Market Commentary Monday, April 22, 2019

April 22, 2019

EXECUTIVE SUMMARY

Week in Review – Quiet Four Days of Trading…for the Major Market Averages
Q1 Earnings – 77% Beating the Street
Econ News – Solid Numbers Out Last Week
Forecasting – 2.8% Q1 GDP Growth Now the Atlanta Fed Estimate
Fed Speak – Kaplan & Evans Talk
Sentiment – Still Not a Lot of Optimism
Market of Stocks – 25 Undervalued Stocks Down Sharply Since 9.20.18 S&P 500 High
Stock Updates – QCOM, AAPL, INTC, MRVL, IBM, MAN, SLB, JNJ, SYF, KEY, BAC, CMA, C, BK, GS & ABT

Market Review

While there were plenty of global headlines last week, ranging from Tiger Woods winning the Masters Tournament to the massive fire at Notre-Dame Cathedral to the release of the Mueller Report, the Easter period was relatively subdued for the U.S. equity markets, at least as measured by the major averages. Aside from a decent 0.60% gain for the Dow Jones Industrial Average, most of the indexes lost a small amount of ground, though it was nice to see the S&P 500 Value index advance 0.22%, compared to a -0.32% drop for the S&P 500 Growth index.

First quarter earnings reporting season began in earnest last week, and the news thus far have been very good, at least as far as the actual bottom-line figures versus analyst expectations. We discuss a dozen results for individual companies below, but FactSet reported that nearly 77% of the S&P 500 members that have released Q1 profit numbers have exceeded estimates, which compares to around 67% that beat the Street for the entire fourth quarter.

No guarantees, of course, that the positive trend will continue, but the latest batch of economic numbers out last week generally were favorable,…

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Solid Economic Numbers

While healthy data on new orders was a positive, the Philadelphia Fed's gauge of manufacturing activity in the mid-Atlantic region came in at a weaker-than-expected 8.5 for April. On the other hand, the latest number of first-time claims for unemployment benefits fell in the latest week to 192,000, the lowest tally in five decades, an impressive feat given how much the labor force has expanded since then.

…with a strong retail sales number,…

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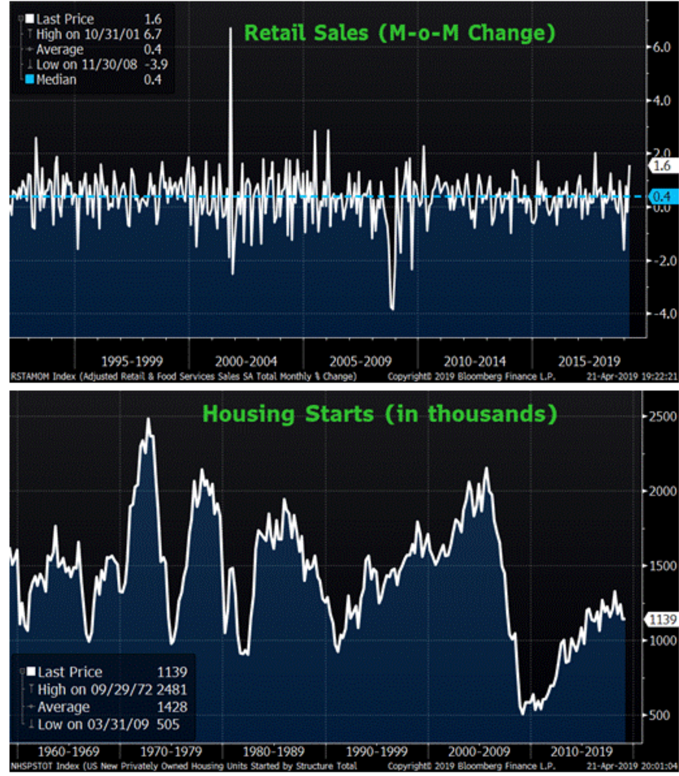
Retail Sales Strong; Housing Data Weak



Uncle Sam said that retail sales managed a much-better-than-expected 1.6% gain in March, bouncing back from a revised drop of 0.2% in February, with a strong 3.3% rebound in vehicle sales last month leading the charge. Countering the strong retail sales number, housing starts for March came in at 1.14 million, well below consensus forecasts, with building permits of 1.27 million also trailing projections.

… a catalyst for economists to raise their estimates of Q1 GDP growth, a position no doubt supported by a healthy leading economic indicators tally.

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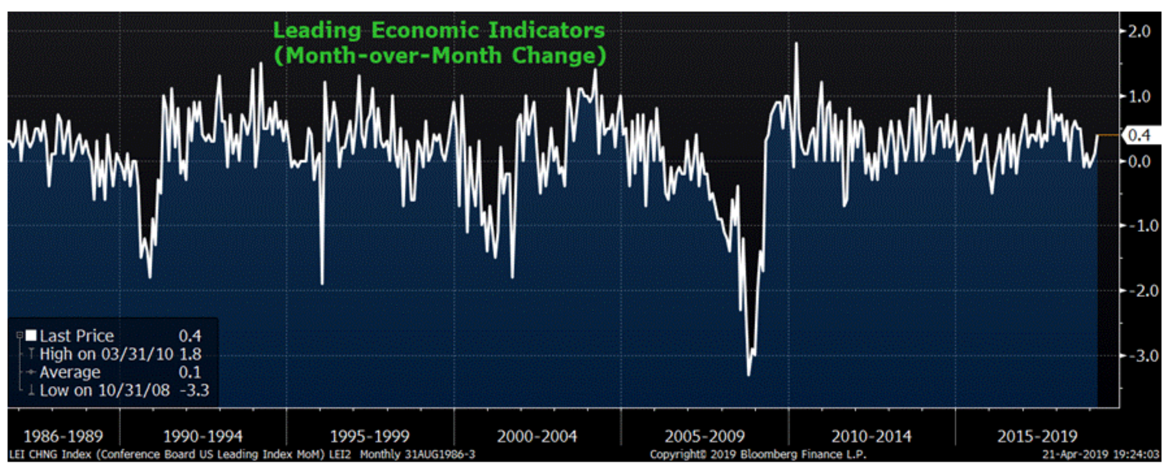
No Signs of an Imminent Recession

The forward-looking index of Leading Economic Indicators rebounded 0.4% last month, with the Conference Board stating, "The US LEI picked up in March with labor markets, consumers' outlook, and financial conditions making the largest contributions," The economy is still likely to slow toward 2% growth in the latter half of 2019, but a well-above-average gain in the LEI is hardly a recession harbinger.



Interestingly, the widely-watched GDPNow real-time economic growth projection gauge from the Atlanta Fed is suggesting that Q1 U.S. GDP will expand by 2.8%, much better than the pessimistic forecasts witnessed earlier in the year.

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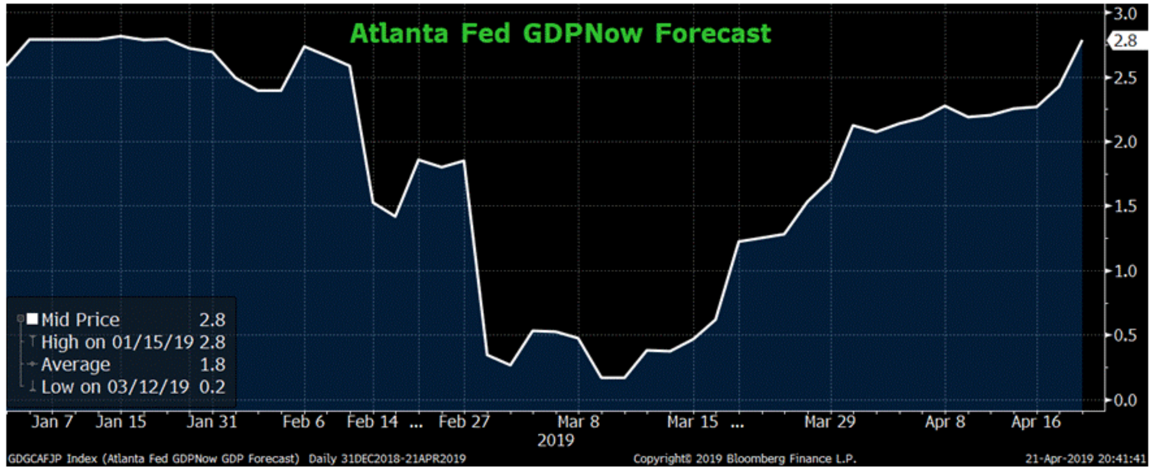
Economic Fortunetelling

As the old saw goes, economists have predicted nine of the last five recessions, and the soothsaying so far in 2019 vividly illustrates why we like the Niels Bohr quotation, "Prediction is very difficult, especially if it is about the future." Indeed, it was just six weeks ago that many were suggesting that U.S. GDP growth would be not much better than zero in Q1, yet now the forecast is for 2.8% annualized growth.

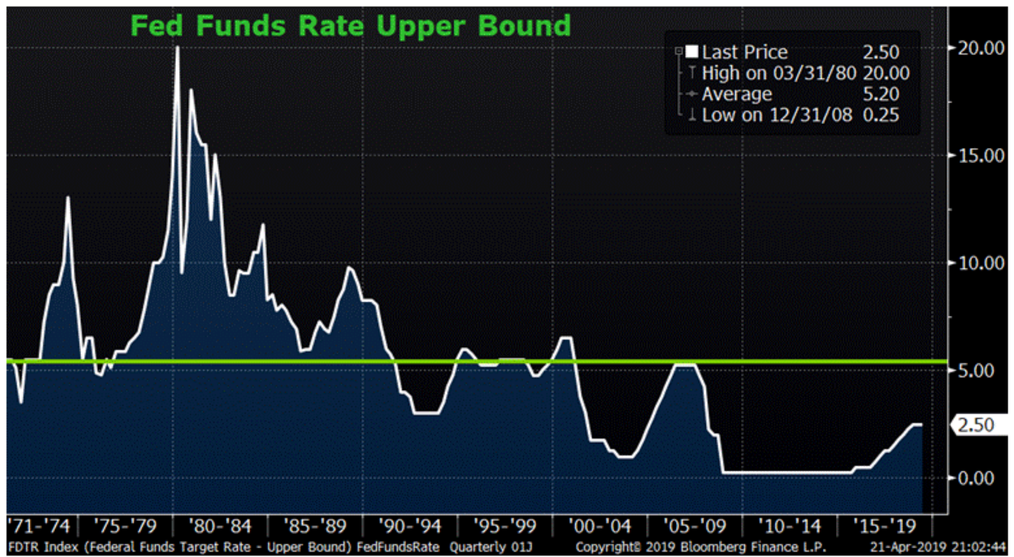


Even better, comments from a couple of Federal Reserve officials last week indicated that the stronger economy is not likely to lead to a near-term shift back toward a tightening of monetary policy. Dallas Fed President Robert Kaplan said, "For the time being, I don't see any reason to change our policy setting," adding, "I don't think inflation is running away from us." Mr. Kaplan also told *The Wall Street Journal* that the Fed might maintain the current Fed Funds rate target "in the neighborhood of where it is for some period of time, even if the economy keeps growing at the current solid pace."

For his part, Chicago Fed President Charles Evans explained, "The economy's performance in 2018 was about as close to bliss as a central banker can imagine." Mr. Evans added that he expects U.S. GDP growth of 1.75% to 2.0% this year, stating, "We're not looking at bad numbers; still, the economy won't feel like it is doing very well compared with last year's very strong performance. The fundamentals for growth in the U.S. remain good and the job market should remain healthy." Given that he believes, "With appropriate monetary policy, I expect core inflation to remain consistent with our 2% objective in the near to medium term," Mr. Evans is now of the mind, "I do have the expectation that towards the fall of 2020 we have one rate increase, and one more rate increase the following year."

Fed is Still Accommodative

While concerns just a few months back that Jerome Powell & Co. were not "dovish" enough have vanished, it is interesting that the Fed's long-run target for the Fed Funds rate remains at 2.8%, the same as in Dec. 2018 and a figure that is well below the long-term 5.20% average.



Of course, even with a rate hike or two from the current 2.25% to 2.5% Fed Funds rate, Jerome Powell & Co. remain quite friendly, with the very low interest rate backdrop bolstering the case for equities.

To be sure, we cannot expect the 2019 rally to continue unabated, but we do like that there remains plenty of nervousness about the advance, whether it is sentiment and fund flows data,…

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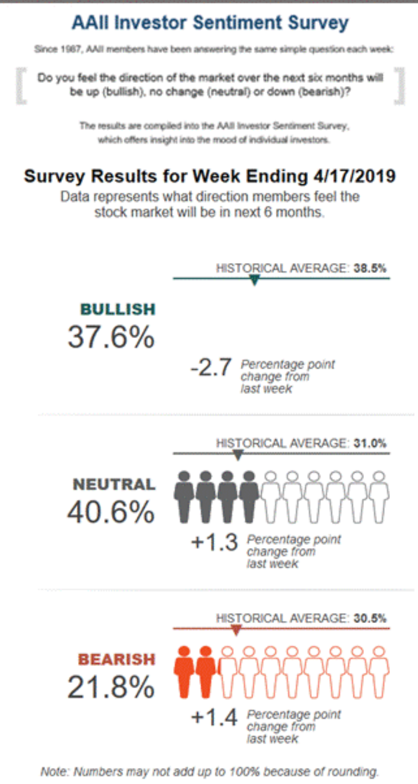
Massive Rally Yet Investors Not Optimistic



Interestingly, despite a 24%+ advance in the S&P 500 since the Christmas Eve closing low, the number of Bulls in the latest AAII Sentiment Survey was below average. True U.S. stock funds and ETFs saw net inflows in the latest week, but bonds have long been garnering far more investor affection.

Combined Estimated Long-Term Fund Flows and ETF Net Issuance
Millions of dollars

Week Ended	4/10/2019	4/3/2019	3/27/2019	3/20/2019	3/13/2019
Total Equity	5,811	-7,496	-11,085	-2,145	12,310
Domestic	6,210	-7,465	-10,896	1,474	12,827
World	-400	-31	-190	-3,619	-517
Hybrid	-122	-3,575	-199	-636	-1,420
Total Bond	7,814	11,275	7,884	10,552	11,322
Taxable	6,676	9,783	5,528	8,660	8,807
Municipal	1,138	1,492	2,356	1,892	2,515
Commodity	-286	-983	141	393	207
Total	13,217	-778	-3,259	8,163	22,419

Source: Investment Company Institute

…or *The Wall Street Journal* running a column this weekend entitled, “As Stocks Climb, Some Investors are Wondering When to Get Out.” The story reminded folks that the S&P 500 gain enjoyed so far this year is the eight best since the 1920s, with several strategists and fund managers arguing that the rally has gone too far. Of course, little attention was given to the fact that the major market averages generally have merely recovered the plunge endured in the fourth quarter of 2018.

Obviously, we have no crystal ball when it comes to market timing, nor does anyone else for that matter, but we continue to believe that far more money has been lost in trying to avoid downturns, corrections and Bear Markets than has been lost in those events themselves, so we see no reason to alter our long-term investment plan.

Indeed, we simply continue to buy and patiently harvest a broadly diversified portfolio of what we believe to be undervalued stocks, generally of dividing-paying companies, to be held for their long-term appreciation potential. And, given that it is a market of stocks and not simply a stock market, we point out that there are plenty of names that have posted sizable losses since the last time the S&P 500 was trading above the 2900 level back in September.

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Worst TPS Performers Since S&P 500 High

Laggards Since S&P 500 High 9.20.18

Symbol	Common Stock	TR Since 9.20.18	4.18.19 Price	Target Price	Sector	P/E	P/S	P/TBV	ROCE	EV/ EBITDA	FCF Yld	Debt/ TE (%)	Div Yld	Mkt Cap
NOV	National Oilwell Varco	-36.9	$26.97	$36.76	Energy	nmf	1.2	2.3	-0.2	13.1	2.7	60%	0.7%	10,409
WRK	Westrock	-36.2	$35.49	$71.17	Materials	8.8	0.5	nmf	7.9	7.1	13.7	nmf	5.1%	9,063
TPR	Tapestry Inc	-34.1	$32.55	$56.11	Consumer Durables	12.1	1.6	35.9	22.7	8.3	9.7	609%	4.1%	9,439
BIIB	Biogen	-33.7	$226.39	$424.18	Pharma, Biotech	8.6	3.3	10.6	34.5	6.6	11.7	141%	0.0%	44,533
CVS	CVS Health	-32.7	$52.63	$105.57	Health Care Equip/Srvcs	7.5	0.4	nmf	-1.2	21.7	12.4	nmf	3.8%	68,335
COHU	Cohu Inc	-30.2	$14.83	$23.33	Semiconductors	9.6	1.3	nmf	-7.7	nmf	6.7	nmf	1.6%	605
FLR	Fluor Corp	-29.7	$41.05	$56.83	Capital Goods	15.3	0.3	2.5	7.1	7.6	-0.9	73%	2.0%	5,731
DBI	Designer Brands	-27.9	$22.50	$32.32	Retailing	13.6	0.5	2.4	-2.3	12.3	6.1	23%	4.4%	1,701
HFC	HollyFrontier	-27.4	$47.34	$81.93	Energy	7.3	0.5	2.5	19.4	4.8	15.0	74%	2.8%	8,084
SLB	Schlumberger Ltd	-24.3	$45.56	$89.19	Energy	29.4	1.9	21.3	5.5	11.9	5.3	554%	4.4%	63,145
WBA	Walgreens Boots Alliance	-24.2	$54.63	$102.33	Food & Staples Retailing	8.9	0.4	nmf	19.7	8.7	9.0	nmf	3.2%	49,948
HAL	Halliburton	-22.0	$31.13	$54.00	Energy	16.4	1.1	4.1	18.6	8.8	4.1	156%	2.3%	27,169
ALB	Albemarle	-21.9	$82.57	$130.00	Materials	15.0	2.6	5.4	19.1	9.3	-1.7	86%	1.8%	8,743
FDX	FedEx	-19.2	$198.15	$301.75	Transportation	12.1	0.7	4.0	18.7	8.5	2.6	133%	1.3%	51,633
CCL	Carnival Corp	-18.5	$53.63	$80.47	Consumer Services	12.7	1.9	1.8	12.7	9.0	0.7	45%	3.7%	36,861
KEY	KeyCorp	-17.5	$16.79	$26.71	Banks	9.4	nmf	1.4	12.3	nmf	nmf	nmf	4.1%	16,816
IP	International Paper	-16.8	$44.43	$68.89	Materials	8.3	0.8	5.0	29.0	6.7	9.1	279%	4.5%	17,838
ONB	Old National Bancorp	-16.7	$16.87	$22.02	Banks	13.1	nmf	1.9	7.9	nmf	nmf	nmf	3.1%	2,960
MOS	Mosaic Co	-16.1	$27.07	$49.97	Materials	12.8	1.1	1.2	4.7	7.9	4.5	52%	0.4%	10,443
CMA	Comerica	-16.0	$78.25	$107.00	Banks	10.0	nmf	1.8	16.7	nmf	nmf	nmf	3.4%	12,129
GT	Goodyear Tire & Rubber	-15.5	$20.51	$32.25	Autos & Components	8.9	0.3	1.1	14.6	5.1	2.6	123%	3.1%	4,764
MCK	McKesson	-15.5	$114.10	$191.58	Health Care Equip/Srvcs	8.5	0.1	nmf	nmf	21.3	11.0	nmf	1.4%	21,887
GILD	Gilead Sciences	-14.3	$62.95	$108.18	Pharma, Biotech	9.4	3.6	52.4	26.1	7.9	9.2	1604%	4.0%	80,255
CAH	Cardinal Health	-14.1	$46.00	$79.94	Health Care Equip/Srvcs	9.2	0.1	nmf	-0.6	11.5	12.1	nmf	4.1%	13,709
ADM	Archer-Daniels-Midland	-13.7	$42.76	$55.97	Food, Beverage & Tobacco	12.2	0.4	1.6	9.7	10.9	-23.3	52%	3.3%	23,949

As of 4.18.19. nmf=Not meaningful. ROCE = Return on Common Equity. TBV = Tangible book value. EV/EBITDA = Enterprise value to earnings before interest, taxes, depreciation and amortization. FCF Yield = Free Cash Flow Yield

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/, Chris Quigley and Jason Clark offer updates on numerous companies that had news last week that was of sufficient importance to trigger a review of their respective Target Prices.

Our favorite litigator that also happens to manufacture semiconductors, **Qualcomm**, (QCOM – $79.89) did the almost-unthinkable on Tuesday. Qualcomm settled with **Apple** (AAPL – $203.86), sending its shares soaring 40% higher for the week. For its part, Apple saw its stock gain 2.5% on the week as the consumer electronics giant will be able to deploy Qualcomm’s 5G modem chips in its next-generation iPhones as it looks to compete with other Qualcomm-supplied rivals.

Qualcomm scores an important victory, especially as Apple had been withholding billions of dollars in royalties, and a courthouse loss could have gravely impacted the companies core licensing business. We wrote in September, “We think that the company has significant upside should it be able to settle its long-playing disputes with Apple,” and last week’s market reaction provided a nice reward for our patience. The multi-year spat was ugly and costly, but Qualcomm

and Apple were able to reach a six-year agreement (plus a two-year option to extend) and drop all litigation worldwide effective April 1, 2019. Qualcomm expects the deal to add around $2 EPS per year, plus the company will receive an unspecified one-time payment from Apple.

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QCOM – Stunning Litigation Settlement

Qualcomm and Apple reach multi-year agreement

Global patent license agreement; chipset supply agreement; litigation to be dismissed

- Direct license between Apple and Qualcomm: six years with two-year option to extend
  - Effective as of April 1, 2019
  - Apple will pay royalties to Qualcomm
- Settlement includes a one-time payment from Apple to Qualcomm
- Multi-year chipset supply agreement
- All worldwide litigation will be dismissed and withdrawn, including claims involving Apple's contract manufacturers

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- Contributes to increased stability for licensing business
- Reflects value and strength of Qualcomm's intellectual property

Expect incremental EPS of ~$2.00 as product shipments ramp[1]

[1]Financial impacts include both the global patent agreement and the chipset supply agreement based on current market conditions and are subject to final review of agreements for tax and accounting treatment
Note: We will provide further updates on our second quarter earnings call scheduled for May 1, 2019

While the announcement resulted in a massive move up for QCOM, the press release was short on details and included no management quotes. We assume that both companies will have more details to share on their respective quarterly earnings calls. Apple's is scheduled for April 30, while Qualcomm's is scheduled for May 1.

The news sent ripples through the chip sector and sent shares of **Intel** (INTC – $58.49) up a little less than 4% and **Marvell Technology** (MRVL – $24.85) up a little less than 5% on the week. Intel announced the following day that it would be dropping out of the 5G chip business, which was not surprising given that it reportedly started to manufacture those chips at the request of Apple as they were seeking to diversify away from QCOM products. There were also significant manufacturing challenges, so we think the move is hardly a bad thing. Marvell got a price target boost from Citi, with analyst Atif Malik writing, "We view MRVL as the best way of playing the second wave of 5G cycle spend," while we generally have been liking how that chipmaker has been executing in recent quarters.

Not surprisingly, the Wall Street analyst community was quick to raise their ratings on Qualcomm, while the consensus estimate for QCOM's fiscal 2019 EPS now stands at $4.10, up from $3.85 a week ago, and for 2020 the projection is now $5.06, up from $4.49 a week ago. We suspect those figures will continue to rise. All of the above in mind, our Target Prices for Apple, Qualcomm, Intel and Marvell have been boosted to $219, $86, $65 and $27, respectively.

Shares of **International Business Machines** (IBM – $140.33) fell 2.8% last week as the company reported Q1 2019 results. IBM earned $2.25 per share, compared to the analyst consensus estimate of $2.22, and had revenue of $18.2 billion, versus the consensus of $18.5 billion. IBM is still struggling to gain momentum on its turnaround plan, with all of the company's segments missing analyst revenue expectations except for the Cloud. The company's gross margin was 43.7%, versus an estimated 44.7%. IBM still expects 2019 operating EPS of at least $13.90 and free cash flow of about $12 billion.

CEO Ginny Rometty was absent from the analyst call. CFO James Kavanaugh said, "Our cloud and cognitive software was up 2% and our consulting revenue was up 9% also both at constant currency. We had significant margin expansion with operating gross margin up 90 basis points, driven by both services segments and we had solid free cash flow. Improving margin has been a focus for us. And our performance this quarter is the result of actions we've been taking, not only our focus on higher value and portfolio optimization, but also driving productivity and operational efficiency, especially in our services business."

On the topic of the balance sheet, Mr. Kavanaugh added, "We've returned $2.3 billion to the shareholders in the quarter, including $1.4 billion of dividends and over $900 million of gross share repurchases. That's $10.3 billion over the last 12 months. We bought back nearly 7 million shares and at the end of the quarter, we had $2.4 billion remaining in our buyback authorization. We plan to suspend share repurchase in 2020 and 2021 as we pay down debt for our Red Hat acquisition to get back to our targeted leverage ratio. We closed the quarter with a cash balance of over $18 billion and total debt of $50 billion. Free cash flow is on track and our balance sheet reflects the strength required to support our continuing investments and return to shareholders."

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. The Red Hat acquisition is expected to close later this year, and we remain enthused about the prospect that Red Hat'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 Red Hat 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 10.3 times earnings and yields 4.5%. Our Target Price now resides at $185.

Global staffing solutions company **ManpowerGroup** (MAN – $97.04) earned $1.39 per share in fiscal Q1 2019 (vs. $1.36 est.). MAN had sales of $5.05 billion (vs. $4.97 billion est.). The earnings beat propelled shares higher by more than 11% as stabilization in France and Italy helped shore up earnings despite ongoing slowing in Germany and the Netherlands. Excluded

from the $1.39 of adjusted EPS is $0.51 of restructuring charges, which include things like organizational simplification in front and back office activities that are not expected to be recurring business items.

CFO John McGinnis explained, "Our first quarter performance resulted in an operating profit decline, excluding restructuring costs of 18%, or 12% on a constant currency basis, on a revenue decline of 2% in constant currency. This reflects operational deleveraging, as the revenue decline in the current period compared to the mid-single digit revenue growth in the prior year. This combined with strong cost management during the quarter results in an operating profit margin at the midpoint of our guidance of 2.9% before restructuring costs. Within our Manpower brand, approximately 60% of the gross profit is derived from light industrial skills and 40% is derived from office and clerical skills. Light industrial skills experienced a slightly higher rate of decrease in gross profit during the quarter, compared to office and clerical skills. A trend that was largely in line with the fourth quarter experience."

Mr. McGinnis added, "We are forecasting earnings per share to be in the range of $1.96 to $2.04, which included a negative impact from foreign currency of $0.10 per share. Although this guidance includes the operating results related to our Switzerland acquisition, it does not include a one-time non-cash purchase accounting gain, which we plan to disclose separately as part of our second quarter results. Our constant currency revenue guidance range is between negative 1% and positive 1%. Walking from the midpoint of flat constant currency growth, the impact of acquisitions net of dispositions reduce revenues by about 1.5% and due to a lower day count the billing days adjusted organic constant currency revenue decline is 1% in second quarter, which is the continuation of the 1% decline in a first quarter on the same basis."

We continue to like MAN's broad geographic footprint, wide range of offerings, good expense management and solid balance sheet. We think that the mixed bag in Europe continues to be both a point of concern and a bright spot due to the potential for the macroeconomic environment to tilt either direction there. The labor market can also vary substantially by region, too. After a tough 2018, we think that the strong start to 2019 can be built upon. Manpower remains highly profitable with a forward P/E ratio of 12.1 and a dividend yield of 2.1%. While we think the double-digit percentage one-day move was an overreaction, MAN shares have often had big moves in response to quarterly results. Our Target Price is now $135.

Oilfield services firm **Schlumberger Ltd** (SLB – $45.56) reported earnings per share of $0.30, matching the consensus estimate, in fiscal Q1 2019. SLB had sales of $7.88 billion (vs. $7.80 billion est.). Shares initially rose on the news but ended up closing 3.9% lower on Thursday and flat overall for the week. SLB saw seasonally lower international activity and an expected reduction in North America land activity, although improved activity in South America helped partially offset the declines.

CEO Paal Kibsgaard offered a macro view, "The significant drop in oil prices in the fourth quarter was driven largely by the U.S. shale production surprising to the upside as a result of the surge in activity earlier in the year, and by geopolitics negatively impacting global supply and demand balance sentiments. The combination of these factors, together with the large sell-off in the equity markets due to concerns around global growth and increasing U.S. interest rates,

created a near perfect storm to close out 2018.Looking forward to 2019, we expect the supply and demand balance sentiment and the oil prices to improve over the course of the year, as the OPEC and Russia cuts take full effect, the lower activity in North America land in the second half of 2018 impacts production growth, the dispensations from the Iran export sanctions expire and are not renewed, and as the U.S. and China continue to work towards a solution to their ongoing trade dispute. So far in January, Brent oil prices are already up around $10, supporting this improving outlook."

Mr. Kibsgaard continued, "Not surprisingly, the recent oil price volatility has introduced less visibility and more uncertainty around the E&P spend outlook for 2019, with customers generally taking a more conservative approach to the start of the year, again delaying the broad-based recovery in E&P spend that we expected only three months ago. However, from our customer discussions, we are seeing clear signs of E&P investment sentiments starting to normalize in the various parts of the world and heading towards a more sustainable financial stewardship of the global resource base. In the international markets, outside the Middle East and Russia, this means that after four years of underinvestment and focus on maximizing short-term cash flow, the NOCs and independents are starting to see the need to invest in their resource base simply to maintain production at current levels."

Looking forward, Mr. Kibsgaard said, "We still expect solid year-over-year revenue growth in the international markets in2019, starting off in the mid-single digits for the first half of the year as our customers take a conservative approach due to the recent oil price volatility. Growth rates will be led by Africa, Asia and Latin America as new investment programs are kicked off in these regions, while we continue to see solid, but more nominal growth rates in the North Sea, Russia and the Middle East as existing activity on projects continue to expand. Conversely, for the North America land E&P operators, higher cost of capital, lower borrowing capacity and investors looking for capital discipline and increased return of capital suggest that future E&P investments will likely be at levels much closer to what can be covered by free cash flow. Assuming the trend of increased capital discipline continues in2019 and WTI oil prices steadily recover to average the same realized level as 2018, we expect E&P investments in U.S. land to be flat to slightly down compared to 2018, with a relatively slow start to the year."

SLB expects capital expenditures to be in the $1.5 billion to $1.7 billion range with sufficient cash flows to cover all business needs without needing to tap the debt markets. We like management's attitude about evolving for the future and we see SLB not only surviving the turbulence in the oil patch but thriving from a sustained upturn in the historically cyclical industry. We think its global income diversification is a positive and believe SLB is the clear technology leader with an important reputation for consistent execution. We are fond of the firm's ability to generate solid free cash flow and the handsome 4.4% dividend yield the shares currently offer. Our Target Price for SLB has been pared to $89.

Pharmaceutical giant **Johnson & Johnson** (JNJ – $137.52) posted earnings per share of $2.10, versus the $2.04 estimate, in fiscal Q1 2019. JNJ had sales of $20.0 billion (vs. $19.6 billion est.). Shares moved up 1.1% following the announcement. Management said that it is seeing strong execution on long-term strategies, while global pharmaceutical growth has tended to be volume growth rather than price growth.

JNJ's VP of Investor Relations Chris Del Orefice commented, "Worldwide sales were $20 billion for the first quarter of 2019, an increase of 0.1% versus the first quarter of 2018. Operational sales growth, which excludes the effect of translational currency, increased 3.9% as currency had a negative impact of 3.8 points. In the U.S., sales increased 1.8%. In regions outside the US, our reported growth declined by 1.7%. OUS operational sales growth was 6% with currency negatively impacting our reported OUS results by 7.7 points. Excluding the net impact of acquisitions and divestitures, adjusted operational sales growth was 5.5% worldwide, 3.1% in the U.S., and 7.9% outside the U.S."

Mr. Del Orefice continued, "Both cost of products sold and selling, marketing and administrative margins for the quarter slightly improved primarily driven by favorable segment mix. We continue to invest in R&D at competitive levels and our investment in research and development this quarter as a percent of sales was 14.3%, which is higher than the first quarter 2018 by over 200 basis points. This increase was primarily driven by higher pharmaceutical milestone payments, including the $300 million milestone payment to argenx associated with our worldwide license and collaboration agreement as well as higher investments in our overall portfolio. Net interest expense was lower by $142 million as a result of higher rates of interest earned, as well as lower average debt balance."

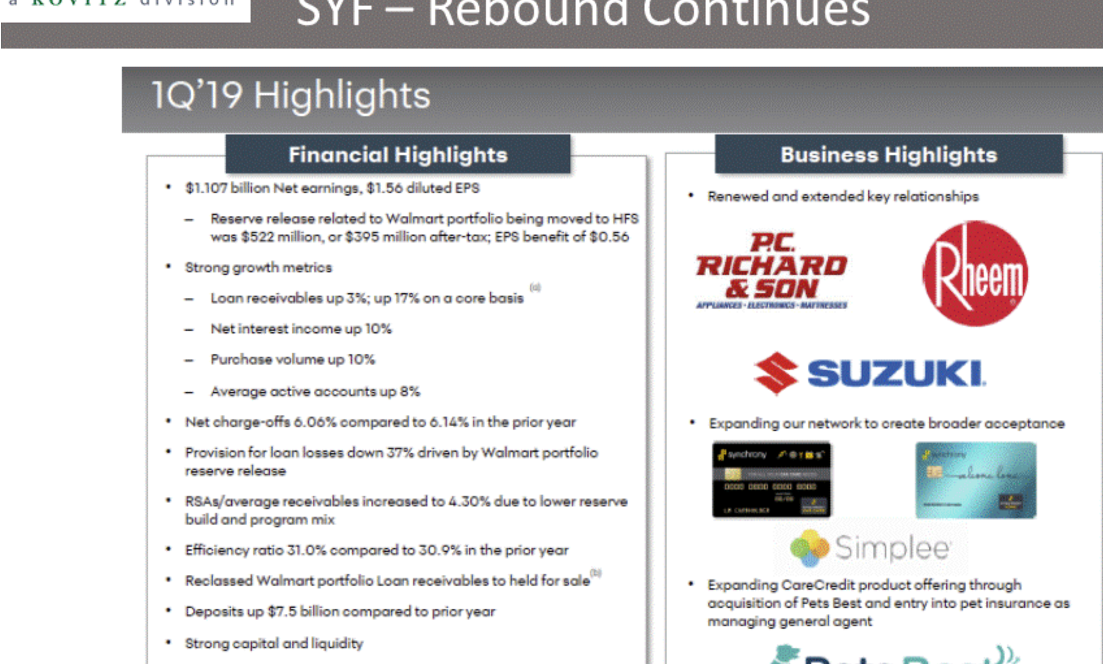
As far as guidance, CFO Joe Wolk said, "Our first quarter results have elevated our confidence in our performance, strengthening the outlook for our operational sales growth. As a result, we are increasing our guidance by 50 basis points, reflecting full year adjusted operational sales growth of 2.5% to 3.5% and operational sales growth of 0.5% to 1.5%. The negative impact of translational currency, however, has increased, but we plan to absorb that impact with the strength of our operational sales outlook I just referenced. Therefore, our expectation for total reported sales in 2019 remains the same. We are increasing the high-end of the range for adjusted operational EPS by $0.03 per share, and we're also tightening the range reflecting an increase of $0.05, bringing the midpoint to $8.78 per share."

We continue to like the product mix and that the majority of its pharmaceutical offerings are specialty drugs, which frequently carry stronger pricing power. We are also comforted by the firm's recent acquisitions, including Auris Health (a digital/robotic surgery maker), which add further diversification. We continue to view the company as uniquely situated with unmatched depth and breadth in growing global health care markets, and we think that there is solid potential for a number of its compounds in clinical trials. Shares trade for 15.8 times forward earnings estimates, with a yield of 2.6%. On the negative side of the equation, Imeys Talc and JNJ face more than 2,400 lawsuits and 14,000 claims over baby powder's cancer links, which we believe continues to be a risk to the company's balance sheet and earnings targets. The suits generally allege that the asbestos in JNJ's baby powder caused ovarian cancer or mesothelioma. Our Target Price has been lifted to $151.

Shares of **Synchrony Financial** (SYF – $33.34) increased more than 2% last week after reporting Q1 financial results and are now up more than 42% in 2019, following a very rocky 2018. The financial services concern said that net interest income increased 10% from the first quarter of 2018 to $4.2 billion. Excluding the Walmart loan portfolio which SYF is in the process of selling off (after losing the relationship), loan receivables increased 17% on a year-

over-year basis to $79.7 billion. The company reported adjusted EPS for Q1 of $1.00, which was solidly above the consensus estimate of $0.89.

The PayPal relationship is definitely paying dividends and helping to offset the eventual loss of the WalMart account. The Walmart loan portfolio is slated to be sold in Q3 or Q4, and while this will impact near-term performance, we would expect that the portfolio will not be hard to sell and some of the proceeds will be used to further reduce share count and others utilized to strengthen the firm's financial position and long-term business prospects. SYF management is still targeting loan growth of 5% to 7% for 2019, which seems reasonable to us.



CEO Margaret Keane commented, "We are maintaining the momentum we generated over the last several quarters. Our focus on organic growth, program renewals, valuable strategic partnerships, forward-thinking technology investments, and actionable data analytics, continue to be key factors in driving solid growth and strong partnerships. Synchrony's balance sheet remains strong as we continue to focus on creating value for shareholders through growth, portfolio acquisitions, and the execution of our capital plan."

SYF shares trade at just 7.4 times NTM adjusted EPS consensus estimates and yield 2.5%. Our Target Price has been lifted to $51.

Shares of regional bank **KeyCorp** (KEY – $16.79) had an up and down week, ending off less than 1%. KEY reported Q1 earnings of $0.40 per share, versus the consensus analyst estimate of $0.41. Revenue for the period of $1.52 billion also came in almost 5% below expectations. Net interest income for the quarter was largely in line with expectations, but fee income missed investor expectations. KEY maintained its guidance for full-year 2019 of $4 billion to $4.1 billion in net interest income and $2.5 billion to 2.6 billion in fees. The big disappointment in Q1 was in investment banking. Management did explain on the conference call that it was more of a timing issue with the government shutdown and delays in deal closings. The IB pipeline seems strong and should drive much stronger momentum for the rest of the year.

CEO Beth Mooney said, "Our results this quarter reflect solid underlying trends in our core businesses, strong expense management and continued strength in credit quality. Revenue benefitted from continued balance sheet growth, including an 8% increase in commercial and industrial loans from the same period last year, and a 5% increase in average deposits. Fee income this quarter declined, primarily due to lower capital markets income, driven by both seasonality and the timing in closing certain transactions. We continued to execute against our continuous improvement plans across the company, driving a meaningful reduction in our expenses, down 7%, excluding notable items, from the year-ago period. Importantly, we remain confident in reaching our targeted cash efficiency ratio of 54% to 56% in the second half of 2019."

Ms. Mooney went on to say, "We have also continued to use our strong capital position to support organic growth and return capital to our shareholders. This morning, we announced our capital plans, beginning in third quarter of 2019. These plans include a 9% increase in our common share dividend, from $.17 to $.185, in the third quarter of this year, subject to approval of our Board of Directors. We plan to repurchase up to $1 billion in common shares over the same period."

We continue to like Keycorp and think that the recent acquisition of Laurel Road Banks' digital lending business is interesting. We also believe that the bank's efficiency can continue to improve as it benefits from the full integration of its recent acquisitions. Shares currently trade at less than 9 times NTM adjusted earnings expectations and carry a 4.1% dividend yield. Our Target Price now stands at $27.

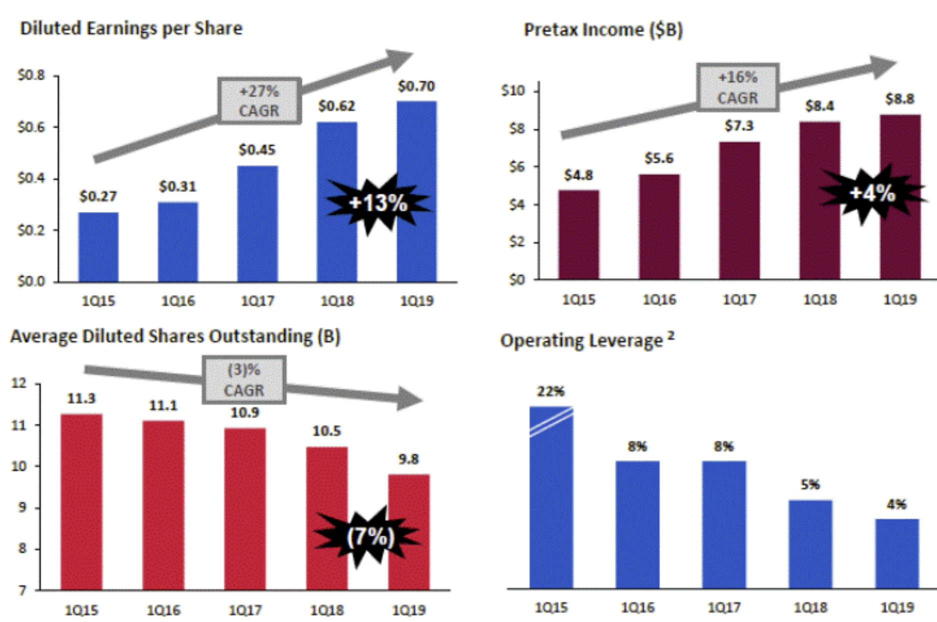
Diversified financial firm **Bank of America** (BAC – $30.03) reported earnings per share of $0.71, versus the $0.66 estimate, for Q1 2019. While revenue of $23.2 billion outpaced analyst expectations, like many in the space, top-line growth was muted, but underlying cost controls and non-interest income streams helped drive favorable bottom-line results. Overall, expenses were down 4%, and with the average diluted share count down 7%, earnings per share increased 13%. The efficiency ratio came in at 57.5% and return on average assets came in at 1.26%, while return on tangible common equity came in at 16%, with all three representing improvements over last year.

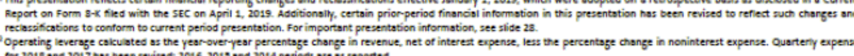
BAC CEO Brian Moynihan said, "Our diverse business mix and commitment to responsible growth drove record quarterly earnings. Economic growth and consumer activity in the U.S. continue to be solid, businesses of every size are borrowing and driving the economy, and asset

quality is strong. It was a challenging capital markets environment but our team and platform are optimized to serve clients and generate stable revenues across a range of market conditions over time. We reduced expenses by 4% from the first quarter of 2018, contributing to the seventeenth consecutive quarter of positive operating leverage. We are well positioned for continued solid results the right way. And we are building on that. We'll add 350 financial centers in new and existing markets by 2021. Our network will provide coverage for more than 90% of the U.S. population. We continue to share success: We will raise the minimum starting pay in our company to $20 over the next twenty-four months; we'll help 20,000 low-to-moderate income clients become homeowners; and we extended our Environmental Business Initiative to $300 billion over 10 years to help create a low-carbon sustainable future. We serve by asking the simple question to customers, employees, and communities: 'What would you like the power to do?' We listen to them and serve them with a team that is second to none."

CFO Paul Donofrio commented, "The strength of our balance sheet allowed us to return our record earnings and additional excess capital to shareholders. We repurchased $6.3 billion in common stock and paid $1.5 billion in common dividends. Those repurchases contributed to a 13% increase in EPS compared with the first quarter of 2018 while book value per share increased eight%. Our diluted share count now has been reduced by 1.5 billion shares in the past four years."

THE PRUDENT SPECULATOR
BAC – Excellent 5-Year Trends




[1] This presentation reflects certain financial reporting changes and reclassifications effective January 1, 2019, which were adopted on a retrospective basis as disclosed in a Current Report on Form 8-K filed with the SEC on April 1, 2019. Additionally, certain prior-period financial information in this presentation has been revised to reflect such changes and reclassifications to conform to current period presentation. For important presentation information, see slide 28.
[2] Operating leverage calculated as the year-over-year percentage change in revenue, net of interest expense, less the percentage change in noninterest expense. Quarterly expense for 2018 and 2017 has been revised; 2016, 2015 and 2014 periods are as reported.

We continue to be fans of BAC and see it as one of our core financial holdings, though the dividend yield is presently *only* 2.0%. We see numerous long-term opportunities upon which BAC can capitalize, from its large deposit base and consumer lending franchise to its "thundering herd" of Merrill Lynch's financial advisors and wealth managers. Credit quality remains solid and the stock is trading for just 10.2 times NTM estimated EPS. Our Target Price has been bumped up to $41.

Financial services company **Comerica** (CMA – $78.25) earned $2.08 per share in Q1, versus the consensus analyst estimate of $1.93. Revenue for the period of $852 million came in slightly below forecasts. CEO Ralph Babb, Jr. explained, "First quarter results were solid and this year is off to a good start. Earnings per share increased 12% over fourth quarter and 33% over first quarter last year. Our results demonstrate our ability to drive broad-based loan growth, while carefully managing loan and deposit pricing as well as maintaining favorable credit metrics and controlling expenses. We continued our share buyback program, repurchasing 5.1 million shares. Altogether, this drove our ROE above 18% for the quarter."

Mr. Babb continued, "Credit quality remained strong in the first quarter. Both net charge-offs and nonperforming assets remained low at 8 basis points and 40 basis points, respectively. Total criticized loans increased slightly from a record low level and represented only 3.6% of total loans as of quarter end. Sustained strong performance of the overall portfolio as well as continued solid economic conditions across our geography and within industry exposures resulted in a small release in the reserve and a reserve ratio of 1.29%. We remain vigilant, closely monitoring our portfolio for signs of stress; however, at this point, we are not seeing any concerning trends."

For full-year 2019 compared to the full-year 2018, management expects growth in average loans of 2% to 4%. Additionally, management forecasts net interest margin should expand by 3% to 4% and noninterest expense should fall by up to 2%. The target for 2019 common equity tier 1 capital ratio is 9.5% to 10% through continued return of excess capital.

While we know that CMA faces headwinds, especially with the potential for rates to stay lower for longer with the Fed back on the sidelines, we like the company's improved balance sheet flexibility that should help drive future EPS growth and return of capital to shareholders. Despite having one of the most attractive deposit franchises, CMA trades for just 9.5 times NTM adjusted EPS estimates and yields 3.4%. Our Target Price has been boosted to $107.

Diversified bank **Citigroup** (C – $69.67) reported adjusted EPS of $1.87 per share in Q1 (vs. $1.80 est.). Shares ended the week up more than 2%, continuing their strong rebound in 2019 (up more than 33%). Generally in-line revenue for the period was a bit lighter than Q1 2018, but favorable expense control and a lower overall tax rate helped net income growth. Return on tangible common equity reached 11.9%, helping to make management's goal for a full-year number of 12%+ seem achievable.

Citigroup CEO Michael Corbat commented, "Our earnings reflect the progress we are making to improve our return on and return of capital. Both our consumer and institutional businesses performed well and we saw good momentum in those areas where we have been investing, such

as U.S. Branded Cards, Treasury and Trade Solutions, and Investment Banking. Importantly, our strategy in North America consumer banking is showing good early results as we introduce new products and engage with a broader range of customers, through digital channels."

"We increased our Return on Tangible Common Equity to 11.9%, had positive operating leverage for the tenth consecutive quarter and had strong growth in both loans and deposits in our core businesses. We returned over $5 billion to our shareholders during the quarter, contributing to the 11% increase in our earnings per share from a year ago. We further reduced our common shares outstanding, down 9% from a year ago, while maintaining our Common Equity Tier 1 Capital Ratio at 11.9%. We remain committed to executing our strategy and continuing to make steady progress towards our financial targets," Mr. Corbat concluded.

THE PRUDENT SPECULATOR
C – Heading in the Right Direction

Conclusions

Results showed continued momentum across the franchise

– Year-over-year revenue growth across products and regions in GCB[1]

– Solid performance in TTS, Investment Banking and Securities Services[1] in ICG

– Positive operating leverage and continued credit discipline

– Delivered 11% YoY EPS growth, including impact of common share buybacks

– Showed solid progress toward RoTCE target of 12% in 2019

Continued strong capital position

– Common Equity Tier 1 Capital Ratio of 11.9%[2]

– Supplementary Leverage Ratio of 6.4%[2]

– Returned ~$17B of capital to date in current CCAR cycle[3]

Opportunities for continued progress

– Continuing to invest in higher return businesses while maintaining expense discipline

– Delivering consistent results and positioning Citi for improved RoTCE

Note:
(1) In constant dollars. Constant dollar excludes the impact of foreign exchange translation into U.S. dollars for reporting purposes. For a reconciliation of constant dollars to reported results, please refer to Slide 31.
(2) Preliminary. For additional information on these measures, please refer to Slides 28 and 29.
(3) Aggregate capital return in 3Q'18, 4Q'18 and 1Q'19.

Even with improving operational execution, a domestic rising rate environment (over the last couple of years) and faster growth markets around the globe (vs. its U.S. business), we believe that Citi shares trade far from their fair value. C is priced at just 8.8 times NTM adjusted EPS expectations and 90% of book value. We continue to see a more focused and recapitalized Citigroup as prepared to reward investors over the long-term. We like that C has good leverage towards the strong U.S. economy, while also having the potential to show outsized benefits versus its peers from growth in Asia, Latin America and other emerging economies. Even though the company faces plenty of operational headwinds in different segments of its business, we

think the bank is on its way to achieving its low-50s efficiency-ratio target by 2020. Additionally, the current dividend yield now stands at 2.6%, and the bank continues to consistently buy back its stock. Our Target Price for C has been hiked to $106.

Bank of NY Mellon (BK – $48.41) saw its shares fall almost 8% last week after reporting Q1 results prior to the market opening on Wednesday. The disappointing quarter saw the global financial services company post adjusted earnings of $0.94 per share, versus Street expectations of $0.96, with revenue of $3.9 billion also coming up short of forecasts.

Q1 results highlighted the difficult environment that BK continues to face. Revenue was down 7%, driven by declining fee revenue and net interest income compression. While expense control improved, with expenses down 1%, it couldn't overcome operational headwinds, as EPS declined 15%, due in large part to the flattening of the yield curve.

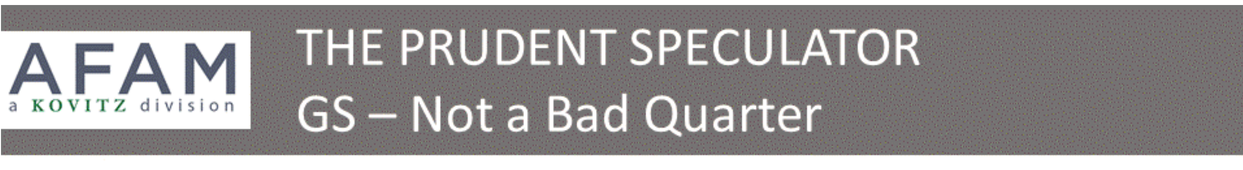
BK CEO Charlie Scharf commented, "Our performance this quarter was mixed. Several of our fee-based metrics in Investment Services were consistent with recent results, while we experienced weakness in Investment Management and net interest income. The year-over-year declines in revenue and earnings per share were primarily driven by the changing mix and cost of our deposits and the impact of the prior year asset management outflows. The impact of divestitures, asset gains and the particularly strong markets and deposit balances in last year's first quarter also made the year-over-year comparison more difficult. Our overall expenses remained well controlled while we continued to increase our investment in technology and infrastructure."

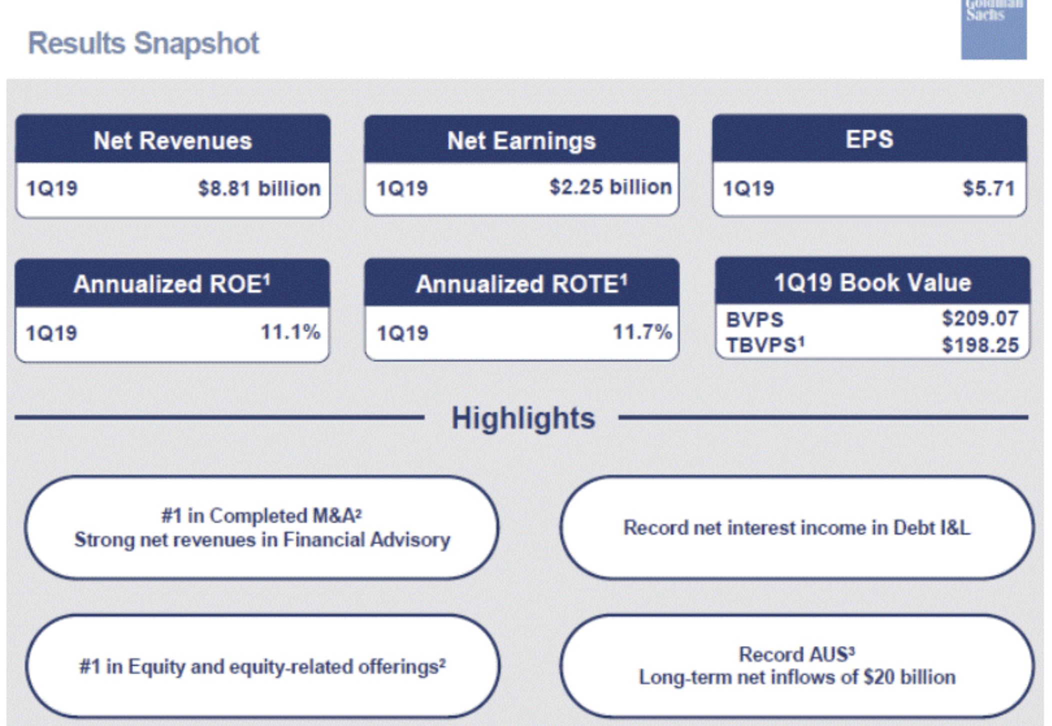
Mr. Scharf added, "While the current expectations for the yield curve will likely negatively impact our revenue growth for the next several quarters, we will remain disciplined on expenses and continue to build out capabilities, which should eventually enable stronger growth. The strategic alliance that we announced with BlackRock Solutions is an example as common clients can immediately gain value. We have said we will work with third parties to more closely integrate the front-to-back operating model, and this is one meaningful example of how we will use our data and tools to benefit our clients, working on our own solutions and with third parties."

While we were disappointed with Q1 and the recent operational performance, we maintain our patience and remain constructive on the fact that management has been adding initiatives to right the ship as BK has struggled with costs, cyclicality of some revenue streams and the overall low interest rate environment. While any benefits from rising interest rates may not be on the near-term horizon, we think BK should be able to add clients as smaller asset managers increasingly outsource administrative and other functions amid a complex regulatory environment. While there is a lot of work yet to do to get BK turned around, we continue to like that the company is well capitalized and that it has a management team that is committed to cost containment and driving growth. BK trades at 11.6 times NTM adjusted earnings expectations and yields 2.3%. Our Target Price for BK has been cut to $62.

Investment banking and brokerage firm **Goldman Sachs Group** (GS – $205.91) posted adjusted earnings per share of $5.71, versus the consensus analyst estimate of $4.97, in Q1 2019. The

bottom-line beat was led by better expense management and a lower tax rate. Unfortunately, investors were seemingly more concerned about a modest top-line miss as revenue of $8.8 billion came in short of forecasts of $8.97 billion, and some 13% below the year-ago period. Management indicated that lower net revenue in Institutional Client Services and Investing & Lending was primarily to blame.





We saw Q1 results as decent enough with annualized return on tangible equity coming in at 11.7%. Goldman ranked #1 globally in year-to-date completed mergers and acquisitions and in equity and equity-related offerings and common stock offerings. CEO Dave Solomon remarked, "We are pleased with our performance in the first quarter, especially in the context of a muted start to the year. Our core businesses generated solid results driven by our strong franchise positions. We are focused on new opportunities to grow and diversify our business mix and serve a broader range of clients globally. With improving momentum across our businesses, we are confident that Goldman Sachs will generate attractive returns for our shareholders."

We continue to be long-term fans of GS and are constructive on the name given the prospects for stronger long-term revenue growth, operating leverage, potential de-regulatory policies and a possible higher earnings multiple than the current forward P/E of 8.4. We like the strategic changes that Goldman is undertaking, but we won't be surprised if it takes a few years for its efforts to begin to be truly rewarded by investors. Management is aiming to expand revenue in

newer, less capital-intensive business lines, while optimizing expenses and capital in its traditional business lines. We believe the company's digital banking platform and expanding emphasis on wealth and asset management should increase long-term returns and drive some underlying stability. Our Target Price is now $287.

In general, health care company shares have materially lagged the equity markets this year after a strong 2018. While, internally, we might be kicking ourselves a bit for not ringing the register on some or all of our **Abbott Labs** (ABT – $73.92) shares when they eclipsed $80 in March, we were glad to see the company turn in a solid Q1 that exceeded both top and bottom-line consensus analyst expectations. Abbott reported adjusted EPS of $0.63, versus forecasts of $0.61. ABT's revenue of $7.5 billion also outpaced expectations by 2%.

While Abbott faced substantial foreign currency headwinds in the quarter, it delivered strong 7% organic revenue growth, along with good expense control. Some of the best performing products in the quarter included the Freestyle Libre continuous glucose monitor and the MitraClip transcatheter mitral valve repair device (which is used to treat clinically significant secondary mitral regurgitation, a leaky heart valve resulting from advanced heart failure), both delivering double-digit growth. As we have written about before, we think the Freestyle Libre has a lot more upside as the monitoring device still remains in the earlier stages of adoption and Jason has personally witnessed the positive impact and ease of use in his home. We are happy that the company continues to try to improve the device as the latest generation lasts longer, is ready for active use faster and works with smart phones. We believe the user-friendliness of Libre and its compelling price should help sway more diabetics away from traditional glucose meter reading devices.

ABT CEO Miles D. White stated, "We're right on track with our expectations to start the year. All of our key long-term growth drivers are performing well and we're targeting another year of strong sales and earnings growth." Indeed, the company projection for full-year adjusted diluted EPS from continuing operations remains unchanged at $3.15 to $3.25, reflecting double-digit growth at the mid-point. We believe that Abbott should be able to continue to enhance its free cash flow generation that can be used to improve the balance sheet, return capital to shareholders and invest in the business. All the positives mentioned, we continue to keep a close eye on ABT shares as the valuation is elevated at 25 times trailing earnings. Nevertheless, our Target Price has been inched up to $82.