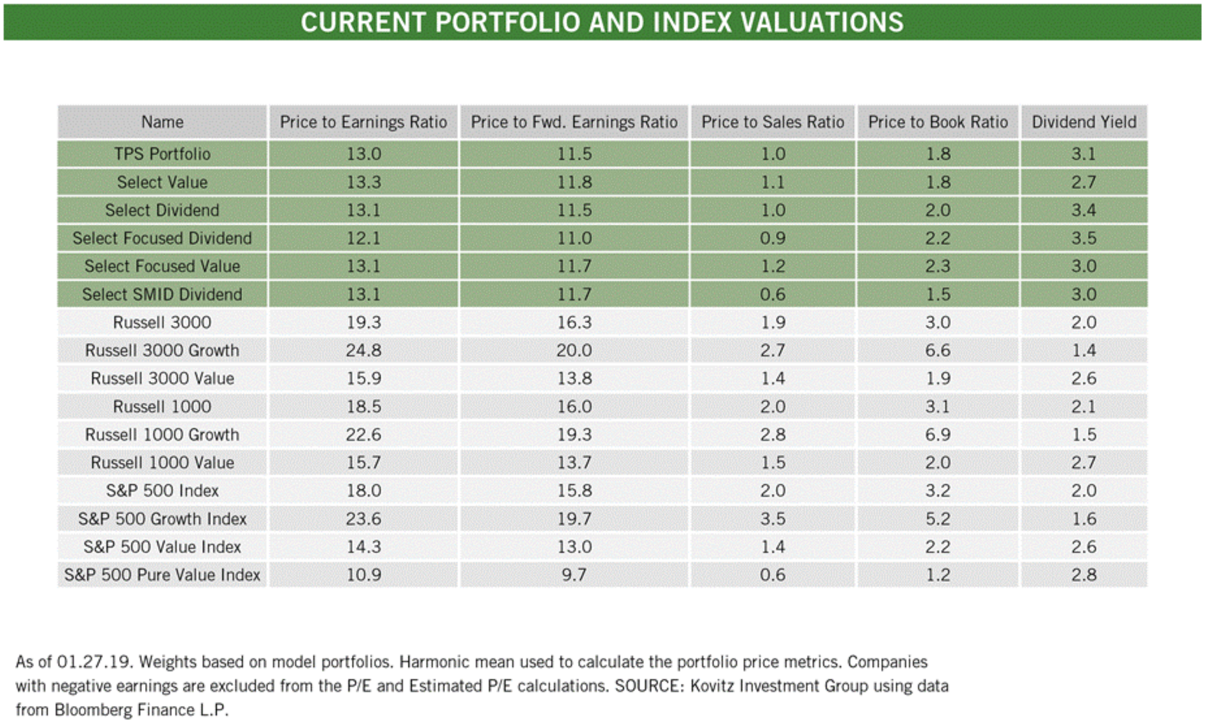
…which adds to our enthusiasm for the long-term prospects of our broadly diversified portfolios of what we believe to be undervalued dividend-paying stocks.



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	13.0	11.5	1.0	1.8	3.1
Select Value	13.3	11.8	1.1	1.8	2.7
Select Dividend	13.1	11.5	1.0	2.0	3.4
Select Focused Dividend	12.1	11.0	0.9	2.2	3.5
Select Focused Value	13.1	11.7	1.2	2.3	3.0
Select SMID Dividend	13.1	11.7	0.6	1.5	3.0
Russell 3000	19.3	16.3	1.9	3.0	2.0
Russell 3000 Growth	24.8	20.0	2.7	6.6	1.4
Russell 3000 Value	15.9	13.8	1.4	1.9	2.6
Russell 1000	18.5	16.0	2.0	3.1	2.1
Russell 1000 Growth	22.6	19.3	2.8	6.9	1.5
Russell 1000 Value	15.7	13.7	1.5	2.0	2.7
S&P 500 Index	18.0	15.8	2.0	3.2	2.0
S&P 500 Growth Index	23.6	19.7	3.5	5.2	1.6
S&P 500 Value Index	14.3	13.0	1.4	2.2	2.6
S&P 500 Pure Value Index	10.9	9.7	0.6	1.2	2.8

As of 01.27.19. 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: Kovitz Investment Group using data from Bloomberg Finance L.P.

Obviously, anything can happen in the short run, and the equity futures were pointing to modest losses when trading resumes this week, so we know that the not-so-nice kind of volatility could reappear, but we generally like the Q4 earnings reports and management comments we have been reading. After all, as our founder Al Frank said, "We think of ourselves as partners in great corporations, growing in wealth as they prevail, rather than traders of pieces of paper."

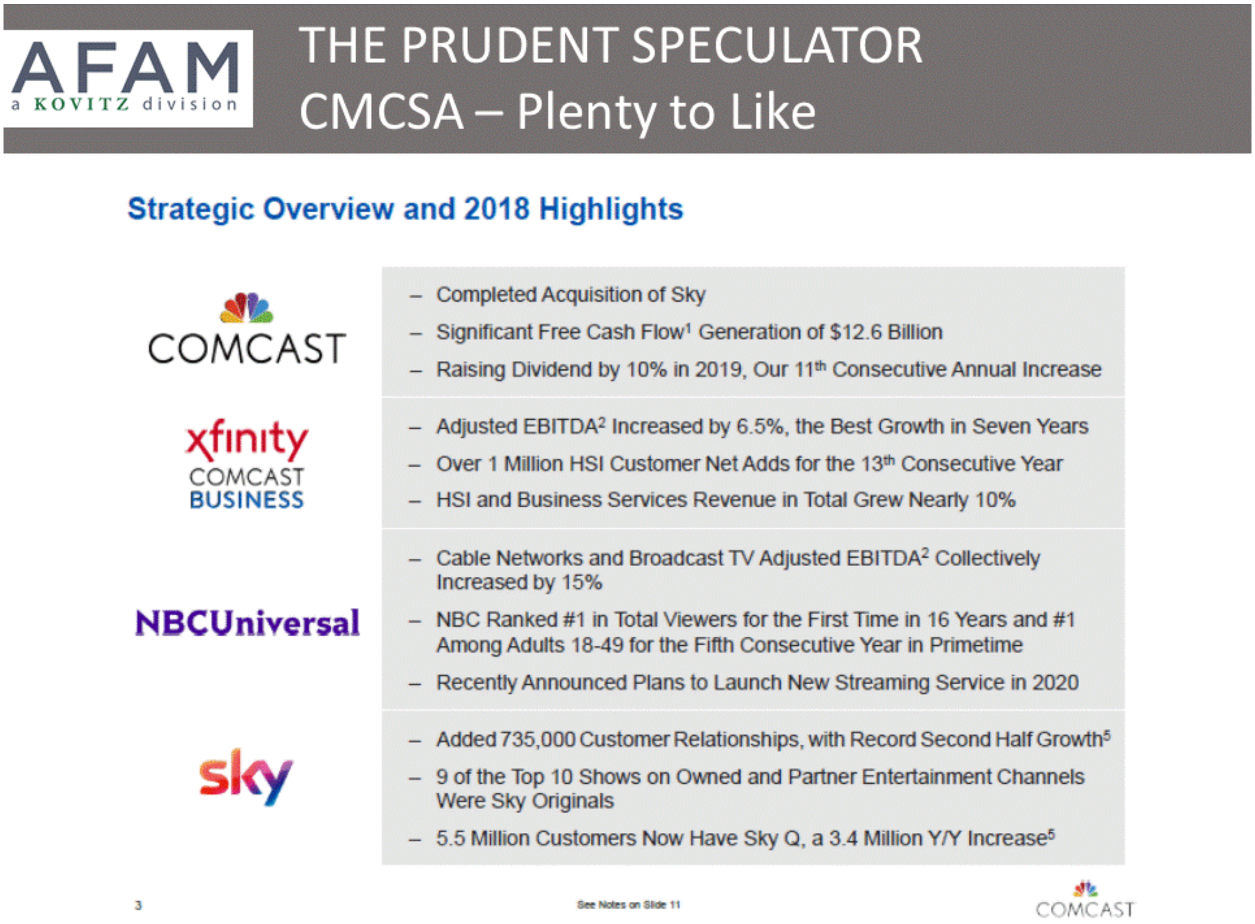
Stock Updates

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/, Jason Clark and Chris Quigley offers updates on a dozen of our companies that had news last week that was of sufficient importance to trigger a review of their respective Target Prices…

Media giant **Comcast** (CMCSA – $35.78) reported earnings per share of $0.64, versus the $0.62 estimate, in fiscal Q4 2018. CMCSA had sales of $27.8 billion (vs. $27.2 billion est.). Though the stock price gave up most of the advance in the ensuing trading sessions, shares moved up 5.5% following the announcement, boosted by the company’s acquisition of Sky, record free cash flow, Q4 customer growth of 258,000 and 7.3% of EBITDA growth.

CEO Brian Roberts said, “For the full year, we added 1 million net new customer relationships, driven by our 13th consecutive year of over 1 million broadband net adds. Our connectivity businesses Residential Broadband and Business Services, in total, grew revenue nearly 10% in 2018. We made progress in transforming the customer experience and taking unnecessary complexity and activity out of the business. Greater than 75% of transactions are now being completed through digital touch points. In the past 12 months alone, we have reduced agent-handled calls by 15 million and truck rolls by 1.5 million, all while adding 1 million new customer relationships. Altogether, this resulted in Cable EBITDA growth of 6.5%, the best for a full year in seven years, and net cash flow growth of 13%. Our focus on network differentiation and product innovation continued throughout the year. We rolled out gigabit speed availability to nearly all of the 58 million homes and businesses in our footprint and are redefining the in-home broadband experience for our customers, with the best speed coverage and control, which we call xFi.”

Mr. Roberts also offered his thoughts on the future, “We hope to build on this positive momentum. We expect connectivity will again be the growth engine of our Cable business in 2019 and beyond, with sustainable benefits to our financial results as our mix shifts more towards these margin-accretive businesses. We see lots of runway ahead and this should help us deliver another year of healthy customer and net cash flow growth in 2019. NBCUniversal has had an incredible run with EBITDA growth at a double-digit compound annual rate since our acquisition and we are well-positioned to succeed for years to come with scale, must-see content, and I believe the premier management team in the media industry. NBCUniversal ended a very good year on a strong note. Fourth quarter EBITDA increased 12%, driven by over 20% growth at our TV businesses. For the full year, TV EBITDA increased by 15% with growth across all revenue streams, reflecting successful execution of our strategy focused on big events and must-see entertainment, news and sports content. There is robust demand for our content across multiple platforms. The popularity of our programming is what gives us a great opportunity to create our own streaming service as we announced last week, which we plan to launch in 2020.”



THE PRUDENT SPECULATOR
CMCSA – Plenty to Like

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Strategic Overview and 2018 Highlights

COMCAST	– Completed Acquisition of Sky – Significant Free Cash Flow[1] Generation of $12.6 Billion – Raising Dividend by 10% in 2019, Our 11th Consecutive Annual Increase
xfinity COMCAST BUSINESS	– Adjusted EBITDA[2] Increased by 6.5%, the Best Growth in Seven Years – Over 1 Million HSI Customer Net Adds for the 13th Consecutive Year – HSI and Business Services Revenue in Total Grew Nearly 10%
NBCUniversal	– Cable Networks and Broadcast TV Adjusted EBITDA[2] Collectively Increased by 15% – NBC Ranked #1 in Total Viewers for the First Time in 16 Years and #1 Among Adults 18-49 for the Fifth Consecutive Year in Primetime – Recently Announced Plans to Launch New Streaming Service in 2020
sky	– Added 735,000 Customer Relationships, with Record Second Half Growth[5] – 9 of the Top 10 Shows on Owned and Partner Entertainment Channels Were Sky Originals – 5.5 Million Customers Now Have Sky Q, a 3.4 Million Y/Y Increase[5]

3 See Notes on Slide 11 COMCAST

We chose to boost our Target Price by a few notches to $55 as we continue to like the company's overall trajectory, which in our view is propelled by its diverse media portfolio (including NBC, Telemundo, E!, NBC Sports Network) and geographically diverse theme parks (Universal Parks & Resorts, including Universal Studios Hollywood). We think the Sky addition, though it came with a big price tag, gives the company international revenue that CMCSA previously lacked. The dividend was hiked along with the earnings announcement, bringing the quarterly payout to $0.21 and the yield to 2.3%.

Old National Bancorp (ONB – $16.61) saw its shares drop more than 5% on Tuesday after the regional bank released its Q4 results. Said numbers included a bottom-line that missed investor expectations as adjusted EPS came in at $0.32, versus a consensus forecast of $0.37. Net interest margin increased to 3.64% and asset quality remained strong with net charge-offs in the fourth quarter of $0.6 million, or 0.02% of total average loans, and 30-to-89-day delinquencies of 0.39%. At the end of the fourth quarter, total risk-based capital was 12.3% and regulatory tier 1 capital was 11.4%.

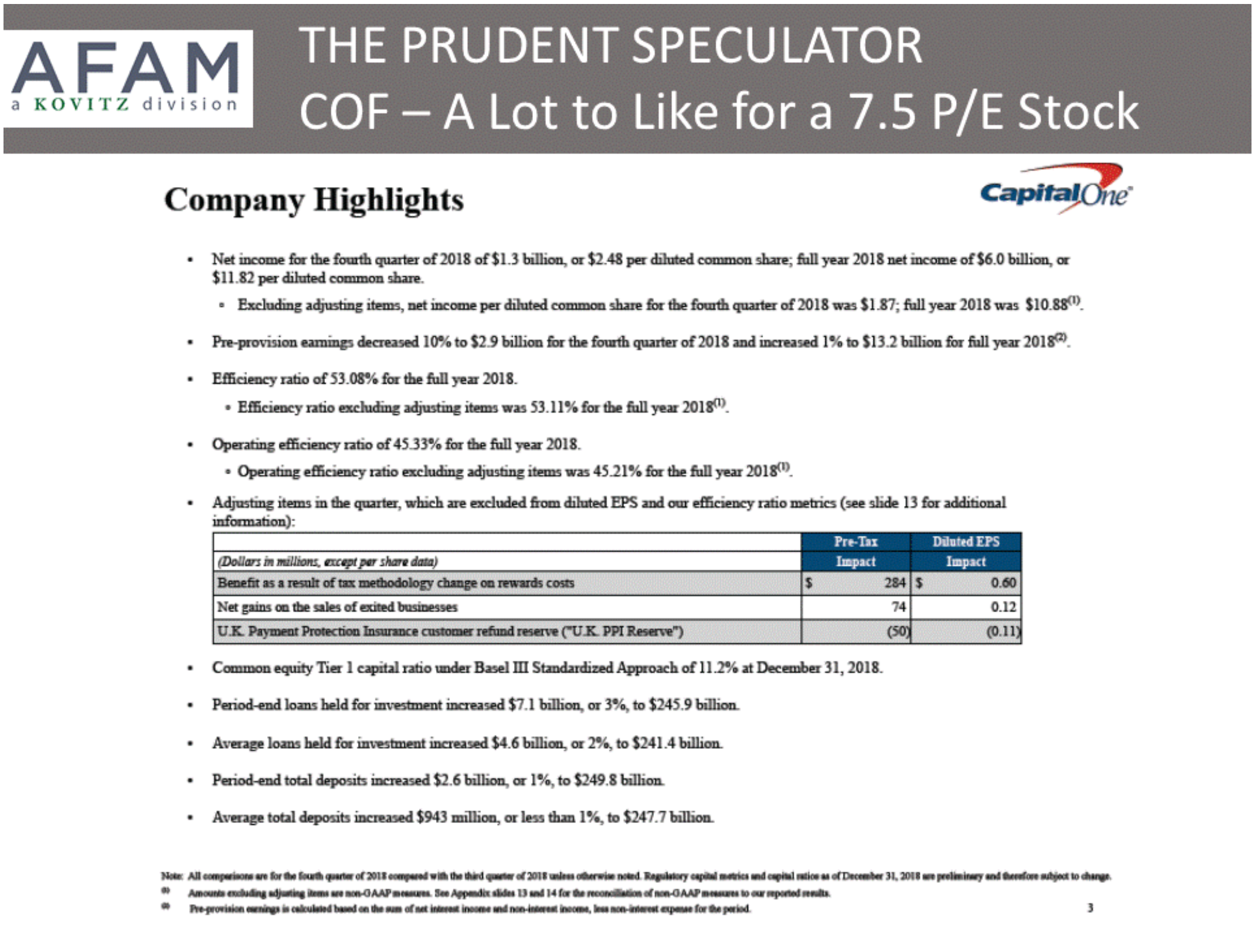
"Old National's strong 4th quarter – punctuated by the 2nd highest commercial loan production in our history – capped a year of outstanding performance that included $283.2 million in organic commercial loan growth, positive operating leverage and strong credit and capital ratios," said CEO Bob Jones. "The 4th quarter also saw us continue to execute our growth strategy by closing on our KleinBank partnership, which effectively doubles our presence in the state of Minnesota."

Interestingly, the stock recouped most of the losses by then end of the week and the shares are now up almost 8% in 2019. Despite the resurgence, we note that the returns on ONB are still in the red over the last year, so we continue to think the ship has yet to set sail. We continue to like Old National's regional focus on Indiana, Wisconsin, Kentucky, Michigan and expanding presence in Minnesota. We also like that the company continues to work on diversifying its revenue stream and keeping operating expenses in line. We view Old National as a quality bank whose management balances a conservative culture with aspirations for growth. Though we will keep a close eye as Mr. Jones is set to retire on May 2 (he will be succeeded by current CFO Jim Ryan), we think ONB remains well capitalized and we look favorably on its current generous dividend yield of 3.1% and its reasonable forward P/E ratio of 12.3. Our Target Price for ONB is now $23.

Shares of **Capital One Financial** (COF – $79.62) skidded almost 5% last week, following Q4 results that fell well short of consensus analyst estimates and after multiple analyst downgrades of price targets for the credit-card giant. The company posted net income of $2.48 per share, and adjusted earnings of $1.87 per share. Wall Street had forecast adjusted EPS of $2.39, so the bottom-line miss was large. While the continued move forward with the Walmart relationship was a positive, including the purchase of the outstanding portfolio of receivables, elevated expenses in the quarter and a near-term lack of growth took their toll.

"In the fourth quarter, Capital One posted solid results as we invest to grow and to drive our digital transformation," said CEO Richard D. Fairbank. "For full year 2018, we delivered 41% growth in earnings per share, excluding adjusting items. Our Domestic Card business continues to gain momentum. Growth in new account originations and purchase volumes is very strong. Profitability for the full year is at record levels and we reached an agreement to acquire the Walmart cobranded and private-label card portfolio at an attractive price and terms. Our national banking strategy continues to gain traction and our Commercial business continues to deliver solid results. We continue to drive for operating efficiency as we transform our technology infrastructure and change the way we work. Full-year operating efficiency ratio, net of adjustments, was 45.2% for 2018. From here, we expect full-year operating efficiency ratio, net of adjustments, to improve modestly in 2019, excluding the one-time Walmart launch and integration expenses. While efficiency ratio can vary in any given year, over the long-term, we believe we will be able to achieve continued gradual efficiency improvement driven by growth and digital productivity gains."

Mr. Fairbanks concluded, "Pulling up, we continue to build an enduringly great franchise with the scale, brand, capabilities, and infrastructure to succeed as the digital revolution transforms our industry and our society. Our digital and technology transformation is accelerating and it's powering our ability to grow new customer relationships and deepen engagement with new and existing customers. We are well-positioned to succeed in a rapidly changing marketplace and create long-term shareholder value."



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THE PRUDENT SPECULATOR

COF – A Lot to Like for a 7.5 P/E Stock

Company Highlights

CapitalOne

- Net income for the fourth quarter of 2018 of $1.3 billion, or $2.48 per diluted common share; full year 2018 net income of $6.0 billion, or $11.82 per diluted common share.
  - Excluding adjusting items, net income per diluted common share for the fourth quarter of 2018 was $1.87; full year 2018 was $10.88[1].
- Pre-provision earnings decreased 10% to $2.9 billion for the fourth quarter of 2018 and increased 1% to $13.2 billion for full year 2018[2].
- Efficiency ratio of 53.08% for the full year 2018.
  - Efficiency ratio excluding adjusting items was 53.11% for the full year 2018[1].
- Operating efficiency ratio of 45.33% for the full year 2018.
  - Operating efficiency ratio excluding adjusting items was 45.21% for the full year 2018[1].
- Adjusting items in the quarter, which are excluded from diluted EPS and our efficiency ratio metrics (see slide 13 for additional information):

	Pre-Tax	Diluted EPS
(Dollars in millions, except per share data)	Impact	Impact
Benefit as a result of tax methodology change on rewards costs	$ 284	$ 0.60
Net gains on the sales of exited businesses	74	0.12
U.K. Payment Protection Insurance customer refund reserve ("U.K. PPI Reserve")	(50)	(0.11)

- Common equity Tier 1 capital ratio under Basel III Standardized Approach of 11.2% at December 31, 2018.
- Period-end loans held for investment increased $7.1 billion, or 3%, to $245.9 billion.
- Average loans held for investment increased $4.6 billion, or 2%, to $241.4 billion.
- Period-end total deposits increased $2.6 billion, or 1%, to $249.8 billion.
- Average total deposits increased $943 million, or less than 1%, to $247.7 billion.

Note: All comparisons are for the fourth quarter of 2018 compared with the third quarter of 2018 unless otherwise noted. Regulatory capital metrics and capital ratios as of December 31, 2018 are preliminary and therefore subject to change.

[1] Amounts excluding adjusting items are non-GAAP measures. See Appendix slides 13 and 14 for the reconciliation of non-GAAP measures to our reported results.

[2] Pre-provision earnings is calculated based on the sum of net interest income and non-interest income, less non-interest expense for the period.

3

No doubt, we were disappointed by the Q4 results and the weaker near-term outlook, but we are always long-term focused and we continue to like that COF is focusing on managing risks, while improving efficiency, even as it invests to grow and transform itself as banking goes digital. COF trades for 7.2 times estimated earnings and offers a 2.0% dividend yield. Our Target Price now stands at $121.

Energy concern **Halliburton** (HAL – $32.10) saw its shares fall more than 3% on Tuesday after reporting Q4 financial results, though the stock ended the week essentially flat. Although HAL beat both top and bottom-line expectations, traders apparently were worried that the company likely faces a difficult 2019, with a continued decline in rig counts and a persistent squeeze on pressure pumping prices domestically.

That said, it was good to see some continued improvement internationally. For Q4, HAL reported adjusted EPS of $0.41, versus expectations of $0.37, on revenue of $5.94 billion (with consensus estimates looking for $5.87 billion). “I am pleased with our overall financial results for the year and for the fourth quarter. Our team optimized our performance in North America as the market softened, and the recovery of our international business continued,” said CEO Jeff Miller.

Mr. Miller elaborated: “The trajectory of this cycle has been far from smooth. As expected, in North America, the demand for completion services decreased during the fourth quarter, leading to lower pricing for hydraulic fracturing services…Our international business continues to show signs of a steady recovery, with revenue increasing 7% sequentially, underscoring the versatility and global reach of our business portfolio…As North American oil production reaches historic highs, operators focus on returns over growth, and the international recovery continues, Halliburton is well prepared to thrive. We intend to dynamically respond to the changing market environment, reduce capital spending, develop differentiating technologies, and generate strong cash flow…Halliburton celebrates 100 years of service in 2019. As we enter our next century, we will remain focused on collaborating with our customers and engineering solutions to maximize their asset value, and on delivering strong cash flow and industry-leading returns for our shareholders.”

Even though Halliburton and its competitors face numerous headwinds in 2019, we still think that long-term exposure to the energy industry will prove quite profitable, especially when shares of a best-of-breed company can be purchased at a discount. We like that HAL is focused on capital discipline, and that the international market seems to be turning. The company has meaningful leverage to the upcycle and could generate free cash flow of over $1 billion in the coming year despite the tough operating environment. HAL shares carry a dividend yield of 2.2%, and our Target Price is presently $54.

Shares of **Kimberly-Clark** (KMB – $108.12) fell approximately 5.5% last week after the consumer product manufacturer’s bottom-line results disappointed as profit margins declined in a “challenging” environment of higher input prices and increased currency market volatility. KMB said its adjusted Q4 EPS came in at $1.60, short of the consensus expectation of $1.66. Group sales fell 1% year-over-year to $4.57 billion, but came in just ahead of analyst expectations, thanks to across-the-board price increases.

KMB CEO Mike Hsu said, “In 2018, we returned to delivering organic sales growth and we continued to launch innovations, pursue our growth priorities and invest in our brands. Overall, it was a challenging macro environment and our margins declined, reflecting significant commodity inflation and currency volatility. Nonetheless, I’m encouraged that in response to these headwinds we achieved higher selling prices in the second half of the year. We also achieved $510 million of cost savings, generated strong cash flow and returned $2.2 billion to shareholders through dividends and share repurchases.”

Unfortunately, the company's 2019 full-year guidance was also weaker than some analysts were expecting. Mr. Hsu commented, "We expect the environment in 2019 will remain challenging, although somewhat better than in 2018. In this environment, our teams will continue to execute our strategies for long-term success. We are targeting to deliver a solid operating plan, with higher organic sales growth compared to 2018 and improved margins despite expectations for significant headwinds from commodities and currencies. We also expect to return substantial cash to shareholders."

Mr. Hsu concluded, "K-C Strategy 2022 is our plan to deliver balanced and sustainable growth by growing our portfolio of iconic brands, leveraging our strong cost and financial discipline and allocating capital in value-creating ways. We will build upon our strong foundation, sharpen our focus on the consumer and further improve our capabilities to create even more competitive advantage going forward. We're also establishing medium-term financial objectives associated with K-C Strategy 2022 that are appropriate and realistic in the current environment. Longer-term, we continue to have significant optimism in the potential of our categories. We are confident in our prospects and our ability to create shareholder value through successful execution of our strategies."

KMB said it expect to realize a net sales decrease of 1% to 2% in 2019. Additionally, the company expects adjusted operating profit growth of 1% to 4% and adjusted EPS of $6.50 to $6.70, compared to $6.61 in 2018. The company also said that its Board of Directors approved a dividend increase of 3% in 2019, pushing the new quarterly payout to $1.03. Further, the company expects 2019 share repurchases of $600 to $900 million, subject to market conditions.

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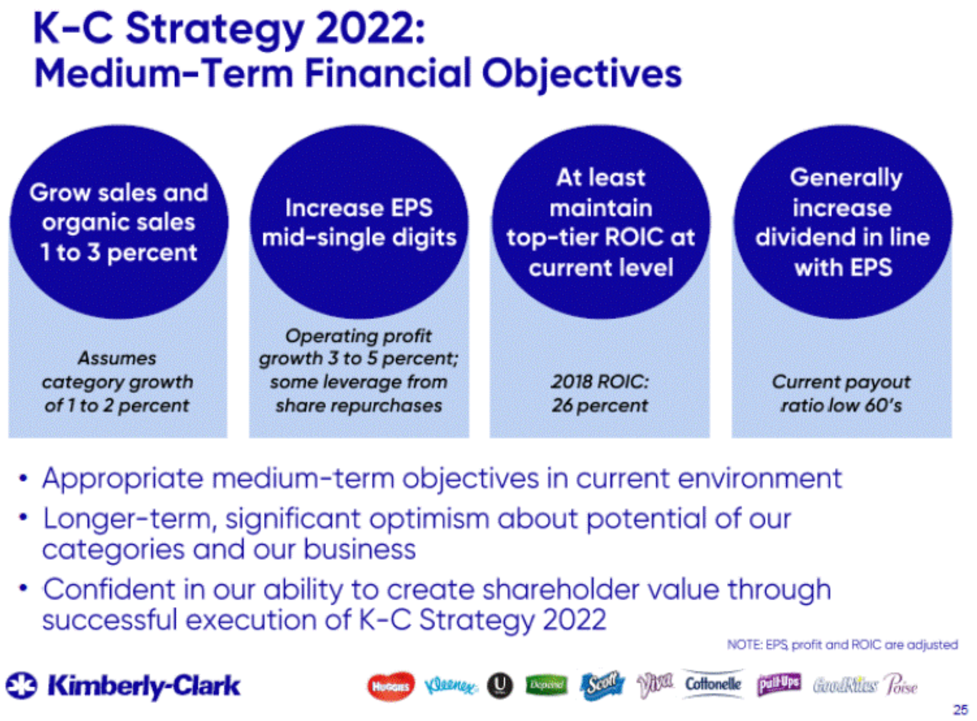
KMB – Quality Defensive Name



K-C Strategy 2022:
Medium-Term Financial Objectives

Grow sales and organic sales 1 to 3 percent	Increase EPS mid-single digits	At least maintain top-tier ROIC at current level	Generally increase dividend in line with EPS
Assumes category growth of 1 to 2 percent	*Operating profit growth 3 to 5 percent; some leverage from share repurchases*	*2018 ROIC: 26 percent*	*Current payout ratio low 60's*

- Appropriate medium-term objectives in current environment
- Longer-term, significant optimism about potential of our categories and our business
- Confident in our ability to create shareholder value through successful execution of K-C Strategy 2022

NOTE: EPS, profit and ROIC are adjusted

Kimberly-Clark

25

While we feel a bit of frustration as we see the likes of competitor Proctor & Gamble getting things turned around, we have not lost hope and like that KMB has leading market share positions in some of the larger household product categories and that its focus on increasing its emerging market businesses should continue to be an important long-term growth driver. We also think that KMB should be able to realize future pricing and margin improvements via product innovation and marketing. Long-term sales growth should be aided by expansion in non-traditional categories and deeper penetration into emerging economies to capitalize on rising incomes and birth rates. KMB generates solid free cash flow, which supports share repurchases and a 3.8% dividend yield. Our Target Price has been trimmed to $129.

Semiconductor equipment firm **Lam Research** (LRCX – $165.49) posted earnings per share of $3.87, versus the $3.66 estimate, in fiscal Q2 2019. LRCX had revenue of $2.5 billion, versus the $2.5 billion estimate. Shares soared by more than 18% over the two days following the announcement.

CEO Tim Archer, new to the post and previously COO, commented, "I believe we are still in the early stages of a long-term secular growth story for the industry and particularly for Lam. What you can expect to see from my leadership as CEO is increased focus on leveraging our core strengths to deliver technology and productivity solutions to the fastest-growing segments of the semiconductor equipment market, which in the long term, we believe, are those tied to the enablement of the emerging data economy."

Mr. Archer added, "I want to provide an update on the investigation we announced in connection with Martin's [former CEO Martin Anstice] departure. As you know from our December press release, our board formed an independent special committee to lead a thorough investigation into allegations of misconduct and conduct inconsistent with our core values. That investigation is now substantially complete, and there have been no other personnel actions and none have been recommended by the special committee. Core values have always been a foundation of Lam's success and I am committed to a culture of trust, respect and open communication built around an environment in which our employees feel free to speak up on workplace issues. To reinforce this culture, the special committee has recommended that we review our policies, practices and training related to workplace conduct and increase our communications on these topics."

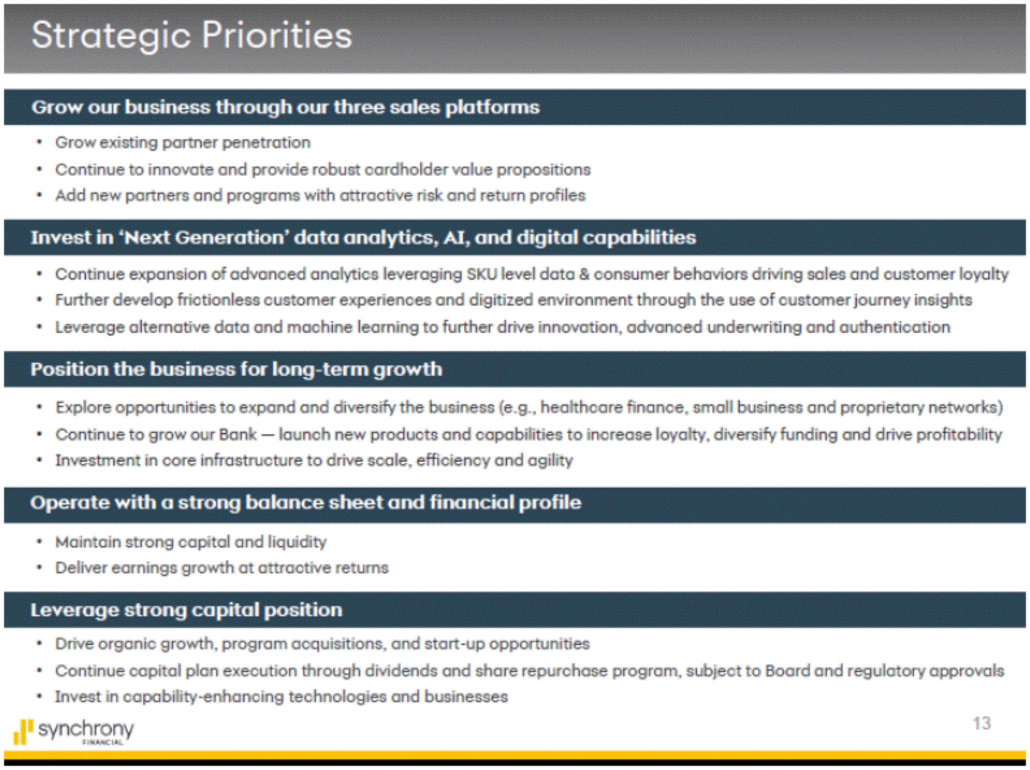
Mr. Archer concluded, "From Lam's perspective, industry performance for calendar 2018 came in largely as we have communicated in our prior earnings call. Overall, WFE was in line with our expectations of single-digit growth at approximately $50 billion, with an increase in memory and a year-on-year decline in non-memory spending. Entering 2019, industry fundamentals have weakened, particularly within memory segments, as customers continue to rein in both NAND and DRAM spending. At this point, 2019, WFE is looking to be down in the mid- to high-teens range. For NAND, 2019 offers what we believe is a solid long-term setup for the industry, as the supply bit growth rate is expected to decline throughout the year. NAND demand should continue to benefit from content increase in consumer and enterprise applications and we've begun to see initial signs of demand elasticity in the client SSD markets as we exited 2018. In DRAM, while near-term dynamics remain challenging, customer behavior remains rational and industry profitability characteristics remain compelling."

A strong IT environment has caused demand for Lam's gear to swell, with sales rising from $4.0 billion in 2013 to $9.6 billion in 2017, while analysts project nearly $11.5 billion in calendar 2021. We like the strong balance sheet with north of $19 per share in cash, while consensus analyst adjusted EPS forecasts for calendar 2019, 2020 and 2021 now stand at $13.41, $16.81 and $18.20, respectively. We were also pleased to see management express enthusiasm for its undervalued stock by announcing a new $5 billion share repurchase program. LRCX trades for less than 13 times projected earnings and has a dividend yield of 2.7%. Happy to see shares bounce materially from the December lows, our Target Price has been bumped up to $229.

Shares of **Synchrony Financial** (SYF – $29.79) jumped more than 13% last week driven by positive reactions from investors following the credit-card issuer's strong Q4 financial results release. SYF said that net interest income increased 11% from the fourth quarter of 2017 to $4.3 billion and loan receivables grew $11 billion, or 14%, to $93 billion. The company reported adjusted EPS for Q4 of $1.09, which was almost 20% better than consensus analyst estimates.

"Synchrony ended the year with significant momentum heading into 2019—we generated strong results this quarter, renewed and extended a number of key relationships, added new programs, and expanded our network. Our business continues to deliver organic growth through innovative marketing, promotions and value propositions, in addition to leveraging the investments we have been making in data analytics, artificial intelligence, and digital capabilities. And we did this while maintaining a strong balance sheet and returning capital to shareholders through growth, portfolio acquisitions, and the execution of our capital plan," said CEO Margaret Keane. "We continue to be well positioned for the future and look forward to the opportunities ahead in 2019."

Indeed, Synchrony also announced that Walmart had agreed to drop its lawsuit against the company, and that the two had agreed to an extension of its profitable and long-standing partnership with Walmart's Sam's Club, removing a huge black cloud that had been overhanging the stock for the past several months. We also think the company's balance sheet remains strong with total liquidity (liquid assets and undrawn credit facilities) of $19 billion, or 18% of total assets, while the estimated fully phased-in Common Equity Tier 1 ratio under Basel III was 14.0%, down from 15.8%, but reflecting the impact of capital deployment through the PayPal Credit program acquisition and continued execution of its capital plan. In addition, credit quality was moving in the right direction as SYF said net charge-offs as a percentage of total average loan receivables were 5.54% compared to 5.78% a year ago.



Strategic Priorities

Grow our business through our three sales platforms

- Grow existing partner penetration
- Continue to innovate and provide robust cardholder value propositions
- Add new partners and programs with attractive risk and return profiles

Invest in 'Next Generation' data analytics, AI, and digital capabilities

- Continue expansion of advanced analytics leveraging SKU level data & consumer behaviors driving sales and customer loyalty
- Further develop frictionless customer experiences and digitized environment through the use of customer journey insights
- Leverage alternative data and machine learning to further drive innovation, advanced underwriting and authentication

Position the business for long-term growth

- Explore opportunities to expand and diversify the business (e.g., healthcare finance, small business and proprietary networks)
- Continue to grow our Bank — launch new products and capabilities to increase loyalty, diversify funding and drive profitability
- Investment in core infrastructure to drive scale, efficiency and agility

Operate with a strong balance sheet and financial profile

- Maintain strong capital and liquidity
- Deliver earnings growth at attractive returns

Leverage strong capital position

- Drive organic growth, program acquisitions, and start-up opportunities
- Continue capital plan execution through dividends and share repurchase program, subject to Board and regulatory approvals
- Invest in capability-enhancing technologies and businesses

synchrony FINANCIAL 13

Despite the positives outlined above, SYF shares trade at less than 7 times NTM adjusted EPS consensus estimates and yield 2.8%. Our Target Price has been boosted to $49.

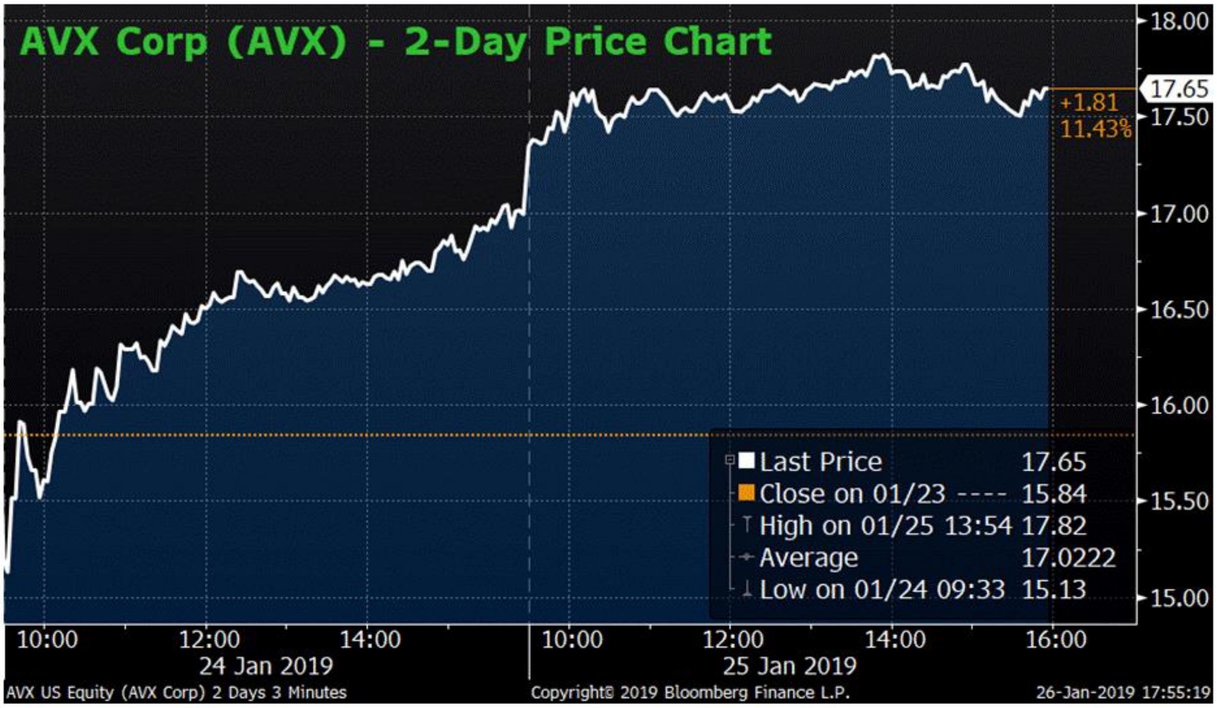
Semiconductor giant **Intel** (INTC – $47.04) reported earnings per share of $1.28, versus the $1.22 estimate, in fiscal Q4 2018. INTC had total revenue of $18.7 billion, versus the $19.0 billion estimate. Shares fell 5.5% following the announcement, weakened by guidance that cautioned headwinds in the last quarter of 2018 were expected to persist at least into the first half of 2019.

Interim CEO and CFO Bob Swan commented, "We had a strong quarter and fantastic year with full year revenue up 13% or nearly $6 billion higher than our original forecast in January. Earnings per share was up 32% and free cash flow was up 38% over last year. And as a result of our continued growth, we are raising the dividend 5%. Our leadership products continue to win share in our expanded TAM as both our data-centric and our PC-centric businesses continued to grow in the fourth quarter. We expect 2019 to be another record year for us as the world's appetite for the analysis, transmission, and storage of data continues to grow. We are forecasting revenue of approximately $71.5 billion, up 1% year on year, and operating margin of approximately 34%, down less than 1 point year on year. We expect a modest decrease in gross margin percentage driven by the 10-nanometer ramp and the growth of our adjacencies. This will be partially offset by increasing OpEx leverage as we continue to make thoughtful trade-offs and invest in R&D that will accelerate our growth and profitability. We expect the full-year tax rate to be approximately 13.5%, following several beneficial discrete events in 2018. And we expect EPS of $4.60. We expect gross capital expenditures of $15.5 billion with logic spending up and memory spending down. The increase in logic CapEx reflects our effort to meet our customers' needs and avoid constraining their growth, while our investment in memory is focused on the sit up of our independent technology development facility in New Mexico."

Mr. Swan concluded, "We expect PC-centric revenue to be up low-single digits on higher modem share and data-centric revenue to be down low-single digits on broad weakness in data center and continued NAND pricing pressure. We expect operating margin of 29%, down 1 point year over year, with a decline in gross margin as a result of the 10-nanometer ramp and the growth of adjacencies partially offset by increased spending leverage. We expect EPS of $0.87, flat year on year. We expect 2019 to be our fourth record year in a row. We feel great about where we are and where we're going. Five years ago, we set out to transform Intel from a PC-centric company to a data-centric company. Today, our strategy, products and people are delivering on that ambition with strong growth, record results and the largest TAM opportunity in the company's history."

It seems possible to us, and to much of Wall Street apparently, that Intel's cloud business may be approaching a point where huge year-over-year growth numbers will become more difficult to achieve. We don't think that's a bad thing, though, as the Cloud transitions from a new business to a mature one and should see enhanced revenue stability over the longer term. Intel also manufactures an industry-leading array of chips and its data center products continue to be popular with end-users and enterprises. We continue to like the company's diversified revenue stream, low levels of debt, forward P/E ratio of just 10.4 and an increased 2.7% dividend yield. Despite the negative market reaction on Friday, our Target Price has been lifted to $63.

Electronic components designer and manufacturer **AVX Corp.** (AVX – $17.65) earned $0.44 per share in fiscal Q3 2019 (vs. $0.35 est.). AVX had sales of $432.0 million, versus the $457.0 million estimate. Traders didn't know what to make of the results, initially dumping the stock on the revenue miss and then scooping up the shares on renewed investor enthusiasm for all things electronic. When all was said and done, AVX shares gained more than 11% in the two days since fiscal Q3 numbers were released.



AVX CEO John Sarvis commented, “Third quarter bookings slowed as our customers realigned their product needs to meet market conditions. Our core product lead times remain extended on certain high capacity on Ceramics, along with continued lead time improvements on our standard Ceramics and Tantalum products. With the additional MLC capacity continuing to come online, combined with current market conditions, lead times will continue to improve over the next several quarters particularly in the commodity type products. Sales in the March quarter should improve in 1% to 2% range. Our backlog remains strong and continues to support growth. Markets were somewhat muted this quarter reflecting typical holiday seasonality, which primarily influenced the US and European markets as customers closed production facilities and distributors adjusted their year-end inventories. Current market conditions are also being impacted by a slowdown in China’s economy with tariffs being primarily impacted along the slowdown in automotive sales and production in all regions. As a result of our sales for the quarter were negatively impacted but we anticipate recovery going forward as new emissions requirement issues in Europe were resolved this past quarter.”

Mr. Sarvis continued, “In general, we see mixed signals from our channel partners with a soft demand in Asia, as well as flat result in Europe, due to the holiday period. Europe should return to growth in Q4 and continuous positive book-to-bill ratios in the USA suggest another strong quarter. Regionally and looking at our revenue split, each geographic region once again faced similar market conditions. We saw with some minor changes in revenue as a percentage of the total due to product demand and availability in each region with the Americas at 27%, Asia 33%, and Europe at 40% of our sales."

AVX expects revenue growth between 1% and 2% in fiscal Q4 2019, with a gross margin between 27% and 28% and a tax rate of 20%. Prices of high-end smartphone handsets have started translating to longer replacement cycles, but we expect smartphone sales to continue to grow over the longer term. Carriers have started rolling out 5G mobile networks in select cities, with widespread availability expected around 2020. We like AVX's balance sheet (net cash of $5 per share, though the company continues to make acquisitions) and 2.3% yield. Our Target Price has been inched up to $24.

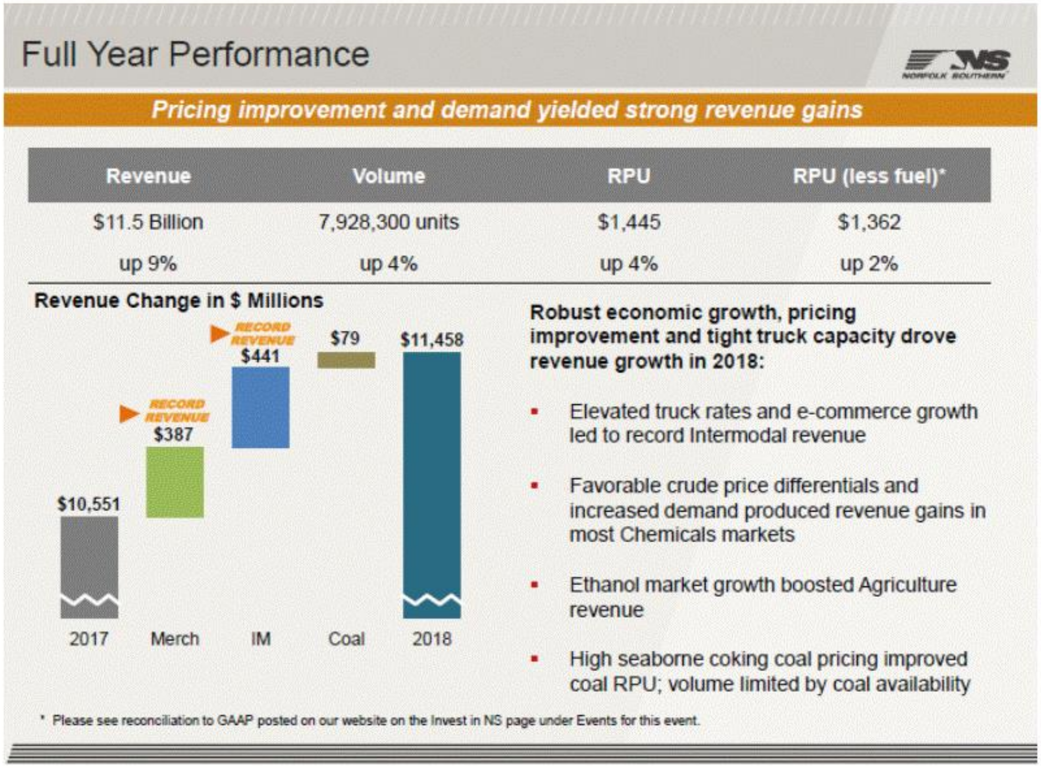
West coast airline **Alaska Air Group** (ALK – $63.48) reported earnings per share of $0.75, versus the $0.71 estimate, in fiscal Q4 2018. ALK had total revenue of $2.1 billion, versus the $2.0 billion estimate. Despite the solid Q4 numbers, shares fell 3.5% following the announcement.

CEO Brad Tilden said, "Last month marked the two-year anniversary of our merger with Virgin America. And as we look back over that time, we're very happy with how far we've come. Just 24 months ago, we were two airlines in complementary geographies with distinct products, operating processes and cultures. Not to mention separate FAA certificates labor agreements and IT systems. Today, virtually all of that has changed. Our operating processes are fully aligned, substantially all of our systems have been merged and all, but one of our labor groups are under single collective bargaining agreements. At this time last year, we faced multiple headwinds from aggressive competition, our own growth, new higher cost labor agreements and rising fuel prices. Today, that picture looks very different. Our growth has slowed, newer parts of our network are maturing and fuel prices are down, demand overall is solid and we're beginning to implement the margin improvement initiatives we laid out at Investor Day. We have good momentum heading into 2019."

Mr. Tilden added, "Many of you have asked us about how recent economic forecasts and market volatility might impact us this year. As you all know, we like to focus our energy internally. Nevertheless, we will say that not unlike other airlines near-term bookings suggest modestly more revenue uncertainty in the first quarter compared to the fourth as we moved through the year's seasonal trough period. But in general, demand is solid and we have not seen any dramatic shifts in the marketplace. Andrew will elaborate more on market conditions in a moment. Most, importantly, we're determined as a leadership team to stay clearly focused on factors we control to deliver consistent value for our guests, employees, communities and shareholders. We believe that if we do this, we'll produce strong relative margins and returns regardless of the industry environment. And that's our primary financial goal. For 2019, this means delivering on the $330 million of revenue initiatives."

We think that capacity ultimately drives valuations for the airlines (perhaps more so than P/E or P/S ratios), and capacity growth in excess of demand (even if demand is high) weakens the ability of airlines to price fares with healthy margins. With long lead times for airplane orders and long leases once they arrive, overshooting capacity can be an expensive mistake. While it might leave some near-term revenue on the table, ALK's modest capacity growth of 2% in 2019 and 3% to 4% in 2020 makes for a good foundation. Moreover, we think that Alaska will remain the premier airline in the Pacific Northwest, offering travelers low fares and a top-level customer experience, while we note that Virgin was named "Best U.S. Airline" by *Condé Nast Traveler* in their 2017 Reader's Choice Awards for the 10th year in a row. We would be surprised to see Alaska fall short of that in upcoming years. ALK trades for 9.5 times NTM earnings and yields 2.2%. Our Target Price now stands at $95.

East coast railroad transportation company **Norfolk Southern** (NSC – $165.12) earned $2.57 per share in fiscal Q4 2018 (vs. $2.29 est.). NSC had total revenue of $2.9 billion, versus the $2.8 billion estimate. Investors seemed unmoved by the results, as evidenced by shares finishing the week almost exactly where they started. Norfolk achieved record Q4 operating income and returned $3.6 billion to shareholders via buybacks and share repurchases.



Full Year Performance

Pricing improvement and demand yielded strong revenue gains

Revenue	Volume	RPU	RPU (less fuel)*
$11.5 Billion	7,928,300 units	$1,445	$1,362
up 9%	up 4%	up 4%	up 2%

Revenue Change in $ Millions

Robust economic growth, pricing improvement and tight truck capacity drove revenue growth in 2018:

- Elevated truck rates and e-commerce growth led to record Intermodal revenue
- Favorable crude price differentials and increased demand produced revenue gains in most Chemicals markets
- Ethanol market growth boosted Agriculture revenue
- High seaborne coking coal pricing improved coal RPU; volume limited by coal availability

* Please see reconciliation to GAAP posted on our website on the Invest in NS page under Events for this event.

CFO Alan Shaw said, “Each business unit posted a revenue per unit gain of 7%, reflecting both improved pricing and higher fuel surcharge revenue as Norfolk Southern delivered fourth quarter year-over-year pricing increases that were the highest in over six years. Merchandise revenue grew 7%, generating a fourth quarter revenue record on flat volume, as carload gains in chemicals and agriculture were offset by weakness in automotive and metals and construction. Our success in pursuit of pricing improvement, combined with higher fuel prices, resulted in a record merchandise revenue per unit. Norfolk Southern’s intermodal franchise once again delivered record-breaking revenue and volume results for the quarter. Our outstanding intermodal franchise, combined with tightness in the trucking sector and high levels of consumer spending, has generated three consecutive quarters of record intermodal volume. Intermodal revenue reached an all-time high in the quarter, reflecting a combination of improved volume, pricing strength and increased fuel surcharge revenue. Moving to coal, revenue increased 7% with a corresponding 7% increase in revenue per unit, as a result of pricing gains and fuel surcharge revenue. Volume increased 1% as our utility franchise benefited from increased winter demand and high natural gas prices in the fourth quarter, while export volume was limited by coal availability.”

CEO Jim Squires commented, "Three years ago we announced a strategic plan aimed at delivering value to our shareholders through growth, productivity and bottom line improvement. Thanks to the hard work and dedication of our employees, we did just that. We lowered our operating ratio over 700 basis points, improved operating income by 39%, and increased EPS 86% compared to three years ago. Building on these successes, we have been overhauling our operations from top to bottom in the quest for shareholder value. In short, we have been reimagining Norfolk Southern."

NSC expects to discuss its annual outlook and future at the Investor Day next month. Shares currently trade for a reasonable 16.1 times NTM adjusted earnings projections of $10.28, while the forecast for 2020 adjusted EPS is now pegged at $11.49. Our Target Price for NSC has been raised to $194.

Last but certainly not least, long suffering shareholders of **International Business Machines** (IBM – $133.97) saw a little green last week, when Big Blue gained more than 10% following a well-received Q4 financial report. The tech giant posted better-than-expected operating EPS of $4.87 for the fourth quarter, versus estimates of $4.82, on essentially in-line revenue of $21.8 billion. Full-year operating EPS came in at $13.81 on a modest sales gain to $79.6 billion. The company's important growth businesses, dubbed Strategic Imperatives, saw revenue of $39.8 billion, up 9% in 2018.

CEO Ginny Rometty explained, "In 2018 we returned to full-year revenue growth, reflecting growing demand for our services and leadership solutions in hybrid cloud, AI, analytics and security. Major clients worldwide, such as BNP Paribas, are turning to the IBM Cloud and our unmatched industry expertise to transform their businesses and drive innovation."

CFO James Kavanaugh added, "In the quarter we expanded both gross margin and pre-tax income margin. In 2018 we repositioned our business model and delivered revenue, operating profit and EPS growth along with strong free cash flow realization. We continue to optimize our portfolio for the high-value, emerging segments of our industry, while returning capital to our shareholders."

Looking to 2019, IBM offered operating EPS guidance of "at least" $13.90 and free cash flow of a whopping $12 billion. Illustrating the importance of its cash generation, the company returned $3.5 billion to shareholders through $1.4 billion in dividends and $2.0 billion in gross share repurchases in Q4 alone.

Certainly, we would like to see IBM's overall top- and bottom-line grow faster, but we like that Strategic Imperatives has steadily become a larger share of the overall sales pie. And, though the jury remains out on the recently-announced $34 billion purchase of Red Hat, a provider of open source software, we are enthused about the fact that the target's OpenShift software runs on private clouds (owned by one company) or public clouds (like AWS or Microsoft Azure), and could finally let Watson, IBM's learning engine, grow nearer to its potential. Assuming it can close the acquisition and overcome the integration risks, we believe it will be better able to keep up with its cloud computing peers. IBM estimates that the global Cloud is only 20% built out, so there is plenty of growth potential, yet its stock trades for just 9.6 times earnings and yields 4.7%. Our Target Price has been boosted to $188.