Market Commentary Monday, March 18, 2019

March 17, 2019

EXECUTIVE SUMMARY

Price-Weighted vs. Cap-Weighted – Boeing's Impact on the Dow vs. R3K
Week in Review – Nice Rally
Sentiment – Bullishness Recedes
New Bull Market – S&P Up 20%+ from Christmas Eve Close
Econ News – Gundlach may be Bearish, but Econ Data Not that Bad
Friendly Fed – No Additional 2019 Rate Hikes in the Cards at Present
Reasons for Optimism – Reasonable Valuations
Stock Updates – ORCL, JBL, COHU & LRCX

Market Review

While the big drop in shares of high-priced Boeing caused the Dow Jones Industrial Average to lag the broad-based, market-capitalization-weighted indexes,…

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Boeing 13x More Important to the Dow

Illustrating the sometimes significant difference between a price-weighted index like the antiquated Dow Jones Industrial Average and a more logical capitalization-weighted gauge like the Russell 3000, Boeing (BA - $378.99) represents 10.32% of the former and 0.74% of the latter.

Dow Jones Industrial Average (Price Weighted)

Company	Index Weighting %	Contribution % to Weekly Return	Weekly Return %
DOW JONES INDUS. AVG	100.00	1.64	1.64
Bottom 8 Contributors			
BOEING	10.32	-1.16	-10.31
JOHNSON & JOHNSON	3.67	-0.01	-0.33
DOWDUPONT	1.47	0.02	1.10
COCA-COLA	1.21	0.02	1.91
PFIZER	1.10	0.02	2.18
EXXON MOBIL	2.12	0.03	1.44
WALT DISNEY	3.03	0.03	1.01
CATERPILLAR	3.52	0.04	1.00
Top 8 Contributors			
INTL BUSINESS MACHINES	3.64	0.12	3.21
MICROSOFT	3.00	0.14	4.89
AMERICAN EXPRESS	2.92	0.15	5.13
MCDONALD'S	4.80	0.16	3.25
3M	5.44	0.19	3.58
VISA	4.00	0.22	5.50
APPLE	4.76	0.35	7.64
UNITEDHEALTH GROUP	6.52	0.38	5.95

Source: Bloomberg. Total Return 3.8.19 - 3.15.19

Russell 3000 Index (Capitalization Weighted)

Company	Index Weighting %	Contribution % to Weekly Return	Weekly Return %
RUSSELL 3000 INDEX			2.84
Bottom 8 Contributors			
BOEING	0.74	-0.085	-10.31
FACEBOOK	1.45	-0.030	-2.13
ELI LILLY	0.40	-0.010	-2.18
BRISTOL-MYERS SQUIBB	0.30	-0.008	-2.78
DOLLAR GENERAL	0.11	-0.005	-4.06
JOHNSON & JOHNSON	1.33	-0.004	-0.33
TESLA	0.14	-0.004	-3.07
LOCKHEED MARTIN	0.27	-0.004	-1.59
Top 8 Contributors			
JPMORGAN CHASE	1.23	0.042	3.44
ALPHABET INC CL A	1.26	0.044	3.51
ALPHABET INC CL C	1.28	0.047	3.69
UNITEDHEALTH GROUP	0.84	0.049	5.95
VISA	0.95	0.052	5.50
AMAZON.COM	2.42	0.135	5.65
MICROSOFT	3.06	0.148	4.89
APPLE	3.04	0.227	7.64

Source: Bloomberg. Total Return 3.8.19 - 3.15.19

…it was a very nice week just ended, with the S&P 500 and Russell 3000 indexes gaining 2.95% and 2.84%, respectively. Growth topped Value, with the Russell 3000 Growth index climbing 3.14%, compared to a 2.54% advance for the Russell 3000 Value index, but we were pleased to see that the rally was accompanied by a decrease in the level of Bullishness, at least as measured by the American Association of Individual Investors.

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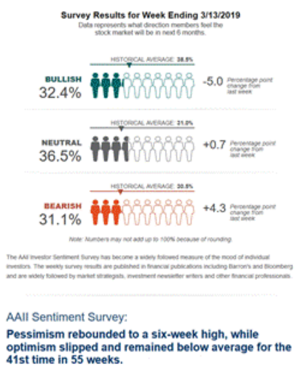
AAII Sentiment – Contrarian Gauge

Given that the S&P 500 closed at its highest level for the year on 3.15.19, we were pleased to see another big drop in the gap between optimists and pessimists in the latest sentiment survey from the American Association of Individual Investors. AAII data and subsequent equity performance suggest that while folks should be greedy when others are fearful, returns have been positive, on average, even with an "optimistic" AAII Bull-Bear Spread.



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	822	0.24%	0.21%	1.17%	1.05%	3.23%	2.84%	6.52%	5.78%
ABOVE	8.49	62.86	801	0.17%	0.15%	0.50%	0.41%	2.03%	1.79%	4.59%	4.11%
	Ten Groupings of 1623 Data Points										
1	-54.0	-14.3	161	0.34%	0.28%	1.30%	1.05%	4.08%	3.46%	8.15%	6.75%
2	-14.1	-7.0	164	0.40%	0.37%	1.27%	1.15%	3.97%	3.64%	7.15%	6.55%
3	-6.8	-0.9	162	0.30%	0.27%	1.67%	1.58%	3.31%	2.91%	6.83%	6.12%
4	-0.8	3.5	159	0.15%	0.13%	1.05%	0.97%	2.56%	2.25%	5.88%	5.45%
5	3.5	8.0	165	0.01%	-0.02%	0.62%	0.54%	2.50%	2.25%	4.97%	4.43%
6	8.1	12.4	156	0.15%	0.14%	0.46%	0.37%	1.73%	1.51%	4.65%	4.13%
7	12.5	17.0	175	0.14%	0.12%	0.88%	0.80%	2.73%	2.52%	5.69%	5.28%
8	17.0	22.6	151	0.27%	0.26%	0.64%	0.56%	2.07%	1.79%	5.58%	5.09%
9	22.6	30.0	165	0.11%	0.09%	0.29%	0.20%	2.13%	1.87%	4.59%	4.00%
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 3.7.19. Unannualized. SOURCE: Kovitz Investment Group using data from American Association of Individual Investors and Bloomberg

Perhaps investor enthusiasm was held back by the country's present Bond King, Jeffrey Gundlach, who proclaimed on Tuesday, "The stock market was and still is in a bear market." While we are always perplexed why the financial media seems to care more about the Doubleline Capital founder and CEO's views on equities than his stance on the bond markets, we could argue that he was technically correct as the S&P 500 had been off 20% (i.e. in a Bear Market) from its highs of 9.20.18 and 9.21.18 on 12.24.18 and 12.26.18. That said, Mr. Gundlach might want to update his comments, given that the S&P 500 is now more than 20% above the Christmas Eve low, ending the Bear Market with the crossing of the Bull Market threshold.

Volatility Aplenty

Bull Market 12.24.18 - 3.15.19	Bear Market 9.20.18 - 12.24.18	Bloomberg Symbol	Index
Stock Indexes			
19.32	-17.77	INDU Index	Dow Jones Industrial Average
24.49	-22.63	CCMP Index	NASDAQ Composite Index
21.10	-19.69	RIY Index	Russell 1000 Index
23.03	-26.08	RTY Index	Russell 2000 Index
21.24	-20.17	RAY Index	Russell 3000 Index
20.65	-19.37	SPX Index	S&P 500 Index
23.35	-21.44	RLG Index	Russell 1000 Growth Index
18.92	-17.94	RLV Index	Russell 1000 Value Index
26.57	-27.83	RUO Index	Russell 2000 Growth Index
19.41	-24.24	RUJ Index	Russell 2000 Value Index
23.59	-21.94	RAG Index	Russell 3000 Growth Index
18.95	-18.40	RAV Index	Russell 3000 Value Index
21.85	-20.15	SGX Index	S&P 500 Growth Index
19.34	-18.43	SVX Index	S&P 500 Value Index
22.94	-22.33	SPXPG Index	S&P 500 Pure Growth
19.44	-22.39	SPXPV Index	S&P 500 Pure Value
11.75	-13.54	MXEA Index	MSCI EAFE Index
	Source: Bloomberg		

The rally on 3.15.19 pushed the S&P 500's total return advance to 20.65% since the 12.24.18 low. And, though the Q4 selloff saw the S&P on Christmas Eve with a negative total return of *only* 19.37%, that day's close represented a 20.06% price-return drop from an all-time intraday high set on 9.21.18. As such, stocks have now had a Bear and a Bull Market during the last six months.

To be fair, Mr. Gundlach's argument against equities is centered on the belief that weakening economic data is "sending bearish signals," but the numbers out last week were not exactly recessionary,…

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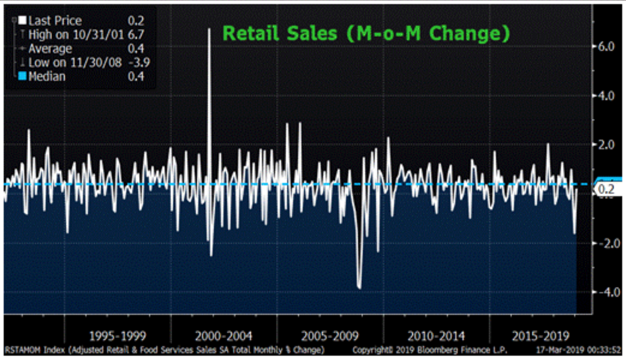
Not Great Numbers, but Hardly Awful



Uncle Sam said that retail sales managed only a 0.2% gain in January, modestly rebounding from a downwardly revised 1.6% stumble in December. Of course, when excluding autos, where sales were very weak in January, the latest month shows a terrific 0.9% increase. Meanwhile, the National Federation of Independent Business said its Small Business Optimism Index rose a tad to 101.7 in February, well above the historical average.

…while consumers continue to be relatively upbeat,…

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Decent Statistics

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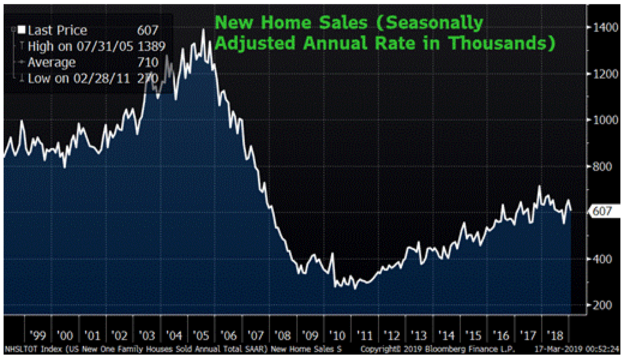

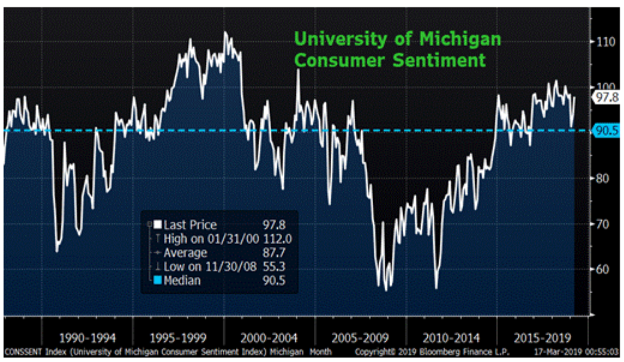

The tally came in a bit below projections and down 6.9% on a monthly basis, but new home sales for January at a 607,000 annual rate contributed to a 19,000 unit improvement in the 3-month average, with that 629,000 rate the best showing since June. Even better the latest read on consumer sentiment for March from the University of Michigan moved up four points to 97.8, easily topping expectations.

…no doubt buoyed by a generally healthy labor market.

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Strong Labor Market

The latest figures (for the week ended 3.9.19) on first-time claims for unemployment benefits saw 229,000 new filings, near lows not seen since the 1960s when the workforce was significantly smaller than it is today. And, job openings jumped a much-better-than-expected 1.4% in January to a near-record 7.581 million, though that number should fade in February, given the recent report of weakness in payrolls last month.

Certainly, all is not rainbows and unicorns,…

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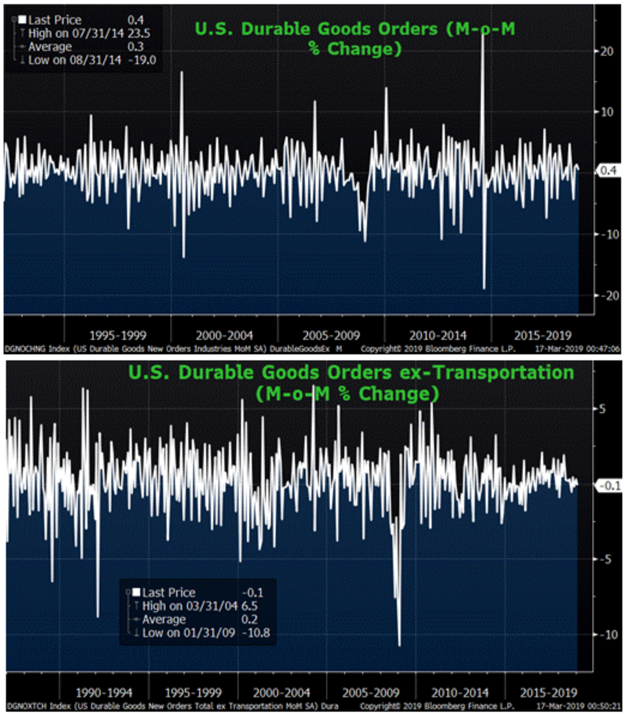
Noisy Data – Durable Goods Orders



Thanks to strength in the commercial aircraft biz, orders for durable goods rose 0.4% in January, well above estimates of a 0.6% decline. Of course, when excluding aircraft and other transportation equipment, orders slipped a weaker-than-expected 0.1%. Further muddying the waters, so-called core capital goods orders (non-defense ex-aircraft) jumped 0.8% in the month, following a 0.9% drop in December.

…as the supposed experts judge the odds of a contraction in the next year at 25%, the highest probability in more than seven years,…

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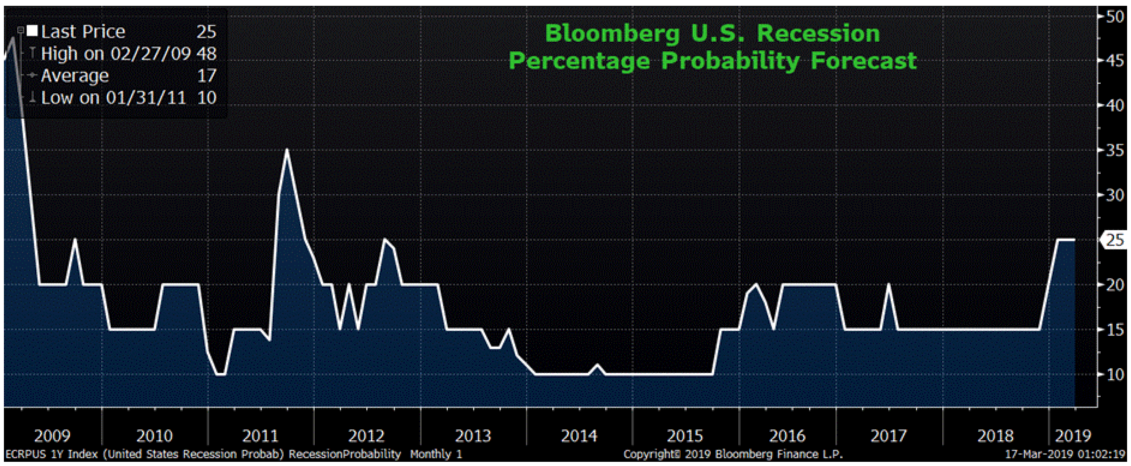
THE PRUDENT SPECULATOR
Recession Forecasts: Contra Indicator?

"Economists See Rising Risk of Downturn," proclaimed *The Wall Street Journal* on Jan. 11, as the chance of recession rose to 25%. The tally was the highest since the fall of 2011…which proved to be a fantastic time to buy equities, as the S&P 500 returned 30.2% over the ensuing 12 months following the Sept. 2011, 35% *high-water* recession projection.



…but the relative softness in the economy is likely to keep the Federal Reserve from raising interest rates any further this year. In fact, those betting on what Jerome Powell & Co. will do are presently predicting that there is a one in three chance that the Fed actually will lower the Fed Funds rate before year end.

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THE PRUDENT SPECULATOR
Low Interest Rates: Fed is Still Friendly

99) Export — World Interest Rate Probability

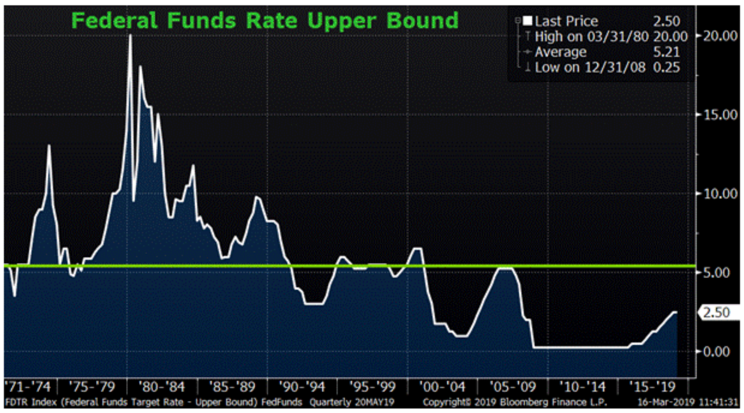
United States — Instrument: Futures: Fed Funds - Effective — Fed Effective Rate 2.40

1) Overview — 2) Future Implied Probability

Current Implied Probabilities — 3) Add/Remove Rates

Dates: Meeting / Calculation — Calculated 03/15/2019 — Based on rate 2.25-2.50

Meeting	Hike Prob	Cut Prob	1.25-1.5	1.5-1.75	1.75-2	2-2.25	2.25-2.5	Fwd Rate
03/20/2019	0.0%	2.3%	0.0%	0.0%	0.0%	2.3%	97.7%	2.40
05/01/2019	0.0%	4.3%	0.0%	0.0%	0.0%	4.3%	95.7%	2.39
06/19/2019	0.0%	13.3%	0.0%	0.0%	0.4%	12.8%	86.7%	2.37
07/31/2019	0.0%	15.5%	0.0%	0.0%	0.8%	14.7%	84.5%	2.36
09/18/2019	0.0%	21.4%	0.0%	0.1%	1.7%	19.6%	78.6%	2.35
10/30/2019	0.0%	25.4%	0.0%	0.2%	2.6%	22.6%	74.6%	2.33
12/11/2019	0.0%	32.3%	0.0%	0.4%	4.5%	27.4%	67.7%	2.31
01/29/2020	0.0%	40.2%	0.1%	0.9%	7.2%	32.1%	59.8%	2.28



It is fascinating that investors, at least as evidenced by the Fed Funds Futures market, now believe that the Federal Reserve has a strong chance of lowering interest rates over the next year after fretting back in December that Jerome Powell & Co. were on a pre-set course to hike rates throughout 2019.

Certainly, we respect that U.S. GDP growth will be slower this year than last, but we think the economy will continue to muddle along, and that this will be supportive of decent growth in corporate profits. Combined with the continued low interest rate environment and reasonable valuations for our stocks,…

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THE PRUDENT SPECULATOR
Managed Account Ports & Benchmarks

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	13.3	12.1	1.1	1.9	3.0
Select Value	13.7	12.4	1.1	1.9	2.6
Select Dividend	13.7	12.3	1.0	2.0	3.3
Select Focused Dividend	12.6	11.7	0.9	2.2	3.4
Select Focused Value	13.7	12.4	1.2	2.4	2.9
Select SMID Dividend	13.6	12.0	0.6	1.6	3.0
Russell 3000	19.8	17.5	2.0	3.1	1.9
Russell 3000 Growth	24.8	21.5	2.8	6.8	1.4
Russell 3000 Value	16.4	14.8	1.5	2.0	2.5
Russell 1000	19.1	17.2	2.1	3.3	2.0
Russell 1000 Growth	23.3	20.8	3.0	7.2	1.4
Russell 1000 Value	16.1	14.6	1.6	2.1	2.6
S&P 500 Index	18.6	16.9	2.1	3.3	2.0
S&P 500 Growth Index	24.3	21.1	3.7	5.6	1.5
S&P 500 Value Index	14.7	13.9	1.4	2.3	2.5
S&P 500 Pure Value Index	11.3	10.2	0.6	1.2	2.8

As of 03.16.19. 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.

…we continue to see no reason to alter our enthusiasm for the long-term prospects of our broadly diversified portfolios of what we believe to be undervalued stocks, even as we are always braced for the inevitable downturns that are part of the investment process.

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/, and we are in the process of posting updated Target Prices to the website, Chris Quigley offers updates on four of our companies that had news last week that was of sufficient importance to trigger a review of their respective Target Prices.

System software firm **Oracle** (ORCL – $52.94) earned $0.87 per share in fiscal Q3 2019 (vs. $0.84 est.). ORCL had total revenue of $9.6 billion, matching the analyst consensus estimate. Although shares initially gained in the extended-hours trading session following the release on Thursday, the stock ended slightly lower on Friday.

Co-CEO Safra Catz said, "Total cloud services and license support revenue for the quarter was $6.7 billion, up 4% in constant currency and now accounts for nearly 70% of total Company revenue, largely recurring revenue. As in past quarters, we are seeing robust double-digit growth rates for total cloud revenue in all regions with especially strong growth in Asia Pacific…Through adoption of Autonomous Database and OCI, we are now shifting the focus for our infrastructure business to the cloud. As a percentage of our total software business, cloud is now more than double what it was just three years ago and provides us with the ability to accelerate overall software revenue growth as this mix shift continues."

Founder Larry Ellison added, "Oracle's future rests on two strategic businesses; cloud applications and cloud infrastructure. The growth in our cloud applications business has been driven by our Fusion Suite and NetSuite. Most customers want their cloud services provider to make their applications work together. Customers do not like to be responsible for the complex process of integrating lots of different applications, running on lots of different vendors clouds. We think our integrated suite approach to the cloud applications business is a primary reason for the very rapid growth in our cloud applications market share. Oracle technology leadership in cloud infrastructure and database plus our market leadership in cloud applications makes us very optimistic about our future."

ORCL expects a currency headwind of 3% for fiscal Q4 (an EPS drag of approximately $0.03 per share) and EPS between $1.05 and $1.09, while revenue is expected to grow 1% to 3% in constant currency terms. The company expects a tax rate of 20%. In addition, ORCL raised its quarterly dividend from $0.19 per share to $0.24 per share. Over the past year, ORCL has repurchased 728 million shares and reduced total share count by 16%.

We continue to be encouraged by the possibilities in the cloud business and we believe that ORCL has an experienced leadership team that will drive top-line growth to the bottom line. Although the stock didn't rise as we might have expected, given the bottom-line beat and the decent guidance, we note that ORCL shares have ascended nearly 25% since December 24. The stock has a strong score in our proprietary valuation algorithm and inexpensive fundamental metrics like a 14.2x forward P/E ratio. Our Target Price is $60. ORCL currently yields 1.8%.

Electronic manufacturing services firm **Jabil** (JBL – $27.17) reported earnings per share of $0.64, versus the $0.61 estimate, in fiscal Q2 2019. JBL had total revenue of $6.1 billion, in line with the analyst consensus estimate. JBL was propelled by solid EMS (Electronics Manufacturing Services) revenue growth and strong demand in the cloud, retail and industrial sectors. Despite the solid numbers, shares slipped 1% following the announcement.

CEO Mark Mondello commented on the three forward-looking priorities of the JBL management team, "The first area is constructing market and product diversification, which we believe drives a higher degree of reliability in terms of our financial results. Second, is to ensure successful ramps of our new business, where our team maintains a high degree of confidence in their ability to deliver. And once delivered its scale, assure this $2.4 billion book of business has the most favorable outlook financially. And third, is driving outstanding financial performance across the company, with a commitment to free cash flow and margins, as we look towards fiscal year 2020."

CFO Mike Dastoor added, "During the quarter, both segments executed exceptionally well and delivered strong consolidated results providing yet another proof point that our diversification strategy is working. Net revenue for the second quarter was $6.1 billion, an increase of 14% year-over-year."

Mr. Dastoor offered the Q3 guidance, “Within DMS, today’s outlook suggests lower revenues driven by continued weakness in mobility, partially offset by improved strength in Healthcare. Turning to EMS, we now expect stronger revenue in 5G wireless and cloud, offset slightly by the protracted recovery in the semi-cap space which is reflected in lower enterprise sales. While we still expect our semi-cap business to be profitable for the year, the continued weakness has lowered our EMS margin expectations by 20 basis points to 3.3% for the fiscal year. Core operating income is estimated to be in the range of $150 million to $200 million with core operating margin in the range of 2.6% to 3.2%. Core diluted earnings per share is estimated to be in the range of $0.47 to $0.67.”

We were pleased to see Jabil opportunistically snapping up nearly 6 million shares of its stock at an average price of $24.35. We think that the EMS business is also attractive, especially as the company continues to bring in new business, while its deal with **Johnson & Johnson** (JNJ – $137.60) has been, as management says, “sensational.” JBL expects the joint effort to yield between $800 million and $1 billion of revenue in fiscal 2020. Of course, we also note that the stock presently trades for just 8.6 times the current EPS estimate for the next 12 months. Our Target Price for JBL has been raised to $44.

Semiconductor equipment firm **Cohu** (COHU – $15.22) earned $0.24 per share in fiscal Q4 2018 (vs. $0.22 est.). COHU had revenue of $171.0 million, versus the $174.0 million estimate. Shares fell 7.2% on Wednesday and 11% over the week, despite the top-line beat.

CEO Luis Mueller said, “Cohu’s fourth quarter sales of $170.6 million were within guidance for the first reported period reflecting the combination of Cohu and Xcerra following the close of the acquisition on October 1st, 2018. Although the mobility market has weakened since early last fall, there was one positive exception in the fourth quarter, as a customer drove volume demand for our testers, handlers and contactors to support production plans for a new device launch in 2019.”

“We are not immune to the same market weakness affecting many semiconductor and semiconductor equipment companies. This includes the impact of continued softness in the mobility and IoT markets that started last fall and persisted into the beginning of this year. Uncertainty around the U.S. and China trade disputes caused slower global GDP growth and consequently demand from customers, particularly in China. Today, even automotive and industrial markets are feeling the impact from soft demand for semiconductors. What is difficult to pinpoint is the exact contribution of each of these various factors are having on the industry and how long they will persist, including any seasonal influences. Aside from continued strength in Cloud, AI and Data Center-related businesses, we’re only now emerging from what is typically the seasonally weak period for the industry. At this point, we have not seen any significant change in tone or sentiment from our customers. There are some bright spots, but overall customers see market weakness continuing into Q2, while expecting a return to growth as we approach the middle of the year, resulting in a stronger second half,” he continued.

CFO Jeff Jones offered the Q1 guidance, “We’re expecting sales to be approximately $145 million. Revenue distribution is expected to be 92% semiconductor test and inspection, and 8% PCB test. Gross margin in Q1 is expected to be approximately 40%. Operating expenses are expected to be approximately $54 million, which includes realizing total cost synergies to date of approximately $2.5 million, or $10 million on an annualized basis. The effective tax rates for periods which are slightly above or below breakeven is not meaningful. For Q1, we expect the tax provision to be nominal to zero. For the full year 2019, we're estimating an effective tax rate of approximately 22%. The diluted share count for Q1 is expected to be approximately 41.5 million shares. Over the mid-term, we're targeting gross margins of 48%, an EBITDA of 22% on quarterly sales of approximately $235 million. Profitability targets include the benefit of annual cost synergies totaling $40 million, that I discussed previously."

While the company's shares have had a difficult year, we think that the outlook for COHU is much stronger than the prolonged sell-off might suggest. COHU trades at a high 23.9 times NTM earnings projections due to the Xcerra deal, but that ratio is expected to drop closer to 8.7 for fiscal 2020. Shares yield 1.6%. While we think the downturn has been overdone, we have trimmed our Target Price to $23.

To be sure, capital equipment makers such as COHU and **Lam Research** (LRCX – $182.39) have been a mixed bag of late, with the former down double-digits last week and Lam up more than 8%. An article from *Digitimes* (https://www.digitimes.com/news/a20190313PD204.html), with the assertion, "NAND flash prices are expected to fall at a slower pace in the second quarter of 2019 than in previous quarters, according to industry sources," gave LRCX shareholders a renewed sense of enthusiasm on Wednesday and Thursday, while chipmaker Broadcom's fiscal Q1 2019 earnings beat and positive outlook helped on Friday. Broadcom CEO Hock Tan said that the anticipated "sharp" decline in the wireless segment revenue would reverse in the second half of the year, resulting in no changes to the already-strong outlook. Taken together, we think the capital equipment makers have a better outlook today than they did a week ago, even if they didn't react to earnings news in the same direction. Our Target Price for LRCX now stands at $226.