Market Commentary Monday, April 1, 2019

March 31, 2019

EXECUTIVE SUMMARY

TPS 630 – April Edition of *The Prudent Speculator* Coming No Later than Wednesday
Week in Review – Q1 Ends on an Uptick
Econ News – 2.2% Q4 GDP Growth; NABE Projections; New Home Sales & Consumer Confidence
Yield Curve – No Longer Inverted, But No Reason to Alter a Long-Term Plan Even if it Were
Buffett Speaks – You Really Want to Bet on America
Interest Rates – Low Rates Make Stocks More, Not Less, Attractive
Sentiment – AAII Less Optimistic Last Week
Lyft Mania – Perspective on the Year's "Hottest" IPO Thus Far
Miracle of Compounding – Growing Wealthy Slowly
Stock Updates – CCL & TNP

Market Review

Work is underway on the April edition of *The Prudent Speculator*. This month we offer one first-time recommendation while our *Graphic Detail* takes a deeper look at historical valuation data compiled by Professors Fama and French as well as via our own in-house factor study. If all goes according to Hoyle, we expect to have *TPS 630* available no later than Wednesday, April 3.

Certainly, the last week of March marked a nice end to a terrific first quarter, as all the major market averages advanced more than 1% over the final five days of the month. Interestingly, the gains came despite continued concerns about the health of the U.S. economy, given that revised GDP growth in the fourth quarter of 2018 came in at 2.2%, down from 3.4% in the third quarter.

And projections going forward have been coming down with the National Association for Business Economics (NABE) the latest to downgrade its estimates. "NABE Outlook Survey panelists believe the U.S. economy has reached an inflection point, with the consensus forecasting real GDP growth to slow from 2.9% in 2018 to 2.4% in 2019, and to 2.0% in 2020," said NABE President Kevin Swift last week. "The panel has turned less optimistic about the outlook since the previous survey, as three-quarters of respondents see risks tilted to the downside, and only six percent perceive risks to the upside."

NABE Survey Chair Gregory Daco added, "A majority of panelists sees external headwinds from trade policy and slower global growth as the primary downside risks to growth. Three-quarters of respondents have reduced their 2019 GDP growth outlook in response to trade policy developments. Nonetheless, recession risks are still perceived to be low in the near term. Panelists put the odds of a recession starting in 2019 at around 20%, and the odds of a recession by the end of 2020 at 35%. In part this reflects the Federal Reserve's dovish policy U-turn in

January. A near-majority of panelists anticipates only one more interest rate hike in this cycle compared to the three hikes forecasted in the December survey."

To be sure, the 2.2% growth in Q4 was hardly awful, and we can say the same for the NABE predictions, given that all the numbers cited are near or slightly above what we've seen as the average GDP growth rate over the last 20 years,…

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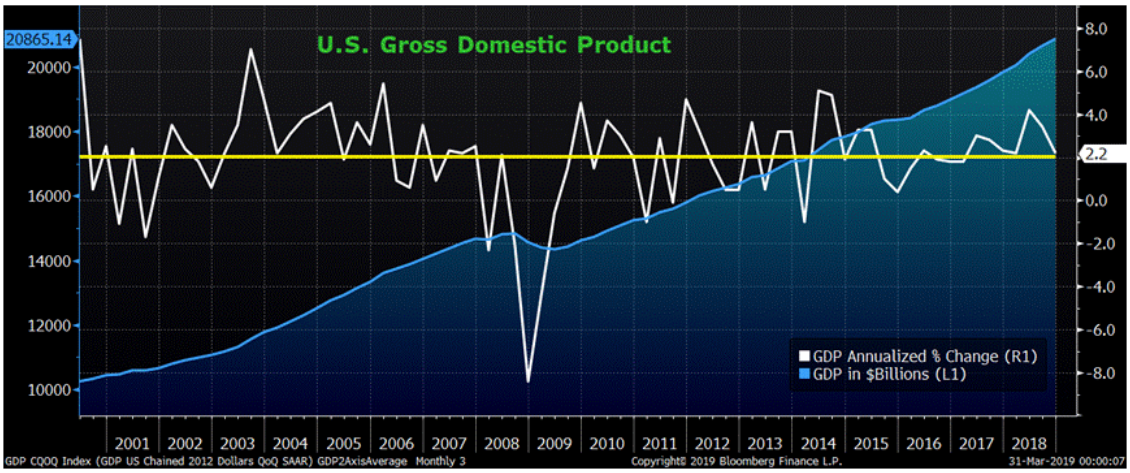
U.S. Economy Slowed, But Still Growing

Uncle Sam calculated Q4 '18 GDP growth at a decent 2.2%. Yes, this was down from a strong 3.4% in Q3 '18, while many are worried that growth will slow further as we move forward, with more than a few thinking a recession is imminent as ongoing trade skirmishes are not helping, but even a modest downturn would still see the economy expand on a nominal basis, with corporate profits likely remaining healthy.



…while more recent economic stats out last week were not exactly recessionary,…

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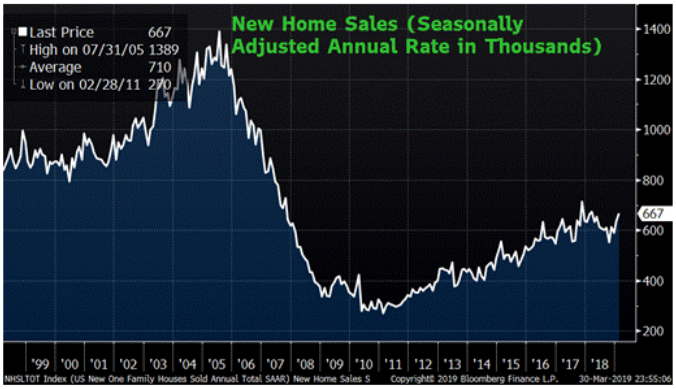
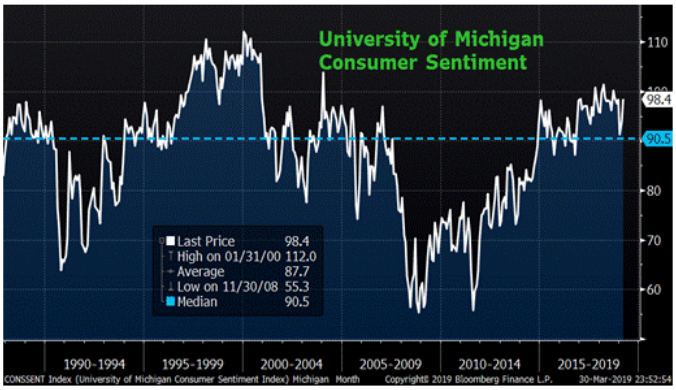
Decent Statistics





Rebounding from a sizable decline in January and not yet reflecting the plunge in mortgage rates during March, new home sales jumped to a 667,000 annual rate in February, with the three-month average climbing to 630,000, the best showing since June. And, the final read on consumer sentiment for March from the University of Michigan topped expectations, coming in at 98.4, well above the historical average.

…and the U.S. Treasury yield curve that was causing plenty of consternation a week ago is no longer inverted (supposedly a harbinger of recession) as of this writing, at least as far as the important 10-Year Less 3-Month Spread goes.

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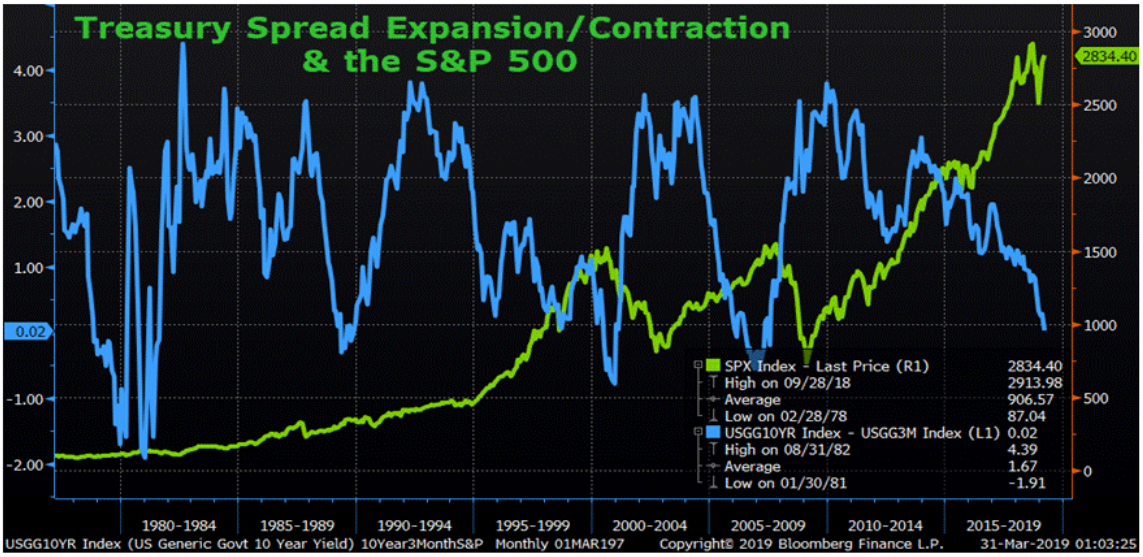
10-Year – 3 Month Spread & Equities

While the important 10-Year less 3-Month U.S. Treasury spread was no longer negative as of 3.29.19, history shows that long-term-oriented equity market investors have done just fine over the past four-plus decades despite several yield-curve inversions along the way.



True, even legendary investor Warren Buffett conceded last week, "It does look like the pace of increase in the economy has slowed down. I'd call it somewhere close to noticeably, but I wouldn't go beyond that." However, the Oracle of Omaha was quick to add, "That doesn't change anything we do. If there was a flashing red light, if there was a blurring red light, we would keep investing the same way we do…You really want to bet on America. God has blessed America."

Of course, slowing GDP growth is hardly unexpected and we really do not see much change in the longer-term economic outlook today than was evident a month ago or even a quarter ago. As such, we are perplexed by why so many are worried about the recent plunge in interest rates, given that stocks are more appealing measured against a 2.41% 10-year U.S Treasury yield as of the end of March versus a 2.71% yield as of the end of February,…

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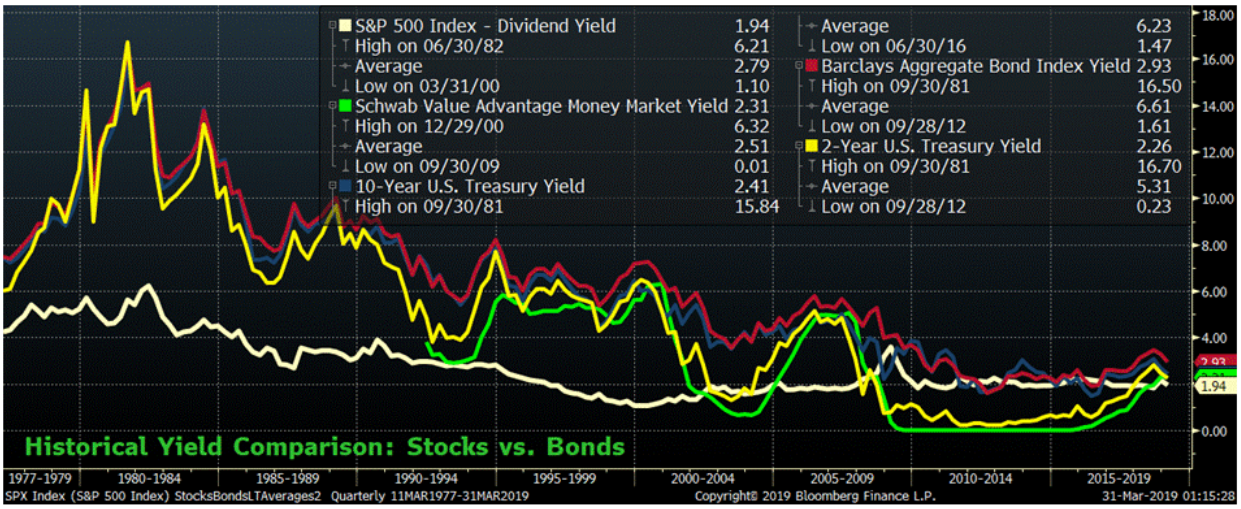
Stocks vs. Government Bonds – Income

Though stocks are not necessarily a substitute for government bonds, the payout on the S&P 500 (1.94%) is still very generous versus coupons on U.S. Treasury securities, especially as yields on the latter have been sinking…and prices rising. Of course, interest payments on bonds generally are fixed, while dividend payments usually rise over time.



…but the contrarian in us actually is pleased that equities are not garnering a lot of excitement, despite near-record highs on many of the indexes.

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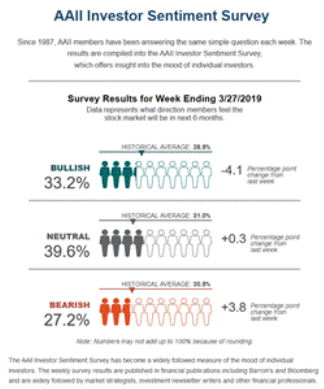
AAII Sentiment – Contrarian Gauge

Given that the S&P 500 just closed out its best first quarter since 1998, we were pleased to see a 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, and Bullishness is below average at present, 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	824	0.24%	0.21%	1.15%	1.03%	3.18%	2.79%	6.50%	5.75%
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 1625 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	160	0.15%	0.13%	1.00%	0.92%	2.45%	2.12%	5.82%	5.40%
5	3.5	8.0	166	0.00%	-0.03%	0.57%	0.48%	2.40%	2.13%	4.92%	4.38%
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	22.5	150	0.27%	0.25%	0.65%	0.58%	2.05%	1.76%	5.57%	5.08%
9	22.6	30.0	166	0.11%	0.09%	0.28%	0.20%	2.15%	1.89%	4.61%	4.02%
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 3.21.19. Unannualized. SOURCE: Kovitz Investment Group using data from American Association of Individual Investors and Bloomberg

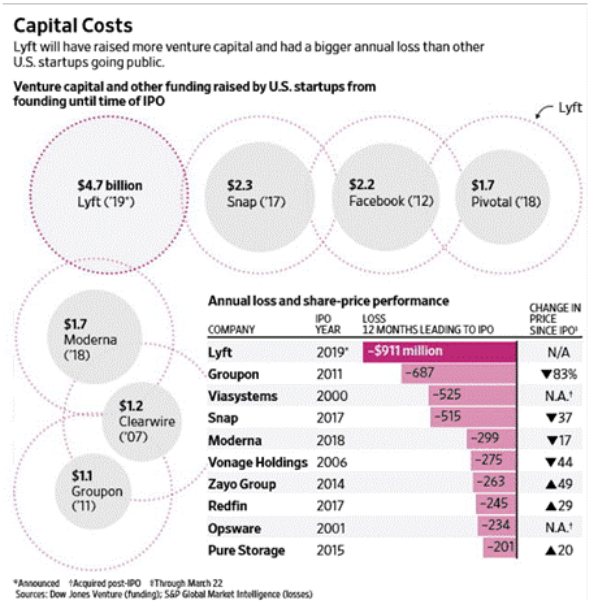
That said, we respect that there was quite a bit of hoopla surrounding Friday's initial public offering of Lyft. After all, Saturday's newspapers shouted headlines like, "Lyft IPO Shines as More Await" and "Ride-hailing Firm Hits $26.5 Billion Valuation as Stock Price Surges." We suppose that we'll take it as a positive sign for the overall health of the equity markets that a business that managed to lose nearly $1 billion over the last 12 months could command a market capitalization on par with highly profitable companies like **Zimmer Biomet** (ZBH – $127.70), **Corning** (GLW – $33.10), **Tyson Foods** (TSN – $69.43), **Cummins Inc.** (CMI – $157.87) and **Royal Caribbean** (RCL – $114.62), but there should be little doubt about which five companies we would want to own.

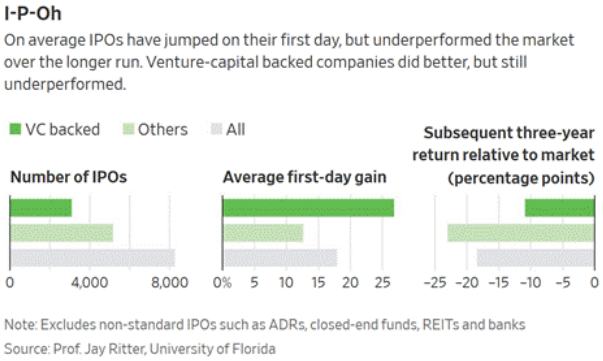
Getting Burned on Hot IPOs

Now there's a stampede of technology unicorns IPOing…in the pipeline are rival Uber; data-mining company Palantir Technologies; Slack Technologies, a maker of chat software; home-rental firm Airbnb and image-search startup Pinterest.

When all these super smart backers of the best startups want to sell out, do you want to be on the other side of the trade?

-- The Wall Street Journal, Mar. 26, 2019





Obviously, one day does not a trading history make, and Lyft could prove to be worth its massive valuation, but it is not a Value stock, which is essentially what can be said for nearly every IPO. Indeed, there is no point in going public at a discount! To be sure, we understand the temptation to want to get in on the next big thing, but to give some credit to the financial media, the *New York Times* ran an accurate and sobering story on Friday: "Lyft's I.P.O. Was a Huge Success, Just Not for Investors Who Bought on Friday."

Nearly Every Post-IPO LYFT Buyer a Loser

While we very much respect that the offering of the profit-less ride-hailing giant has to be viewed as a major victory…for the insiders and private equity investors who sold, and the big institutions who received shares at the $72 IPO price, the opening pop to $87.24 in LYFT and the near-immediate retreat of the stock price meant that most of the open-market (trading volume was 71 million shares) buyers were stuck with sizable paper losses, given the $78.29 closing price.

As the *Times* wrote, "Lyft's first-day gain is measured off the I.P.O. price (which was set on Thursday, when shares were divided up mostly among large funds). Ordinary investors who wanted in had to wait to buy the stock until it was available on public markets on Friday, and at a much higher price than the big funds paid…And those who bought as soon as trading began are already sitting on losses of a little more than 11 percent…It serves as an important reminder that amid all the hoopla around trading debuts, small investors wind up taking a lot of the risk. Most of the gains on the first day of trading for a stock are realized with the first trade."

Trading in Lyft stock certainly was exciting, but we will let the day-traders attempt to get rich quick, as our mission is to set our portfolios up to help us grow wealthy slowly. No guarantees, of course, but we think the best way to achieve that objective is not by owning high-flyers like Lyft, but instead by buying and patiently harvesting a broadly diversified portfolio of what we believe to be undervalued stocks, generally of dividend-paying companies.

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Miracle of Compounding: Dow 50000

It is amazing how relative modest yearly return numbers can lead to substantial growth when time and simple math are applied. For example, Dow 50000 by the year 2031 would be achieved with annual price gains for the index of 5.5%...which is merely the historical average.

Miracle of Compounding - Dow 50000 by 2031

(Initial Value of Dow Jones Industrial Average = 25929, March 2019)

	Inflation 2.9%	Intermediate Gov't Bonds TR 5.1%	Dow Jones Industrial Average Price Return 5.5%	Corporate Bonds TR 5.9%	S&P 500 TR 9.9%	Fama/French Dividend Stocks TR 10.4%	Fama/French Value Stocks TR 13.1%
Mar-19	25,929	25,929	25,929	25,929	25,929	25,929	25,929
Mar-20	26,681	27,251	27,355	27,459	28,496	28,626	29,326
Mar-21	27,455	28,641	28,860	29,079	31,317	31,603	33,167
Mar-22	28,251	30,102	30,447	30,795	34,417	34,889	37,512
Mar-23	29,070	31,637	32,121	32,611	37,825	38,518	42,426
Mar-24	29,913	33,251	33,888	34,535	41,569	42,524	47,984
Mar-25	30,781	34,946	35,752	36,573	45,685	46,946	54,270
Mar-26	31,673	36,729	37,718	38,731	50,208	51,829	61,380
Mar-27	32,592	38,602	39,793	41,016	55,178	57,219	69,420
Mar-28	33,537	40,570	41,981	43,436	60,641	63,169	78,514
Mar-29	34,510	42,640	44,290	45,999	66,644	69,739	88,800
Mar-31	36,540	47,100	49,296	51,587	80,493	84,999	113,589
Mar-34	39,812	54,680	57,886	61,267	106,844	114,373	164,333
Mar-39	45,930	70,120	75,655	81,603	171,293	187,572	304,115

Compounded at average annualized rates that have been the historical returns on each investment from June 1927 to December 2018. Source: Al Frank using data from Morningstar, Bloomberg and Professor's Eugene F. Fama & Kennerh R. French. Past performance not a guarantee of future performance.

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 updated Target Prices are in the process of being posted to our website, Jason Clark offers updates on a couple of our companies that had news last week that was of sufficient importance to trigger a review of their respective Target Prices.

Shares of **Carnival Corp.** (CCL – $50.72) sank more than 10% last week. Despite reporting fiscal Q1 top and bottom-line results that exceeded consensus analyst expectations, investors reacted negatively to the cruise company's cut in its full-year guidance (discussed below). For the quarter, Carnival posted adjusted EPS of $0.49, which topped consensus expectations of $0.44. Revenue for the period of $4.67 billion came in above forecasts calling for $4.31 billion.

Carnival CEO Arnold Donald commented, "First quarter earnings included revenue growth from higher capacity and improved onboard spending, offset by the timing of cost increases and a drag from fuel price and currency compared to the prior year. First quarter adjusted earnings were better than the mid-point of December guidance by $0.07 per share."

Looking ahead, Mr. Donald added, "For the full year, our earnings guidance now reflects $155 million, or $0.22 per share, from fuel price and currency moving against us. Operationally, we continue to expect revenues and adjusted earnings per share improvements in line with our December guidance. We expect adjusted earnings per share to be higher than the prior year, despite a $45 million, or $0.06 per share, year over year drag from currency and the price of fuel."

He continued, "At this time, cumulative advanced bookings for the remainder of 2019 are ahead of the prior year at prices that are in line with the prior year on a comparable basis. Pricing on bookings taken since January have been running in line on a comparable basis to the prior year while booking volumes are ahead compared to the prior year. As a result, even with higher capacity, there is less inventory remaining for sale than at the same time last year."

Mr. Donald concluded, "Booking trends achieved during wave season rivaled last years' historical highs and were consistent with the demand trends we experienced going into the year, building further confidence in our full year guidance. For our North America and Australia brands, our booked position is ahead of the prior year at higher prices while our Europe and Asia brands are well ahead of the prior year at lower prices. Our brands are strong and growing, including Continental Europe, where we continue to expect revenue growth driven by double-digit capacity increases."

Based on current booking trends, the company continues to expect full year 2019 constant currency net cruise revenue to be up approximately 5.5%, with capacity growth of 4.6%. Full year 2019 adjusted EPS should now be in the range of $4.35 to $4.55, compared to December guidance of $4.50 to $4.80. By way of contrast, adjusted EPS in 2018 came in at $4.26.

Not surprisingly, we think the selloff last week was overdone. We still believe that CCL is again being conservative in its forecasts, as this has shown up in net yield predictions the past three years. Why does this matter? We think that there is potential upside to Carnival's current outlook if demand stays steady, however if demand slows, we believe that the EPS outlook has less downside risk. We also note that CCL shares are trading at just slightly above 11 times NTM adjusted earnings expectations.

While near-term headwinds will continue to blow, we maintain our long-term optimism on CCL and the overall cruise industry space, given favorable demographic trends and the fact that there are still meaningful growth opportunities in emerging economies, which are encouraging for global revenue diversification and the ability to rapidly reach a new customer base. CCL shares now sport a 3.9% dividend yield. Our Target Price has been trimmed to $80.

Shares of **Tsakos Energy Navigation** (TNP – $3.10) fell a little last week after the marine shipper announced its Q4 financial results. Believe it or not, Q4 adjusted EPS come in at $0.03, better than the consensus analyst estimate calling for a very slight loss.

Management explained, "In 2018, TNP produced total voyage revenues of $529.9 million, slightly higher than in 2017. The first three quarters of the year saw a difficult market with healthier rates evident only in the fourth quarter, as the market at last benefited from a positive

turn-around instigated by a fast declining orderbook, increased scrapping and a surge in U.S. oil exports which in large part nullified the renewed production cuts by OPEC. In this challenging and unpredictable environment and as a result of TNP's solid employment strategy, the company generated $38.2 million in operating income, before non-cash charges, and adjusted EBITDA of $190.7 million. The average daily time charter equivalent rate per vessel per day was $18,226 with fleet utilization again at a high 96.2% as a result of the company's time-charter policy and the excellent and long-standing relationship with many high-end charterers across the globe."

COO George Saroglou added, "With global oil consumption on the rise, driven by Chinese and Indian demand, and the U.S. becoming a leading force in global crude oil exports, freight rates should maintain their upward trajectory by the second half of 2019 and beyond. The low orderbook and the high scrapping levels spurred, to a large extent by the upcoming IMO 2020 regulations, will further support the market to attain higher profitability. As a result, vessels in spot and profit-sharing charters are expected to capture the firming freight market and solidify further the company's bottom line. Increased appetite of major oil companies for long-term charters in the crude and product sectors, is a strong indicator of a sustainable improvement in market conditions going forward."

No doubt, TNP has been a disappointment for the last few years, and we have grown weary of waiting for the pricing cycle to turn. That said, while we continue to debate its place in our portfolios, we know that the stock has traded at several times its current level during previous cyclical highs in the tanker biz. We still like the exposure and think that TNP is set up with its contract structure to not only survive, but thrive, as business conditions improve, while we have at least had some rewards for our patience via the generous dividend.

TNP shares change hands at 0.5 times estimated sales and 22% of book value per share, both ratios well below the historical norms. With a relatively young fleet and desire to make it younger, a more subdued industry-wide order book going forward and relatively consistent growth in global oil demand likely for the foreseeable future, we continue to think this micro-cap name fits in well with the much more well-known integrated oil and oil-service companies that account for the lion's share of our Energy Sector exposure. Sporting a current dividend yield of 6.5%, our Target Price for TNP floats in today at $5.