Market Commentary Monday, March 4, 2019

March 4, 2019

EXECUTIVE SUMMARY

TPS 629 – March Newsletter Coming Later Today
Reasons for Optimism – Low Interest Rates, Healthy Corporate Profits and Reasonable Valuations
Taking a Breather – Modest Pullback Last Week
Value vs. Growth – Latter Winning Again
History Lesson – Last Time Value was this Cheap Relative to Growth was in the Year 2000
Target Prices – New Listing Posted
Stock Updates – FL, CM, SFL, TPC, SJM & BASFY

Market Review

The March edition of *The Prudent Speculator* is nearing completion. If all goes according to plan, we expect to post *TPS 629* later today. This month, we offer one first-time recommendation and our *Graphic Detail* features our Quarterly Earnings Scorecard.

And, our *Editor's Note* this month concludes: "We continue to see no reason to alter our enthusiasm for the long-term prospects of our portfolios, especially as interest rates remain low,…

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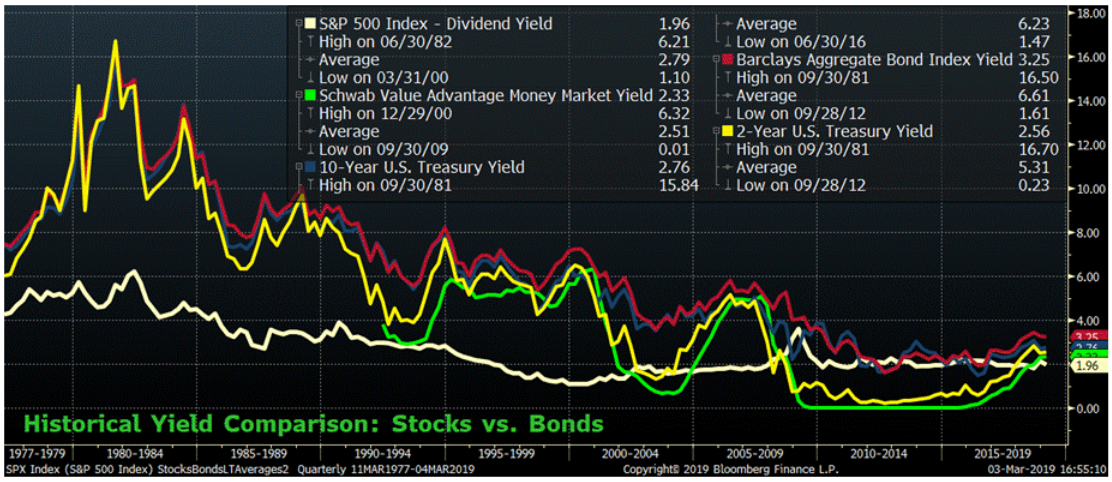
THE PRUDENT SPECULATOR
Equity vs. Fixed Income Yields

Though stocks are not necessarily a substitute for bonds, U.S. Treasuries and money market funds, the current payout on the S&P 500 (1.96%) is still very generous versus the income provided by fixed income. And, the comparison to the average yields for all of the securities below over the past four-plus decades very much favors equities.



…corporate profits are healthy,…

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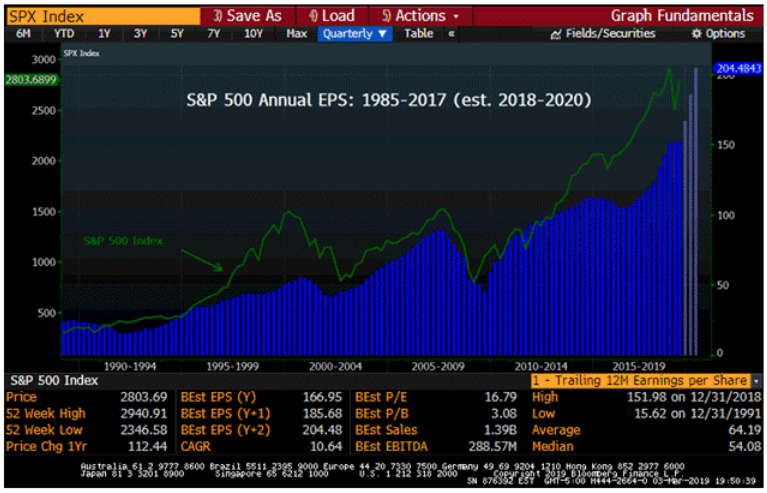
THE PRUDENT SPECULATOR
Profit Growth Likely to Continue

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



S&P 500 Earnings Per Share		
Quanter Ended	Bottom Up Operating EPS 3 Month	Bottom Up Operating EPS 12 Month
ESTIMATES		
12/31/2019	$44.53	$166.07
9/30/2019	$43.29	$156.57
6/30/2019	$41.04	$154.66
3/31/2019	$37.21	$152.27
12/31/2018	$35.03	$151.60
ACTUAL		
9/30/2018	$41.38	$150.42
6/30/2018	$38.65	$140.37
3/31/2018	$36.54	$132.23
12/31/2017	$33.85	$124.51
9/30/2017	$31.33	$118.56
6/30/2017	$30.51	$115.92
3/31/2017	$28.82	$111.11
12/31/2016	$27.90	$106.26
9/30/2016	$28.69	$101.42
6/30/2016	$25.70	$98.17
3/31/2016	$23.97	$98.61
12/31/2015	$23.06	$100.45
9/30/2015	$25.44	$104.14
6/30/2015	$26.14	$108.30
3/31/2015	$25.81	$111.50
12/31/2014	$26.75	$113.01

Source: Standard & Poor's. As of 2.28.19

and valuations continue to be reasonable."

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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	13.4	12.1	1.1	1.9	3.0
Select Value	13.6	12.3	1.1	1.9	2.6
Select Dividend	13.8	12.4	1.0	2.2	3.3
Select Focused Dividend	12.6	11.7	0.9	2.2	3.4
Select Focused Value	13.6	12.3	1.2	2.6	2.9
Select SMID Dividend	13.6	12.2	0.7	1.5	2.9
Russell 3000	19.9	17.4	2.0	3.1	2.0
Russell 3000 Growth	25.4	21.4	2.8	6.9	1.4
Russell 3000 Value	16.4	14.7	1.5	2.0	2.5
Russell 1000	19.0	17.1	2.1	3.2	2.0
Russell 1000 Growth	23.2	20.6	3.0	7.3	1.4
Russell 1000 Value	16.0	14.6	1.6	2.1	2.6
S&P 500 Index	18.5	16.8	2.1	3.3	2.0
S&P 500 Growth Index	24.2	20.9	3.6	5.5	1.5
S&P 500 Value Index	14.6	13.7	1.4	2.3	2.5
S&P 500 Pure Value Index	11.4	10.3	0.6	1.2	2.8

As of 03.02.19. 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.

Certainly, we recognize that stocks can move in both directions, as we saw over the last five days. Even with a decent gain on Friday, the latest trading week ended in the red for seemingly the first time since Christmas. The S&P 500 and Russell 3000 indexes lost 0.23% and 0.27%, respectively, while Growth again topped Value. The Russell 3000 Growth index dropped 0.14%, compared to a negative total return of 0.39% for the Russell 3000 Value index.

No doubt, the fact that Value has been underperforming for a while now can be disconcerting, but double-digit percentage returns so far in 2019 make it difficult to complain too vehemently,…

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THE PRUDENT SPECULATOR
Market of Stocks – Varying Index Returns

Returns Race					
2019 Return %	2018 Return %	2017 Return %	2016 Return %	Bloomberg Symbol	Index
Stock Indexes					
12.10	-3.48	28.11	16.50	INDU Index	Dow Jones Industrial Average
14.69	-2.81	29.73	8.97	CCMP Index	NASDAQ Composite Index
12.81	-4.79	21.68	12.04	RIY Index	Russell 1000 Index
18.08	-11.03	14.63	21.28	RTY Index	Russell 2000 Index
13.18	-5.25	21.12	12.72	RAY Index	Russell 3000 Index
12.26	-4.39	21.82	11.95	SPX Index	S&P 500 Index
13.80	-1.52	30.21	7.07	RLG Index	Russell 1000 Growth Index
11.84	-8.28	13.64	17.33	RLV Index	Russell 1000 Value Index
20.18	-9.34	22.14	11.28	RUO Index	Russell 2000 Growth Index
15.90	-12.85	7.82	31.72	RUJ Index	Russell 2000 Value Index
14.27	-2.12	29.58	7.38	RAG Index	Russell 3000 Growth Index
12.12	-8.59	13.17	18.38	RAV Index	Russell 3000 Value Index
12.78	-0.01	27.43	6.89	SGX Index	S&P 500 Growth Index
11.67	-8.97	15.35	17.39	SVX Index	S&P 500 Value Index
14.95	-4.22	26.76	4.22	SPXPG Index	S&P 500 Pure Growth
14.05	-12.02	17.73	19.62	SPXPV Index	S&P 500 Pure Value
9.80	-13.94	27.22	4.54	ACWX Index	ISHARES MSCI ACWI EX US
		Source: Bloomberg. As of 3.1.19			

While Growth has won the performance derby over the last three+ years, thanks in large part to high-flying Amazon, the double-digit percentage returns for the Value indexes this year is a nice consolation prize.

…especially when now might appear to be the best time to be moving toward Value stocks since the year 2000!

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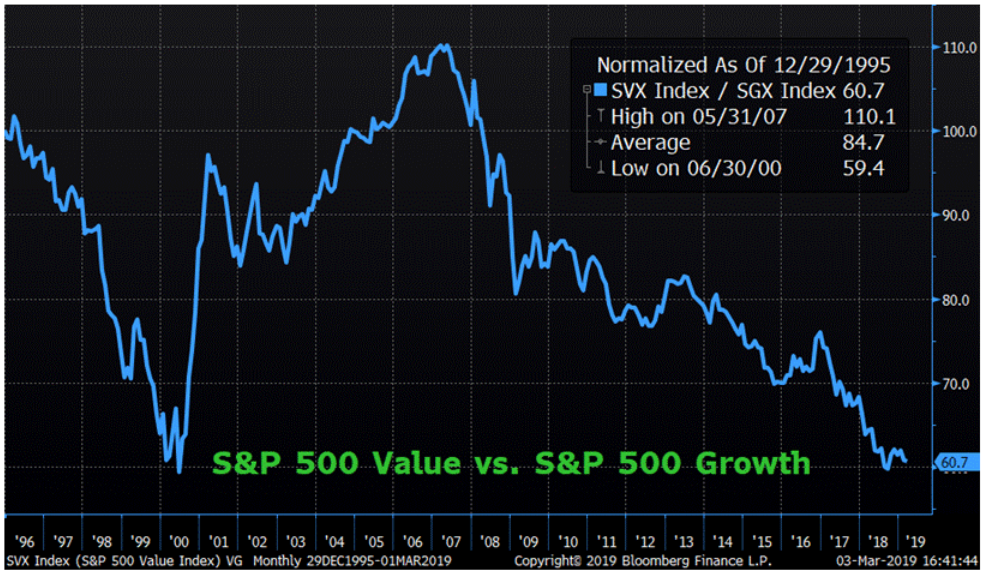
THE PRUDENT SPECULATOR
Value Attractiveness like Year 2000 Levels

While it is frustrating to see the Amazons continue to head north, while companies with inexpensive financial fundamentals lag behind, Value Stocks are now extraordinarily attractive relative to Growth.



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 have posted updated Target Prices to the website, Jason Clark and Chris Quigley offer updates on a half dozen of our companies that had news last week that was of sufficient importance to trigger a review of their respective Target Prices.

Shares of **Foot Locker** (FL – $63.07) jumped 6% on Friday after the footwear and apparel retailer reported strong Q4 financial results that included same store sales growth of 9.7%, more than double the figure for which analysts were looking. Revenue came in at $2.27 billion, versus consensus analyst estimates of $2.19 billion, while adjusted EPS for the quarter was $1.56 (almost 12% above forecasts).

"The fundamentals of our core business remain strong and led to meaningful improvement in our financial results, not only during the fourth quarter but throughout 2018," said CEO Richard Johnson. "This positive performance was made possible by our team's unrelenting focus on providing compelling assortments to our customers, launching exciting collaborations with our strategic partners, both long-standing and new, and making our stores and digital channels unique and exciting destinations."

CFO Lauren Peters commented, “Impressive teamwork delivered impressive financial results in 2018. We delivered a gain in our gross margin rate above the guidance we provided at the beginning of the year, achieved an inventory turn above our long-term target, and made important investments, both directly in our business and by taking strategic stakes in other companies, which we believe will drive long-term growth.”

Mr. Johnson added, “Looking at 2019, we believe that by maintaining our focus on bringing differentiated experiences to youth culture, we can continue to elevate our financial performance by generating a mid-single digit comparable sales gain and another double-digit percentage increase in earnings per share.”

Foot Locker spent $62 million to buy back 1.2 million shares during the quarter, yet the company reported $891 million of cash on its balance sheet, with only $124 million of debt (a net cash per share position of more than $6.75). The company also last month announced a double-digit percentage increase in its quarterly dividend to $0.38 per share (the stock now yields 2.4%) and a new $1.2 billion share repurchase program.

While we believe FL needs to continue to invest in staff that can improve the in-store experience and in its digital presence, which can pay long-term dividends, we like the company’s solid cash position and strong execution. We have boosted our Target Price to $83 as we note that despite the terrific growth of late, FL trades for just 13.4 times trailing earnings.

North-of-the-border financial giant **Canadian Imperial Bank** (CM – $84.20) earned $2.26 per share in fiscal Q1 2019, versus consensus analyst estimates of $2.35. Like many Canadian banks, CM was hit in the quarter by higher credit provisions and lower-than-expected capital market activity. Of course, given the recovery in markets thus far in 2019, it wouldn’t seem out of line to expect a pick-up in security issuance, deal activity and asset management fees.

While results were weak for the capital markets segment, most other segments generally performed better. CM’s U.S. segment continued its strong growth, with loans, deposits and net income all up double-digits. Management also reported that the Private Bancorp unit, which was acquired in mid-2017, turned accretive to earnings this quarter, which was 18 months ahead of schedule. The bank also announced strong Common Equity Tier 1, Tier 1 and Total capital ratios of 11.2%, 12.7% and 14.7%, respectively.

CEO Victor G. Dodig stated, “In the first quarter, we delivered solid performance across our strategic business units. We continue to make progress on our strategy to build a client-focused North American bank with diversified earnings growth and disciplined expense and capital management while delivering superior shareholder returns.”

Overall, we have been pleased that the company has improved multiple measures of its core business performance. We also like that the organization continues to make inroads in the U.S., while the Private Bank purchase is proving to be a solid acquisition. CM continues to benefit from the Canadian government keeping the banking segment attractive by maintaining barriers

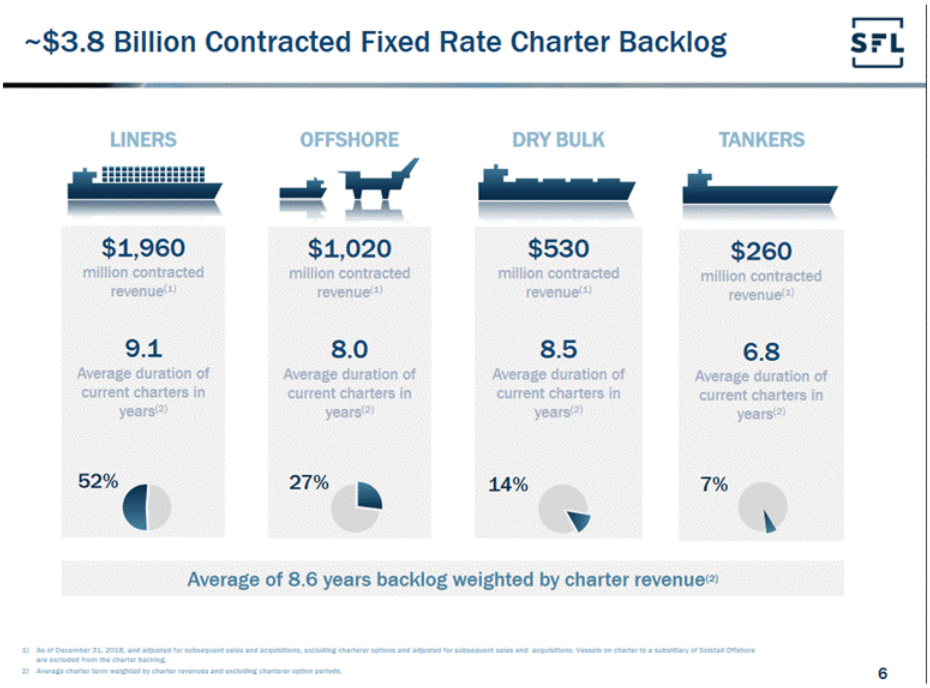
to entry. CM trades for less than 9 times forward earnings estimates and yields a generous 5.0%. Our Target Price has been trimmed to $110.

Marine shipping concern **Ship Finance Int'l** (SFL – $12.30) reported earnings per share of $0.28, versus the $0.30 estimate, in fiscal Q4 2018. SFL had adjusted revenue of $118.6 million, versus the $121.6 million estimate. Shares traded higher by three percent on Tuesday, though the stock gave up all of the gains as the week concluded, closing down 1.7% for the week.

CEO Ole B. Hjertaker stated, "This is our 15-year anniversary of profits and dividends, and the dividend represents $1.40 per share on an annualized basis or 11% dividend yield, based on closing price of $12.49 yesterday. Over the years, we have paid more than $25 per share in dividends or more than $2.1 billion in aggregate and we have a fixed rate charter backlog of $3.8 billion, which should support continued dividend capacity, going forward. The reported net income for the quarter was approximately $3.5 million or $0.03 per share. This is after an impairment charge of nearly $36 million, relating to five offshore support vessels, mitigated by gains relating to the sale of other offshore assets. Aggregate charter revenues recorded in the quarter, including 100% owned subsidiaries accounted for as investment in associates was approximately $160 million and the EBITDA equivalent cash flow in the quarter was approximately $126 million."

Mr. Hjertaker added, "2018 has been an active year with multiple transactions. We have grown our backlog by more than $1.3 billion and seen a major change in the fleet mix. We believe that we are well positioned to continue growing our balance sheet, and over the years, we have sold most of the older vessels and we have really renewed the vessels. So, of the initial fleet, only one vessel remains while we have acquired all the other 85 vessels in the fleet, subsequent to our start, back in 2004."

SFL – Risk Mitigation via Fixed Rates



We like that management continues to be committed to maintaining an overall conservative profile as evidenced by its strategy to charter out most of its assets on a long-term basis to reputable operators in the shipping and offshore markets. We also like that it is making fleet changes to reflect the current operating environment, while keeping an eye on the long term. The current 11.4% dividend yield is very rich, while the stock trades for just 1.1 times book value. Our Target Price for SFL is $16.

Shares of **Tutor Perini** (TPC – $19.42) jumped almost 10% over Thursday and Friday after the construction firm reported financial results that included a record backlog. For Q4, TPC turned in adjusted EPS of $0.98, which was almost 35% above consensus analyst expectations. Revenue of $1.18 billion fell short of forecasts, but was seemingly forgiven because of the sizeable backlog and prediction for material increases in business during Q1.

CEO Ronald Tutor offered, “We concluded the year with excellent fourth-quarter results highlighted by record backlog, strong operating margins across all segments, improved performance in the Specialty Contractors segment and solid operating cash generation. The outlook for further backlog growth remains favorable, as we expect to book more than $2.5 billion of pending awards during the first quarter of 2019. We expect that our growing backlog will provide a solid foundation for revenue growth and improved profitability over the next several years.”

Backlog set a new record of $9.3 billion, an increase of 28% compared to $7.3 billion as of December 31, 2017. New awards and adjustments to contracts in process totaled $2.0 billion in the fourth quarter. Significant new awards included the $800 million Minneapolis Southwest Light Rail Transit project, $245 million of incremental funding for a technology project in California, $244 million for various electrical and mechanical projects in New York, a $100 million military facility project in Saudi Arabia and an $88 million airport parking garage project in South Carolina. Backlog is expected to continue growing in 2019 due to a sizeable volume of identified pending awards.

Management said it is anticipating strong, double-digit revenue growth and higher operating margins across all segments in 2019, with particularly notable margin improvement expected in the Specialty Contractors segment and slight margin improvements in the Civil and Building segments. For 2019, Tutor established its initial EPS guidance in the range of $2.00 to $2.30, with earnings expected to be weighted more heavily toward the second half of the year due to the anticipated timing of project ramp-up activities, as well as typical business seasonality.

As readers are aware, our patience with TPC has been thin, and while we were generally pleased with the results, backlog and potential, we want to see consistent execution by the company. While the stock trades for 8.5 times NTM adjusted EPS estimates, our Target Price stands at a conservative $28.

JM Smucker (SJM – $105.42), a manufacturer and marketer of food products, earned an adjusted $2.26 per share in fiscal Q3 2019, versus the analyst consensus of $2.01. Revenue was $2.01 billion, just ahead of the $1.99 billion consensus. Shares jumped more than 5%, as SJM reported a positive contribution from the company's recently acquired Ainsworth Pet Nutrition brand, as well as growth in Rachael Ray Nutrish, Smucker's Uncrustables, Nature's Recipe and Sahale Snacks.

CEO Mark Smucker said, "Our outlook across the businesses reinforces why we remain excited about the long-term prospects for delivering on our three key financial priorities of top line growth, prudent cost management, and delivering earnings per share growth. With growth in a number of areas contributing to our third quarter results, we continued to make progress on our three consumer-centric growth imperatives of leading in the best categories, building brands consumers love, and being everywhere. Turning to our strategic imperative of building brands consumers love, we are following through on our commitment to increase marketing investments to support our innovation and growth brands. As I mentioned, in the third quarter, our marketing expense increased over $30 million compared to the prior year. A higher level of marketing and innovation support, coupled with a more agile go-to-market approach, is critical to achieving an anticipated high single-digit net sales increase for growth brands over the next five years. Combined net sales for growth brands are projected to increase 18% for the full 2019 fiscal year. We will also continue to invest in core brands to achieve our net sales growth target."

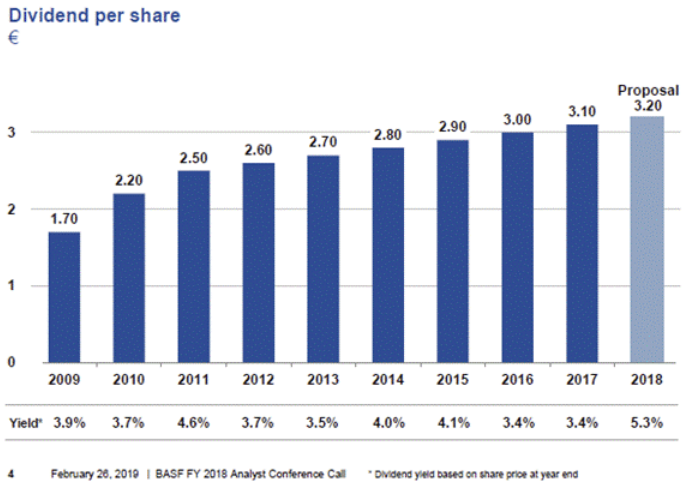
CFO Mark Belgya added, “We maintained our previously issued full-year guidance. Expectations for net sales and gross margin remain unchanged, with fiscal year net sales of $7.9 billion and an estimated gross margin of 38%. Adjusted earnings per share is expected to be in the range of $8.00 to $8.20. Key factors included in this forecast include better-than-anticipated third quarter results, a shift in certain marketing expenses from the third quarter to the fourth, the price decline on Jif peanut butter effective in March, and a full-year tax rate of 26% reflecting a fourth quarter rate comparable to the third quarter. Our projections for free cash flow remains in the range of $700 million to $750 million, with CapEx estimated at $350 million to $370 million.”

We like the diversification SJM adds to our broadly diversified portfolios and think that management’s focus on pet foods and healthier franchises will boost the long-term prospects for the company. Shares have climbed since the end of December, but we think they have plenty of room left to run. SJM sports a P/E ratio under 13 and a 3.2% dividend yield. Our Target Price has been bumped up to $139.

Germany’s **BASF SE** (BASFY – $19.41) reported Q4 2018 EPS of $0.19, versus the consensus estimate of $0.20. The company had $17.8 billion of adjusted revenue, compared with the analyst consensus of $16.5 billion. BASF benefitted from higher prices, increased volumes and a good portfolio mix, while Chemical segment performance and currency effects dragged on earnings. While the company had a difficult finish to 2018, shares have bounced nicely off the Christmas Eve low.

BASF CEO Martin Brudermuller commented, “Global economic growth slowed in the course of 2018. Geopolitical developments and trade conflicts, in particularly between the US and China, led to an increased uncertainty and an overall cautious market sentiment in the second half of the year. In the EU, GDP growth slowed to under 2%, mostly driven by weaker export demand. And in Asia, the slowdown was pronounced, especially in China. As a result, demand from key customer industries, mainly automotive, was dampened. In 2018, the global automotive industry recorded a 0.8% decline in growth compared to a plus of 2.3% in the prior year. We will continue our active portfolio pruning towards higher value and clearer focus. This is an ongoing task, and one major portfolio change in 2019 will be the merger of Wintershall and DEA. We will accelerate our excellence program announced in November. The target is to achieve an annual EBITDA contribution of €2 billion from 2021 onwards. For 2019, we aim to achieve an EBITDA contribution of €500 million. For the implementation, we expect one-time costs of €0.8 billion in the period 2019 until 2021.”

Attractive shareholder return



Dividend policy

- Increase the dividend per share every year

Key facts

- Dividend proposal of €3.20 per share, an increase of 10 cents
- Dividend yield of 5.3% based on the share price at year end 2018

4 February 26, 2019 | BASF FY 2018 Analyst Conference Call * Dividend yield based on share price at year end

BASF

BASFY expects to increase the dividend to 3.20 euros per DAX-traded share (a $0.65 annual dividend for the U.S.-traded shares, net of taxes). The dividend payout has been hiked each year since 2009. Though the near-term headwinds continue to mount, including the ability of BASF to move product depending on the water level of the Rhine, we think that the challenges can be overcome via stronger execution, cost controls and the company's acquisitions (including the seed and herbicide business from Bayer, global polyamide business from Solvay and waterproofing systems company Thermotek). In addition, we like BASF's strong free cash flow yield, favorable valuation in our proprietary scoring framework and net current yield of 3.4%. Our Target Price for BASFY is presently $29.