# Market Commentary Monday, May 6, 2019

May 6, 2019

**EXECUTIVE SUMMARY**

Week in Review – Another Good Five Days; But the Seventh Day Reignited Trade Worries
Sentiment – Still Not a Lot of Optimism
Jobs – Terrific Labor Report
Econ News – More Good than Not So Good Numbers
FOMC Meeting – Rates Remain Unchanged; Economy Healthy; Inflation Transitory
Interest Rates – Still Very Supportive of Stocks
Valuations – Very Reasonable…for our Portfolios
Ups and Downs – Monday Likely Brutal, But Long-Term Market Trend is Higher
Stock Updates – FLR, AMGN, GILD, RCL, MRK, PRU, ACA, MET, KLIC, HSBC, AAPL, QCOM, HFC, WRK, KIM & CVS

**Market Review**

While the latest set of tweets on Sunday afternoon from President Trump, threatening new tariffs on China by the end of the week, have the equity futures pointing to big losses when trading resumes today, the major market averages closed near all-time highs last week. The Dow Jones Industrial Average pulled back by 0.14%, but the broad-based S&P 500 and Russell 3000 indexes advanced 0.22% and 0.34%, respectively, while Value beat Growth for a change. The Russell 3000 Value index rose 0.59%, compared to a 0.10% increase for the Russell 3000 Growth index.

Interestingly, and a positive from a contrarian sense, despite the big rebound off of the Christmas Eve Bear Market lows, investors are hardly euphoric about the prospects for stocks,…

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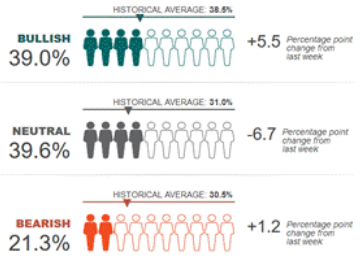
# THE PRUDENT SPECULATOR
## Massive Rally Yet Investors Not Optimistic

### AAII Investor Sentiment Survey

Since 1987, AAII members have been answering the same simple question each week. The results are compiled into the AAII Investor Sentiment Survey, which offers insight into the mood of individual investors.

**Survey Results for Week Ending 5/1/2019**
Data represents what direction members feel the stock market will be in next 6 months.




*Note: Numbers may not add up to 100% because of rounding.*

The AAII Investor Sentiment Survey has become a widely followed measure of the mood of individual investors. The weekly survey results are published in financial publications including Barron's and Bloomberg and are widely followed by market strategists, investment newsletter writers and other financial professionals.

**May 2, 2019**
Optimism about the short-term direction of the stock market rebounded in the latest AAII Sentiment Survey as neutral sentiment receded from its recent high. Pessimism stayed within its recent range.
Bullish sentiment, expectations that stock prices will rise over the next six months, rebounded by 5.5 percentage points to 39.0%. The rise puts optimism a bit above its historical average of 38.5%.
Neutral sentiment, expectations that stock prices will stay essentially unchanged over the next six months, pulled back by 6.7 percentage points to 39.6%. The drop follows last week's three-year high. Even with the lower reading, neutral sentiment remains above its historical average of 31.0% for the 14th consecutive week and the 15th time in 17 weeks.
Bearish sentiment, expectations that stock prices will fall over the next six months, rose 1.2 percentage points to 21.3%. Pessimism is below its historical average of 30.5% for the seventh consecutive week and the 12th time in 13 weeks.

Interestingly, despite near record highs on the major market averages, the number of Bulls in the latest AAII Sentiment Survey was just a smidge above average, while U.S. stock funds and ETFs saw net outflows in the latest week, with bonds continuing to garner plenty of investor affection.

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

| Week Ended | 4/24/2019 | 4/17/2019 | 4/10/2019 | 4/3/2019 | 3/27/2019 |
|---|---|---|---|---|---|
| Total Equity | -16,195 | 4,542 | 5,811 | -7,496 | -11,085 |
| Domestic | -7,240 | 3,993 | 6,210 | -7,465 | -10,896 |
| World | -8,955 | 549 | -400 | -31 | -190 |
| Hybrid | -131 | -976 | -122 | -3,575 | -199 |
| Total Bond | 9,976 | 8,809 | 7,824 | 11,265 | 7,884 |
| Taxable | 7,592 | 7,559 | 6,686 | 9,773 | 5,528 |
| Municipal | 2,384 | 1,250 | 1,138 | 1,492 | 2,356 |
| Commodity | -342 | -101 | -286 | -983 | 141 |
| **Total** | 13,217 | -778 | -3,259 | 8,163 | 22,419 |

*Source: Investment Company Institute*

…even as there was more good news on the health of the jobs market last week. In addition to the ADP Employment report showing a much-better-than-expected 275,000 new private sector payrolls created during April, Uncle Sam turned in a terrific labor report card on Friday,…

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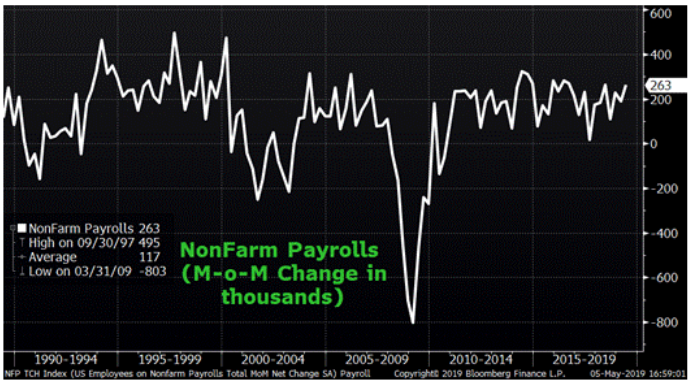
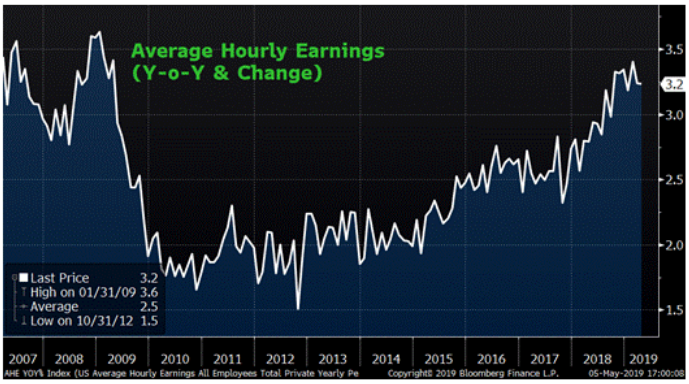
# THE PRUDENT SPECULATOR
## Very Good Employment Report




Uncle Sam said that the number of new jobs created during April jumped to 263,000, well above the consensus forecast in the 180,000 range and significantly better than the revised 189,000 tally for March. Meanwhile, the gain in average hourly earnings came in at 3.2% on a year-over-year basis, matching the advance in March and continuing to suggest that inflation in the labor market is contained.

…with a near-50-year-low on the jobless rate!

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# THE PRUDENT SPECULATOR
## Historic Lows in Jobless Numbers

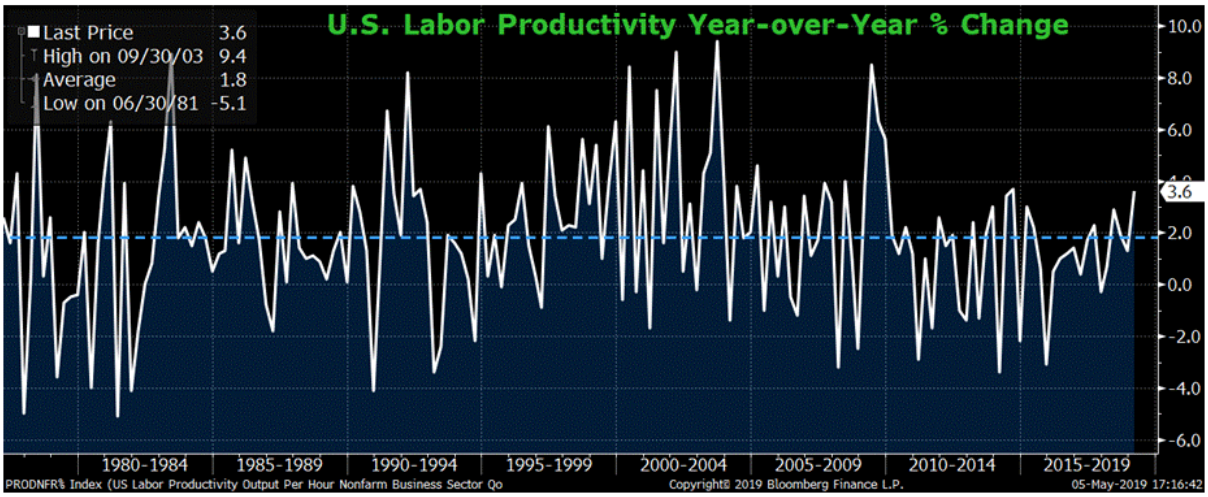


The headline payrolls number in April came in better than expected and the unemployment rate dipped to 3.6% last month, the lowest level in 50 years! And, the latest figures (for the week ended 4.27.19) on first-time claims for unemployment benefits saw 230,000 new filings, still near lows last seen back in December 1969 when the workforce was significantly smaller than it is today.

Other labor-related economic data out last week was also upbeat, with a surprisingly good worker productivity tally,…

# THE PRUDENT SPECULATOR
## Strong Sign for Corporate Profit Growth

It took a far less increase in hours to produce a far greater amount of output in the first quarter, driving productivity sharply higher to a 3.6% annual rate, well above expectations calling for a 1.9% increase. The best showing since Q3 2014, the report bodes well for healthy earnings growth for Corporate America.




…while there was also healthy manufacturing and consumer statistics.

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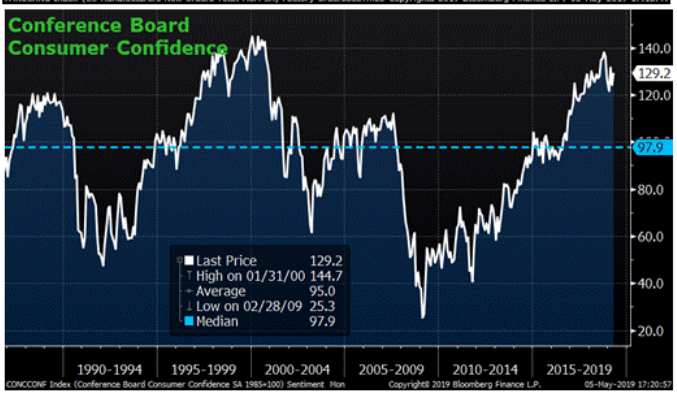
# THE PRUDENT SPECULATOR
## Favorable Econ Numbers


Factory orders rose a better-than-expected 1.9% in March, with a 1.4% bump up in orders of core capital goods (nondefense ex-aircraft) suggesting that Q2 business investment will be strong. The Conference Board's final reading on Consumer Confidence for April came in at 129.2, better than analyst projections and one of the best readings seen since prior to the Financial Crisis / Great Recession.

Of course, all was not completely rosy, as the forward-looking PMI…

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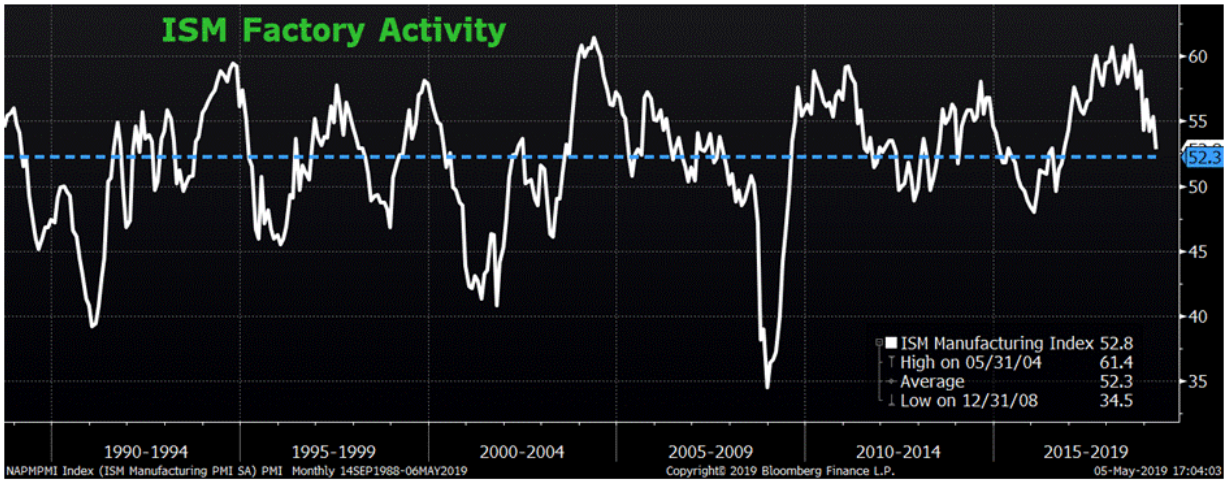
# THE PRUDENT SPECULATOR
## ISM Manufacturing Retreats

The latest read on the health of the factory sector came in at a worse-than-expected and right at the historical average 52.3 for April, with the Institute for Supply Management stating, "The past relationship between the PMI® and the overall economy…corresponds to a 2.9% increase in real gross domestic product (GDP) on an annualized basis."




…and NMI reports from the Institute for Supply Management disappointed.

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# THE PRUDENT SPECULATOR
## ISM Non-Manufacturing Pulls Back

The latest read on the health of the service sector (NMI®) came in at a weaker-than-expected, though still above average, 55.5 for April, with the Institute for Supply Management stating, "The past relationship between the NMI® and the overall economy…corresponds to a 2.4% increase in real gross domestic product (GDP) on an annualized basis."


Weighing the latest economic evidence, we would come to a similar conclusion as did the Federal Reserve last week when Jerome Powell & Co. chose to leave interest rates unchanged at the latest FOMC meeting. The Fed Chair commented, "The Committee also believes that solid underlying fundamentals are supporting the economy, including accommodative financial conditions, high employment and job growth, rising wages, and strong consumer and business sentiment. Job gains rebounded in March after a weak reading in February and averaged 180,000 per month in the first quarter, well above the pace needed to absorb new entrants to the labor force. Although first-quarter gross domestic product (GDP) rose more than most forecasters had expected, growth in private consumption and business fixed investment slowed. Recent data suggest that these two components will bounce back, supporting our expectation of healthy GDP growth over the rest of the year."

To be sure, there was plenty of investor consternation around the fact that the Chair did not seem overly concerned about inflation running below the Fed's 2% target. Quashing hopes of a near-term Fed rate cut, Mr. Powell explained, "The Committee is strongly committed to our symmetric 2% inflation objective. For much of this long expansion, inflation ran a bit below our 2% objective, alongside considerable slack in resource utilization. But last year, with the unemployment rate at or below 4%, inflation moved up. From March through December, core inflation–which excludes volatile food and energy components–was at or very close to 2%. Overall inflation fluctuated from a few tenths above 2% to a few tenths below over this period,

with the moves mostly due to changes in energy prices. As expected, overall inflation fell at the start of this year as earlier oil price declines worked through the system. Overall inflation for the 12 months ended in March was 1.5%. Core inflation unexpectedly fell as well, however, and as of March stood at 1.6% for the previous 12 months. We suspect that some transitory factors may be at work. Thus, our baseline view remains that, with a strong job market and continued growth, inflation will return to 2% over time and then be roughly symmetric around our longer-term objective."

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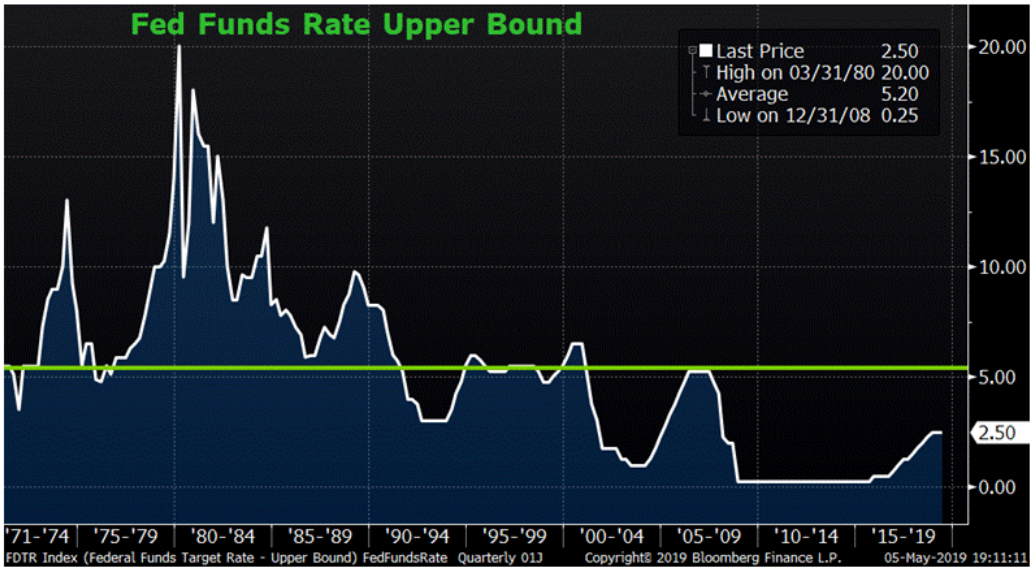
## THE PRUDENT SPECULATOR
## Fed is Still Accommodative

While concerns again have arisen that Jerome Powell & Co. are not "dovish" enough, it is interesting that the Federal Reserve's long-run target for the Fed Funds rate remains at 2.8%, a figure that is well below the long-term 5.20% average.




While we respect that many think that the Fed Funds rate is too high, given very low inflation levels, we continue to believe that the Federal Reserve and the extraordinarily low interest rate climate are very much positives that support the case for equities.

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## Fed Model: Favorable Earnings Yield

The so-called Fed Model suggests that the yield on 10-Year Treasuries should be similar to the S&P 500 Earnings Yield, which is the inverse of the P/E ratio. If the 10-Year is greater than the S&P Earnings Yield, a market is overvalued and if the reverse is true, as it is today, a market is undervalued. Though some argue that the Fed Model is no longer an effective tool, we like today's relatively rich earnings yield of 5.19%.


After all, the dividend yields on our strategies generally are above the yield of the 10-Year U.S. Treasury, while our trailing and forward P/E ratios are hardly rich.

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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 | 14.0 | 12.5 | 1.1 | 2.2 | 2.9 |
| Select Value | 14.4 | 12.8 | 1.2 | 2.1 | 2.5 |
| Select Dividend | 14.3 | 12.6 | 1.0 | 2.3 | 3.2 |
| Select Focused Dividend | 13.0 | 12.0 | 0.9 | 2.5 | 3.3 |
| Select Focused Value | 14.9 | 13.0 | 1.3 | 2.7 | 2.7 |
| Select SMID Dividend | 13.9 | 12.4 | 0.6 | 1.6 | 2.9 |
| Russell 3000 | 20.6 | 18.3 | 2.0 | 3.2 | 1.9 |
| Russell 3000 Growth | 26.3 | 22.9 | 2.9 | 7.2 | 1.3 |
| Russell 3000 Value | 16.8 | 15.2 | 1.5 | 2.1 | 2.5 |
| Russell 1000 | 19.8 | 18.0 | 2.1 | 3.4 | 1.9 |
| Russell 1000 Growth | 24.5 | 22.1 | 3.1 | 7.6 | 1.3 |
| Russell 1000 Value | 16.4 | 15.0 | 1.6 | 2.1 | 2.5 |
| S&P 500 Index | 19.3 | 17.7 | 2.2 | 3.5 | 1.9 |
| S&P 500 Growth Index | 25.2 | 22.0 | 3.8 | 5.8 | 1.4 |
| S&P 500 Value Index | 15.2 | 14.5 | 1.5 | 2.4 | 2.4 |
| S&P 500 Pure Value Index | 11.9 | 10.8 | 0.6 | 1.3 | 2.8 |

As of 05.04.19. 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.

Not surprisingly, we retain our long-term enthusiasm for our broadly diversified portfolios of what we believe to be undervalued stocks, generally of dividend payers, even as we very much understand that sizable setbacks, such as what appears to be likely in today's trading, are always part of the investment process. No doubt, the markets do not like uncertainty, but we do think that a trade agreement with China will ultimately be made, even as there will be more trials and tribulations along the way.

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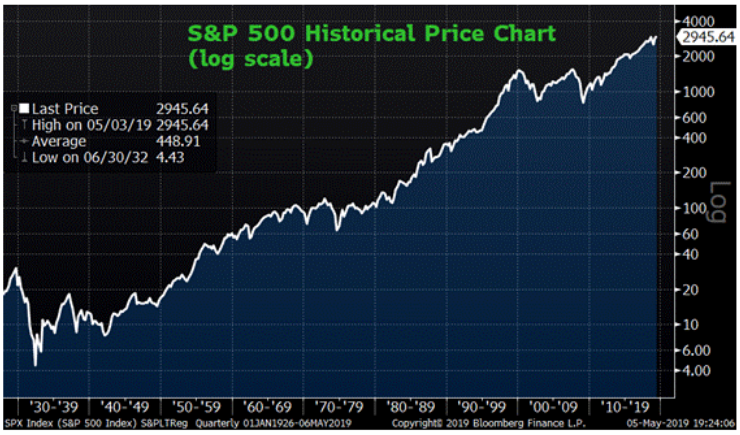
# THE PRUDENT SPECULATOR
## Ups & Downs, But Long-Term Trend Is Up

The 2018 Bear Market, the Bursting of the Tech Bubble in 2000-2002 and the Financial Crisis/Great Recession in 2007-2009 are about the only visible blips on the long-term (back to 1927) chart of the S&P 500 index, but if one utilizes a log-scale for the Y-axis, the swings of the equity markets over the past 90+ years are more easily evident. Of course, the long-term trend has been very favorable AND these charts show only price appreciation of the S&P 500, ignoring the historically lucrative impact of dividends and their reinvestment.


**Stock Updates**

Keeping in mind that all stocks are rated as "Buy" until such time as they are a "Sell," while a listing of all current recommendations is available for download via the following link: https://theprudentspeculator.com/dashboard/, Jason Clark and Chris Quigley offer updates on 16 of our companies that had news last week that was of sufficient importance to trigger a review of their respective Target Prices.

Notably absent from the list is construction and engineering firm **Fluor** (FLR – $29.32), shares of which were crushed on Thursday, following a disastrous earnings report and the resignation of the CEO. The investment team is spending time reevaluating the position, which generally has shrunk to a very small weighting in our broadly diversified portfolios, and will make a final decision on its disposition this week. We will keep readers updated via the *Market Commentary* should we decide to hold or add, or via a *Sales Alert* should we opt to sell.

Despite turning in a solid Q1, shares of **Amgen** (AMGN – $177.31) gave back another 2% last week as traders seemed concerned about some slowing in some of the biotech giant's legacy drug sales. Amgen reported adjusted EPS of $3.56, versus consensus expectations of $3.47, on revenue of $5.56 billion, slightly above average forecasts of $5.54 billion. Amgen's osteoporosis drug Prolia, cholesterol reducer Repatha and cancer drug Kyprolis all enjoyed double-digit

percentage growth in the period to counter biosimilar pressure on Neulasta and anemia drugs Aranesp and Epogen, as well as at-risk generic pressure on Sensipar. 2019 total revenue guidance now stands at $22.0 billion to $22.9 billion and adjusted EPS guidance is now $13.25 to $14.30.

"We continue to generate strong, volume-driven growth for our newer products, while effectively defending our mature products," said CEO Robert A. Bradway. "We are also advancing a record number of first-in-class molecules targeting significant areas of unmet need through our pipeline."

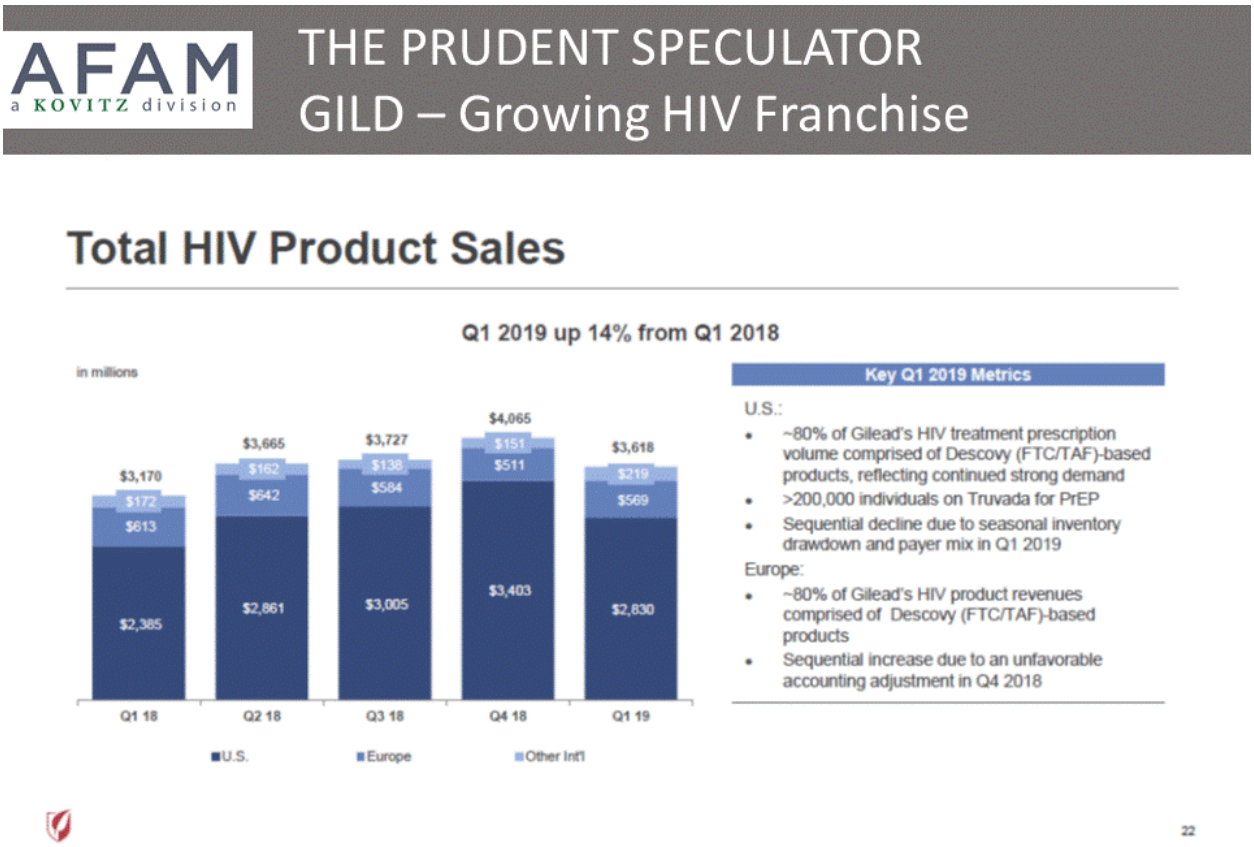
The company generated $1.7 billion of free cash flow in Q1, paid a dividend of $1.45 per share and repurchased 15.9 million shares of common stock at a total cost of $3.0 billion. At the end of Q1, AMGN had $2.1 billion remaining under its stock repurchase authorization.

We continue to like the potential of the pipeline of new products, strong free-cash-flow generation, solid financial footing and 3.3% dividend yield. While AMGN maneuvers through some of its legacy products seeing declining revenue and new medications picking up, there have been some calling for the company to make a big acquisition. We think Amgen has remained smartly conservative with its near-term outlook, and we believe that management would rather return capital to shareholders via buybacks and dividends versus overpaying for a bolt-on purchase, though we think they would move on the right purchase at the right price. Our Target Price for AMGN shares now sits at $226.

**Gilead Sciences** (GILD – $67.13) saw its shares rise by more than 3% last week after the biopharma company reported its Q1 results. Total revenue came in at $5.3 billion, compared to $5.1 billion in the year-ago period. Net income was $2.0 billion, or $1.54 per diluted share, up from $1.5 billion, or $1.17 per diluted share in 2018. Non-GAAP net income was $2.3 billion, or $1.76 per diluted share, compared to $2.0 billion, or $1.48 per diluted share, in 2018. Q1 revenue growth, the first quarter of year-over-year growth in three years, could be attributed to 14% HIV growth and Yescarta's (non-Hodgkin lymphoma treatment) launch, which helped counter the 24% decline in hepatitis C revenue.

New CEO Daniel O'Day commented on the company earnings call, "As many of you know, when I made the decision to join Gilead, I was drawn to the potential that I saw to build on the legacy of transforming care for people with serious illnesses in a company that has a deep commitment to patients and science. I now had a chance to see the extent of that potential up close. Let me share some of what I have observed the areas that I focused on up until now and a few thoughts on what you can expect next. The first thing I'll say is that it's been really exciting to see the scientific strength from the perspective of being inside the company. I've taken part in a series of deep dives into the R&D programs in each of our therapeutic areas. This includes spending time at KITE to dig into our work in cell therapy. I'm excited about the progress that we're making in inflammation and with results of the FINCH-1 and FINCH-3 are the studies that were announced at the end of March. I just want to express my enthusiasm for this work as we mobilize the organization for the launch of filgotinib, a medicine that will be a significant step forward for patients with rheumatoid arthritis."

Mr. O'Day continued, "Inflammation is one of the three emerging areas for us, and we anticipate that filgotinib will be an important future growth driver. As I deepened my understanding of Gilead's therapeutic areas, I've had the pleasure of participating in two scientific congresses beginning with CROI or the Conference on Retroviruses and Opportunistic Infections. And here, I had the opportunity to watch as we share the promising results from DISCOVER — from the DISCOVER study of Descovy for PrEP. More recently, I attended the International Liver Congress in Vienna, where we presented data from across our liver disease programs and had the chance at both of these conferences to meet with key thought leaders and get their perspectives on our R&D programs.




Internally, we expect Gilead to focus on its HIV franchise, allowing Kite to innovate and operate as its own oncology cell therapy unit, launch immunology drug filgotinib before the end of next year and partner to test new combination regimens. We also might expect the continued strong cash generation to facilitate more acquisitions, additional share buybacks and elevated dividend payouts. GILD shares trade at less than ten times NTM adjusted EPS consensus projections and carry a divided yield of 3.8%. Our Target Price for GILD is now $108.

Cruise line operator **Royal Caribbean** (RCL – $130.89) reported a strong Q1 with adjusted earnings per share of $1.31, well above the $1.10 estimate. RCL had sales during the first quarter of $2.44 billion (vs. $2.38 billion est.).

CEO Richard Fain commented, “It’s been a great first quarter, and we’re on our way to another great year. This quarter we were able to beat our earnings guidance, essentially due to higher revenues and our revenues for the full year are also looking better than what we expected with higher pricing in every quarter. I have to stress that we are both delighted and a little bit surprised with this very nice outlook as our initial guidance was already very strong. We think that this is a result of several elements, our superior new buildings, strategic revenue management decisions, our global footprint, very well-positioned brands and an enhanced destination offering.”

Mr. Fain conceded, “Now, while our revenue outlook has only gotten better, our earnings forecast was negatively impacted by some things outside our control, namely currency, fuel and an incident that occurred at the beginning of April at the Grand Bahama shipyard. The accident impacted the yard’s operation and therefore affected directly and indirectly the ships that were scheduled to be drydocked there. Luckily, there were no serious injuries, but we did have to cancel three sailings on Oasis of The Seas in order to have her repaired. This is a very unusual event, and not only have we never experienced anything like it. I’ve never heard of anybody else ever experiencing it either.”

Looking ahead, Mr. Fain added, “Now, as it pertains to our improved business outlook, I should first highlight the new buildings that our guests will be able to enjoy this year. First, we continue to enjoy delicious yields on our new ships from last year, Celebrity Edge and Symphony of the Seas. We continue to find that our guests appreciate the innovation and the focus that characterize our new ship and more importantly they’re willing to pay for it. In May, we will introduce the beautiful and relatively small Celebrity Flora, which will debut in the Galapagos targeting the expedition segment. The ship was especially designed for that very unique itinerary and is already making a huge statement in the market. Two weeks ago, we took delivery of Spectrum of the Seas and she is indeed beautiful. She’s currently carrying happy guests in route to China and when she arrives in Shanghai in a few weeks, she will be the largest and the newest ship in Asia. This will help reinforce Royal Caribbean’s existing leadership and our commitment to that market.”

Despite the optimism, the company did lower full-year guidance to a range of $9.65 to $9.85 (from $9.75 to $10.00 prior) as a result of a $0.50 headwind from the drydock accident with Oasis, alongside rising foreign exchange and fuel costs. This implies that excluding these factors, the company could have earned $10.15 to $10.35, given strength in the underlying business. As we also remain enthused about the overall prospects of the cruise industry, especially given favorable demographic and cruise-pricing trends, not to mention strong experience-oriented travel demand and the long-term potential in emerging markets, we continue to want to keep sailing with our RCL investment. Shares trade for a more-than-reasonable 13.2 times projected next-12-month earnings with a dividend yield of 2.1%. Our Target Price has steamed ahead to $159.

Shares of **Merck** (MRK – $80.00) increased more than 4% in price last week after the global pharma giant reported Q1 financial results that were better than expected on both the top and bottom line. MRK turned in adjusted EPS of $1.22, versus consensus expectations of $1.05. Revenue for the quarter was $10.8 billion, compared to forecasts calling for $10.4 billion.

MRK's key growth driver Keytruda experienced sales growth of 55% versus Q1 2018. Merck also enjoyed strong trends in its China business.

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THE PRUDENT SPECULATOR
MRK – Terrific Q1

Q1 PERFORMANCE HIGHLIGHTS
ALL GROWTH RATES EXCLUDE IMPACT OF EXCHANGE

MERCK

DELIVERED WORLDWIDE SALES GROWTH

$10.8B

11%

DROVE NON-GAAP EPS GROWTH

$1.22

GAAP $1.12[1]

18%

CREATED SHAREHOLDER VALUE

Returned $2.5 billion to shareholders through dividends and share repurchases

Executed on value-enhancing business development, including the acquisitions of Immune Design and Antelliq

ADVANCED THE PIPELINE

Announced five additional approvals for KEYTRUDA globally, including 1L NSCLC (KN-189) in China and 1L RCC (KN-426) in the U.S.

Announced two filing acceptances in our hospital/specialty business in the U.S.

Expanded V114 Phase 3 program with additional studies

1. The GAAP to non-GAAP reconciliation is available in the Supplemental Tables to Merck's Q1 2019 earnings release.

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"Our strong start to 2019, with double-digit sales and EPS growth in the first quarter, demonstrates our execution across all aspects of our business and the strength of our key growth pillars, including oncology and vaccines," said CEO Kenneth C. Frazier. "Our investments in research and development are paying off, and we are confident in our science-driven strategy, growth prospects and ability to sustainably deliver value to patients and shareholders."

Merck also announced that it was raising its full-year 2019 revenue range to $43.9 billion to $45.1 billion. Additionally, the company said it was narrowing and raising its full-year adjusted EPS guidance to a range of $4.67 to $4.79. We expect new cancer drug combinations will further propel Merck's overall drug sales. Although the stock has performed quite well over the last year, we think there is additional upside available with the potential of Keytruda and a wide lineup of high-margin drugs, as well as a pipeline of new drugs which should ensure strong returns on invested capital over the long term. MRK boasts a history of returning cash to shareholders, a diversified revenue stream and solid free-cash-flow generation. We have boosted our Target Price to $89.

Despite reporting Q1 financial results that fell a bit short of analyst expectations, shares of **Prudential Financial** (PRU – $103.13) ended last week down less than 1%. We believe that the quarter wasn't all that bad as the insurance leader delivered solid ROE and book value growth. PRU posted adjusted EPS of $3.00, versus consensus analyst expectations of $3.14. Revenue of $13.6 billion was also below estimates of $13.9 billion. Management cited $0.22 per share of compensation-related items that hampered results in Q1. Seasonally higher long-term compensation expenses had a $0.13 impact and were accounted for in the Corporate and PGIM segments. In addition, above-trend long-term and deferred compensation expenses tied to PRU's stock price and equity market performance hit the bottom line by $0.09.

CEO Charles Lowrey commented, "The first quarter of 2019 marked a solid start to the year for Prudential. We accelerated our strategy to bring greater financial opportunity to more customers. We produced an adjusted operating return on equity, at the higher end of our 12-13% target, increased our book value per share, and generated good business fundamentals. With a foundation of a rock-solid balance sheet, we continued to return capital totaling $915 million to shareholders via share repurchases and dividends."

We continue to like that management has actively divested non-core businesses and shown discipline in its international expansion. We also like the potential of its sales of pension de-risking products. Further, we believe the international business can continue to deliver earnings growth, despite low interest rates and challenging demographics in Japan, while the domestic business has bounced back a bit in 2019 alongside strong equity market returns. Management projects full-year EPS between $12.75 and $13.25 and PRU shares now trade at less than 8 times NTM adjusted EPS expectations and 76% of book value, while offering investors a 3.9% dividend yield. Our Target Price for PRU is presently $137.

Shares of infrastructure construction services company **Arcosa** (ACA – $37.43), which we inherited after it was spun off from **Trinity Industries** (TRN – $22.23), rocketed more than 23% on Friday after the company reported much stronger results than investors were expecting. For Q1, ACA posted adjusted EPS of $0.58, 78% greater than consensus forecasts, on revenue of $411 million (versus forecasts of $392 million).

CEO Antonio Carrillo explained, "Arcosa's first quarter results were better than our expectations. This strong start to 2019 supports our confidence in our full year guidance. We achieved year-over-year revenue growth in each of our business segments, benefitting from organic initiatives and the addition of ACG Materials, which we acquired in December 2018. First quarter adjusted EBITDA growth outpaced revenue gains, despite start-up expenses of $1.8 million related to the re-opening of our Madisonville, Louisiana barge facility, lost production at our Caruthersville, Missouri barge facility due to flooding, and inefficiencies at all of our barge plants as we ramped up production. Adjusted EBITDA margin expansion was driven by strong margin improvements in Energy Equipment from increased throughput, improved operating efficiencies, and the fourth quarter 2018 divestitures of several businesses. Additionally, Energy Equipment margins benefitted from the partial recovery of a previously recorded bad debt expense."

Mr. Carrillo continued, “We continued to execute effectively on our stage one priorities: growing Construction Products, improving margins in Energy Equipment, expanding our Transportation Products business as markets continue to recover, and operating a lean corporate structure. Our strong start to the year and confidence in current business trends support our expectations for substantial growth in 2019. We reaffirm our full year revenue and adjusted EBITDA guidance ranges of $1.70 billion to $1.80 billion and $215 million to $225 million, respectively. The mid-point represents 18% year-over-year adjusted EBITDA growth in 2019, after absorbing additional standalone company costs and initial pricing on a long-term components contract.”

We believe that Arcosa being on its own puts it in an improved position to expand its most profitable businesses. We like the diverse portfolio and, from what we can tell, there is meaningful upside potential for the inland barge and wind businesses. We also like that the company paid down more than 40% of its debt and that it now has more cash than debt. We continue to evaluate ACA and the small position size in our portfolios, but for now we have lifted our Target Price to $46.

Life and health insurer **MetLife** (MET – $48.00) announced that it earned $1.48 per share in fiscal Q1 2019 (vs. $1.27 est.). Shares jumped 6.5% last week as investors responded positively. During Q1, MET’s U.S. business saw an 11% year-over-year increase in adjusted earnings. The improvement was almost entirely due to the group benefits business. On a constant currency basis, adjusted earnings were up 13% in the Asia region due mainly to volume growth. MetLife also saw strong constant currency adjusted earnings growth of 23% in the EMEA region.

“I’m stepping into the CEO role at an exciting time for MetLife,” said new CEO Michel Khalaf. “We are building on our momentum from 2018 with an excellent first quarter in 2019. Our business performance more than offset some market headwinds. Our commitment is to be a responsible steward of capital by investing in profitable growth, strengthening expense discipline, and creating long-term value for our customers and shareholders.”

Overall, we still believe that MET has a solid financial foundation, and we like its business mix and ability to generate stable cash flow. Previous leadership spent a lot of time and effort stabilizing the business, which Mr. Khalaf believes has been accomplished and he is now seemingly looking towards actions to drive growth. We remain fans of the substantial international operations and see them as a core driver for raising the growth profile. We are fond of MET’s underwriting discipline and its position as the market leader in group life, where it provides insurance to 90% of the companies in the Fortune 100. MET trades at 8.5 times NTM consensus adjusted EPS estimates and 81% of book value per share. MET carries a dividend yield of 3.7%. Our Target Price has been hiked to $76.

Semiconductor equipment manufacturer **Kulicke & Soffa** (KLIC – $23.55) posted earnings per share of $0.00, versus the -$0.02 estimate, in fiscal Q2 2019. KLIC had sales of $115.9 million, versus the $126.3 million estimate. Shares rose 4% following the announcement, though they finished the week down a smidge.

KLIC CEO Fusen Chen commented, “Despite the current industry conditions, all global organizations continue to be increasingly focused on cost control while we also prioritize our

ongoing business development process and ever, to drive fundamental business optimization. We continue to be cautiously optimistic and to believe the current demand environment has stabilized. Further, from a micro industry standpoint, we see improving trends such as a slight pickup in both utilization rate for the fuel capacity or — and we also experienced slight pickup in our production in the March quarters. Also, major trends such as the 5G and IoT are anticipated to be key driver supporting higher level of semiconductor unit growth. We continue to anticipate the 5G transition, will help reinvigorate the premium smart phone market. Drop demands for infrastructure — and the broadened adoption of new low-cost end devices. We expect our core market leading product will benefit from this evolving transition."

KLIC has $143 million left on its share buyback program and spent $26.9 million on repurchasing 1.2 million shares in Q2. We like that KLIC has its "hands" in many new areas of technology: 5G, automotive, Internet of Things, and solid-state memory. We also are pleased that KLIC is working to maintain and expand margins, while investing heavily in R&D. KLIC has a diversified customer base and opportunity to switch to advanced packaging as nodes continue to shrink. In addition, KLIC yields 2.0%. Our Target Price remains $29.

Globally diversified bank **HSBC Holdings PLC** (HSBC – $44.70) reported earnings per share of $1.05, versus the $0.95 estimate, in fiscal Q1 2019. HSBC had revenue of $14.4 billion (vs. $14.3 billion est.). Shares rose nearly 3% following the announcement as profits soared, though Brexit uncertainty caused the bank to set aside $200 million for loan loss reserves.

CFO Ewen Stevenson commented, "On the basis of the headline numbers, obviously a very good quarter, bottom line profit of $4.9 billion and even if you ignore certain favorable items included in adjusted earnings, still a good quarter overall. On the balance sheet, we grew lending by 7% from Q1 2018 and we grew deposits by 2%."

He continued, "We recognize the headline results are significantly flattered by some favorable items, but even ignoring those items topline revenue growth continues to be solid and strongest in the areas we've targeted for growth, particularly Asia. We've moderated our cost growth relative to last year's run rate. Credit conditions continue to be relatively benign. On outlook, we recognize that a combination of geopolitical outcomes, volatile interest rates and the direction of markets could impact our results this year and into 2020. We remain alive to those risks and will continue to proactively manage costs and investment accordingly. So, we're happy with the quarter and the start we've made to the year. We've got a lot of work to do in order to be happy with the full year. But it does give us a very good base to build on. Our focus remains on executing the strategy we announced in June last year and meeting our financial targets that underpin that."

While HSBC shares climbed steadily from 2016 through early 2018, the back half of 2018 was a disaster. Fortunately, the bank seems to be making progress trimming expenses and shoring up its risk portfolio. The Brexit uncertainty continues to linger, but we are pleased that HSBC management isn't sitting idly and waiting for Parliament and the EU to reach some sort of divorce agreement. We like the bank's global footprint, which gives it the unparalleled ability to offer services around the world and believe HSBC's exposure to higher economic growth markets, as well as continued cost-cutting initiatives and efforts to improve operational

efficiencies, should eventually boost the bottom line. Shares currently yield 5.7% and our Target Price now stands at $55.

Technology hardware designer and manufacturer **Apple** (AAPL – $211.75) earned $2.46 per share in fiscal Q2 2019 (vs. $2.37 est.). AAPL had sales of $58.0 billion, versus the $57.5 billion estimate. Since the release, shares moved up 5.5%. The company continues to move away from its iPhone dependency into software and subscriptions, as evidenced by the record Services segment revenue of $11.5 billion.

CEO Tim Cook said, "We had a blockbuster quarter for iPad, with revenue up 22% from a year ago; this is our highest iPad revenue growth rate in six years. And it was another sensational quarter for wearables with growth near 50%. This business is now about the size of a Fortune 200 company, an amazing statistic when you consider it's only been four years since we delivered the very first Apple Watch."

CFO Luca Maestri added, "We expect revenue to be between $52.5 and $54.5 billion in the June quarter. This guidance range comprehends 300 basis points of negative foreign exchange impact year-over-year. Also as a reminder, in the June quarter last year, our Services revenue included a favorable $236 million one-time item in connection with the final resolution of various lawsuits. We expect gross margin to be between 37% and 38%. We expect OpEx to be between $8.7 billion and $8.8 billion. We expect OI&E to be about $250 million and we expect the tax rate to be about 16.5%. Also reflecting the approved increase, today our Board of Directors has declared the cash dividend of $0.77 per share of common stock payable on May 16, 2019, to shareholders of record as of May 15, 2019."

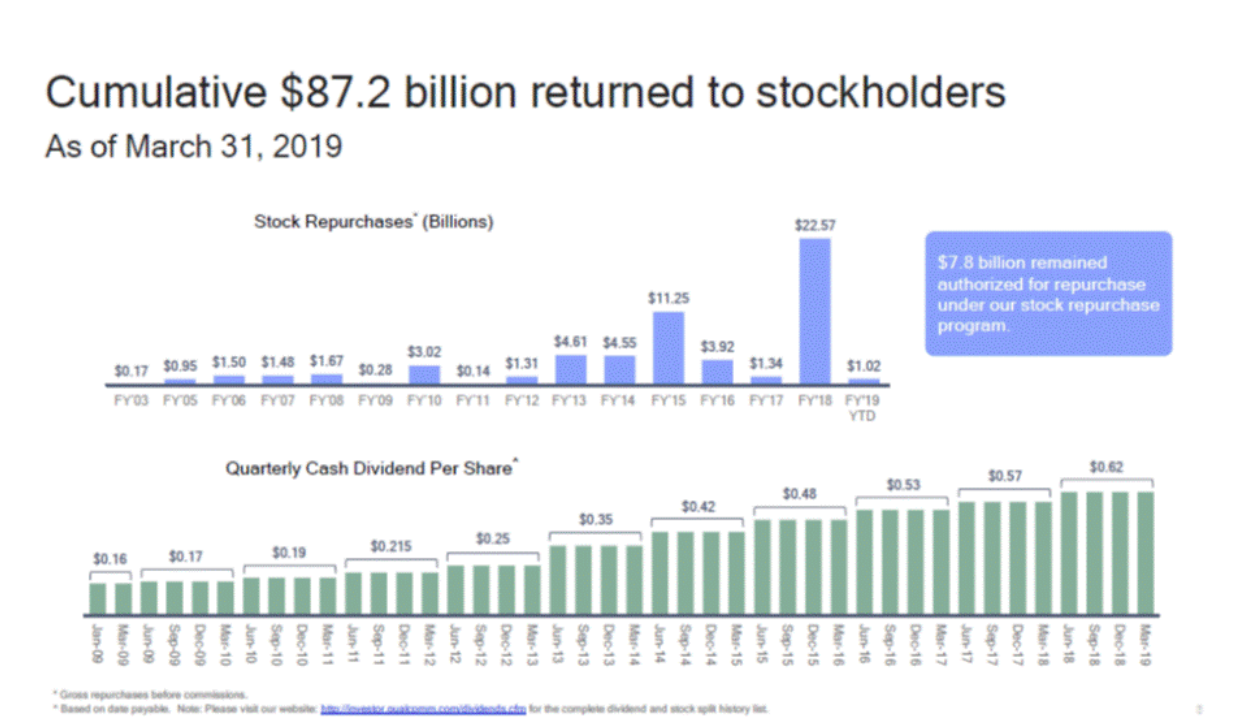
Apple is also expanding its Apple News and Apple TV products, while recent launches of Apple Card and Apple Arcade are likely to be well-received by customers. Apple's balance sheet still sports its mountain of cash and the demand for its products we believe is robust over the long term. Apple's App Store also has a substantial amount of recurring and ancillary revenue, which we would argue is hugely valuable even if the company never sold another iPhone. We believe the valuation remains fair, with metrics like a forward price to earnings ratio of 17.5, a free cash flow yield of 5.9% and a dividend yield of 1.5%. We have ratcheted our Target Price for AAPL up to $233.

Semiconductor firm **Qualcomm** (QCOM – $89.29) reported earnings per share of $0.77, versus the $0.71 estimate, in fiscal Q2 2019. QCOM had revenue of $4.9 billion, versus the $4.8 billion estimate. After initially skidding in after-hours trading on May 1, QCOM shares gained more than 3% over the next two days, adding to the company's meteoric rise related to the Apple settlement. On that front, we learned that QCOM's one-time settlement payment from Apple is expected to be in the $4.5 billion to $4.7 billion range.

CEO Steve Mollenkopf added some color on the future of QCOM, now that the Apple dispute is in the rear-view mirror, "First, 5G will be a significant opportunity for Qualcomm, both within cellular and in other industries. It is the key technology enabler for the future of the Internet and having a strong and differentiated technology position is an important asset for our shareholder. Second, we enter into the 5G era with strength in products, at favorable competitive dynamic and

more customer diversity and technology breadth that in earlier generations of cellular. We'll continue to invest where we can leverage our core competencies and bring innovative solutions to large markets."

CFO Dave Wise said, "Our guidance for the third fiscal quarter, we estimate GAAP revenues to be in the range of $9.2 billion to $10.2 billion, and estimate GAAP EPS of $3.57 to $3.77, which includes the revenues related to the settlement with Apple, and the contract manufacturers. We estimate fiscal third quarter non-GAAP revenues to be in the range of $4.7 billion to $5.5 billion and non-GAAP EPS to be approximately $0.70 to $0.80." We note that the one-time settlement is excluded from adjusted EPS because it is unusual and not expected to reoccur. Revenue and earnings related to the six-year agreement with Apple will always be included in GAAP and adjusted numbers, assuming that both parties hold up their ends of the bargain.


Numerous bumps in the road in the past year have adversely impacted Qualcomm, including Broadcom's attempted purchase, the NXP deal falling through and the lengthy Apple spat, but we are pleased that those events are behind QCOM. Internally, we debated ad nauseam the extent to which we thought QCOM could come through on their guidance – and the investment team all had some level of astonishment that QCOM turned down Broadcom's big offer. With the benefit of hindsight, we certainly are glad that no merger occurred and that we opted to stick with the undervalued stock. While some shareholders could certainly argue for taking the gains

and running, we think that the present picture offers some of the greatest reasons for optimism in years. QCOM shares also have a yield of 2.8% and we will be curious to see what management chooses to do with the Apple windfall. Our Target Price has been increased to $98.

Oil and gas refiner **HollyFrontier** (HFC – $46.74) posted earnings per share of $0.54, versus the $0.38 estimate, in fiscal Q1 2019. HFC had revenue of $3.9 billion, versus the $3.5 billion estimate. Shares slid following the announcement, as investors were unimpressed with HFC's comments that it's not seeing opportunities for M&A at present and that margins slipped slightly.

CEO George Damiris commented, "Adjusted EBITDA for the period was $282 million, $34 million less than the first quarter of 2018, principally driven by maintenance in our Refining and Marketing segment and weaker base oil margins in our Lubricants business, which were partially offset by stronger earnings at HEP and two months of contributions from our Sonneborn acquisition. Our Lubricants and Specialty Products business reported adjusted EBITDA of $20 million despite a very challenging base oil market. During the quarter, we returned $135 million of cash to shareholders through regular dividends and share repurchases. Our focus remains on improving reliability and by extension, both unit and absolute costs across our refining system. With the rebound in the gasoline market and no major planned downtime until September, we believe we are well-positioned for strong financial performance heading into the summer driving season."

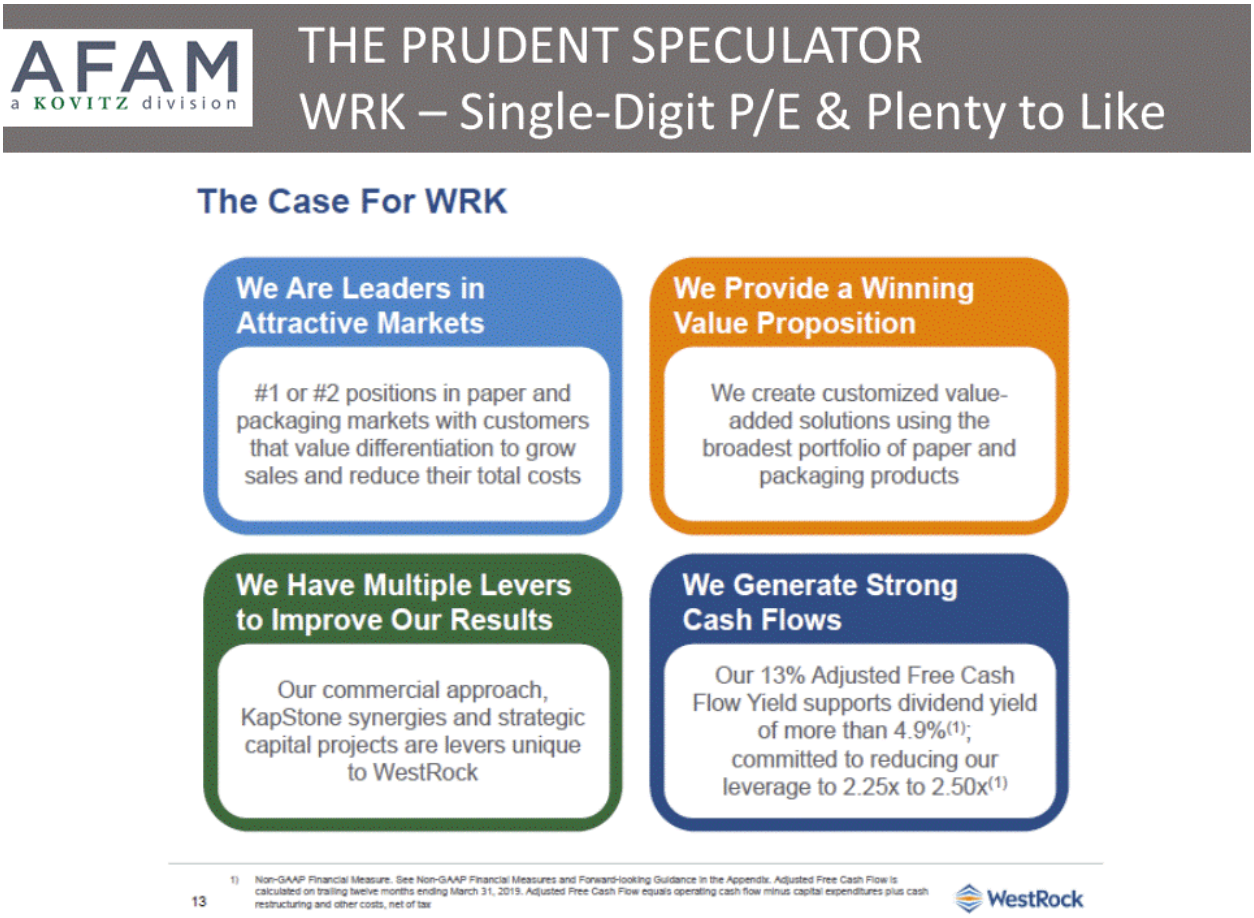
Although we trimmed our stake more than once last year, we continue to like having our exposure to HFC, especially as the stock trades for under 10 times NTM adjusted earnings expectations and offers a dividend yield of 2.8%. We also like that Holly's refinery capabilities give the firm flexibility to tailor output more towards higher margin products as opportunities allow. Our Target Price for HFC is now $79.

Paper packaging firm **Westrock Co.** (WRK – $39.29) earned $0.80 per share in Q2 2019 (vs. $0.61 est.). WRK had sales of $4.6 billion (vs. $4.7 billion est.). Shares have rebounded nicely since the announcement. WRK benefitted from its KapStone acquisition and price improvement, while mill downtime dragged on results.

"WestRock has multiple levers to improve our results. These levers include our commercial approach that supports organic growth, our strategic capital projects and the capture of the KapStone synergies that will lower our cost. As is the case with many companies they have grown by acquisition, we're simplifying our business with systems and processes and along the way building our capabilities to be successful in very competitive markets," said CEO Steve Voorhees. "We're reducing our exposure to commodity markets and increasing the stability of our business by providing value-added products and services for our customers. While we're doing this, we're generating strong cashflow and paying an attractive dividend. And we remain committed to returning our leverage to 2 in quarter to 2.5 times target."

We are constructive on WestRock continuing to experience good box volumes, which was consistent with commentary from competitors. The company continues to launch sustainable and environmentally friendly solutions, which reduce waste and eliminate plastic packaging. Though in its early stages, WRK expects this area to be a source of significant growth potential. We also

like that management will focus the coming quarters on trying to get the balance sheet back in better shape (after taking on $4.4 billion in new debt to get the KapStone deal done).




We continue to be attracted to WRK as a high-yielding and reasonably priced e-commerce play (via shipping boxes). Despite some headwinds on inputs and cost of delivering products, we like that WRK has improving pricing with the economy strong and more delivered products being purchased by consumers. WRK shares yield 4.6% and our Target Price is now $71.

**Kimco Realty** (KIM – $18.20) had funds from operations per share of $0.38 in fiscal Q1 2019 (vs. $0.36 est.). KIM had revenue of $295.0 million (vs. $282.0 million est.). Shares rose 3.4% following the announcement. The open-air shopping center REIT benefitted from a 3.7% increase in net operating income, while occupancy climbed by 20 basis points in Q1 (for the first time in a decade). KIM inked deals with Target, ULTA, Old Navy, Burlington, Ross, Five Below and others.

"We have positioned ourselves to take advantage of and withstand the vicissitudes of the retail real estate environment. Our assets are concentrated in high-quality markets with high barriers to entry and anchored by profitable high-volume stores. These are the locations where retailers want to be, and will invest heavily to integrate e-commerce with their physical footprint. In talking to our retailer partners, we have heard consistently that there is no lack of available retail

space on the market but that there is a lack of high-quality retail space. Our quality locations, below market leases and the diversity of our tenant base give us tremendous flexibility and staying power to navigate the current environment," stated CEO Conor Flynn. "As we keep an eye toward the future, we continue to make substantial progress with our mixed-use platform. To date, we have a total of over 4300 residential units and 550 hotel keys entitled under construction or open-and-operate. With respect to the entitlements, we are creating a multi-year runway of future investment opportunities that we can activate at our discretion. Over the long term, this will change the growth profile and quality of our largest NOI contributors."

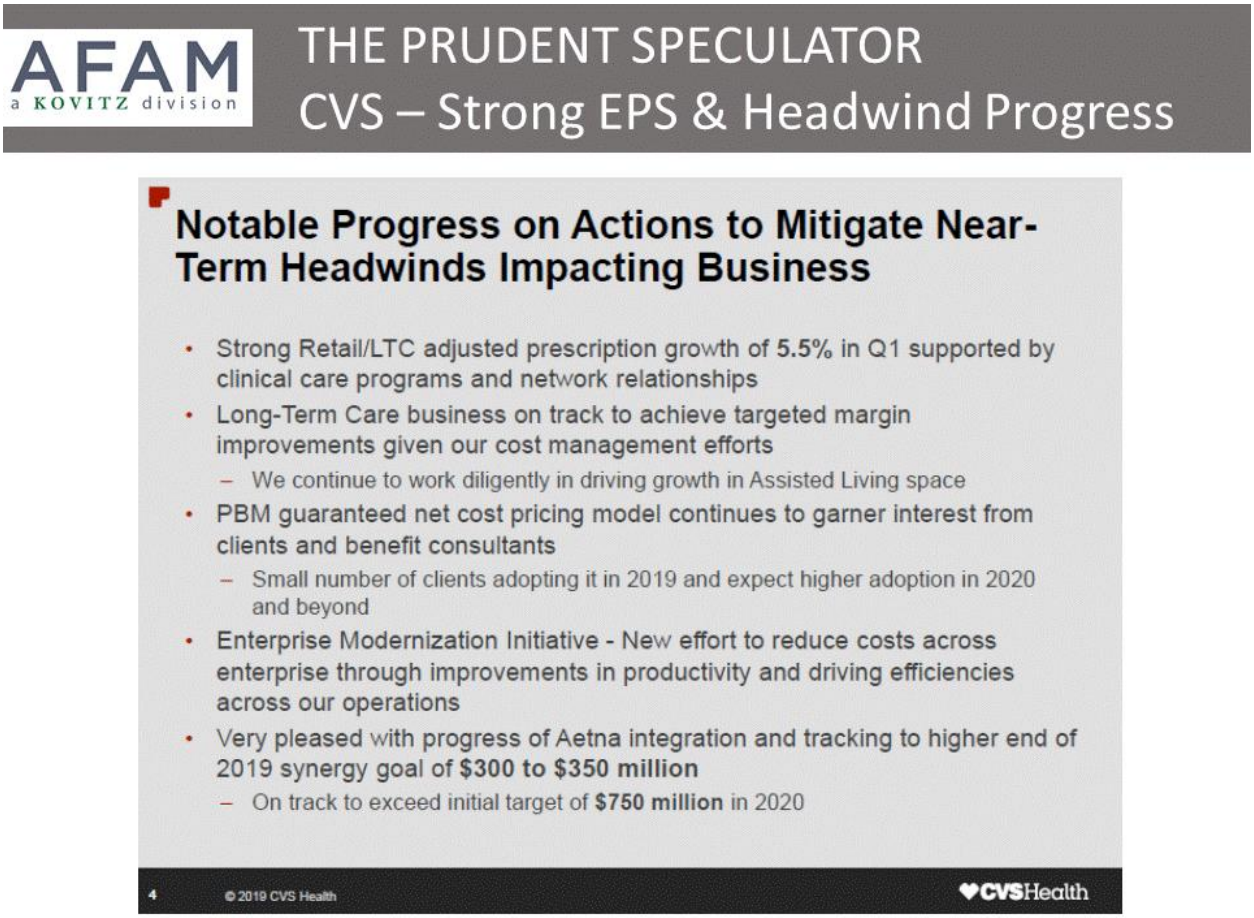
While there is no doubt that the retail landscape continues to be challenging, it seems the death of brick-and-mortar stores was greatly exaggerated. KIM shares still trade well below the 2016 highs, which we think is undeserved, and the strong economic backdrop should continue to help the company negotiate solid deals for its high-quality portfolio. KIM currently yields 6.2% and trades at less than 12 times NTM FFO expectations. Our Target Price has been nudged up to $25.

**CVS Health** (CVS – $56.66) earned $1.62 per share in fiscal Q1 2019 (vs. $1.51 est.). CVS had sales of $61.6 billion (vs. $60.2 billion est.). Shares moved up more than 5% last week, thanks to the announcement and news that the integrated pharmacy health care provider raised EPS guidance for the full year from a range of $6.68 to $6.88 to a range of $6.75 to $6.90. For Q2, CVS expects EPS between $1.68 and $1.72.

CEO Larry Merlo stated, "The strong performance was driven by all businesses achieving or exceeding what was contemplated at the high end of our guidance ranges with the Health Care Benefits segment leading the favorability. We executed smooth January one implementations in both the Pharmacy Services and Health Care Benefits segments posted significant Medicare Advantage membership growth, continue to grow share in our retail pharmacy and were aligned some of our operations to drive greater value."

Mr. Merlo added details on some of the policy changes by the Trump Administration. We note that the Congressional Budget Office does not expect the changes in rebates to result in cuts to drug prices by drug makers and Medicare costs would increase by $170 billion. Mr. Merlo said, "I want to begin by acknowledging the clarifying guidance that CMS issued for plan sponsors that bid should reflect current law and not the newly proposed rebate rule. That guidance also stated that there are a number of issues that need to be addressed before the rule can be finalized. And should the rebate will be implemented the CMS demonstration project provides planned protection for much of the risk in applying rebates at the point of sale. Additionally, this demonstration project will allow the administration to evaluate in real-time, the potential impact to Part D members' premiums and to the actual costs that will be incurred by CMS. This is both a prudent step and an important analysis before such a significant change to the Part D program is made permanent. The demonstration project will allow the administration and the private sector to learn together and make adjustments for the Part D program over a more reasonable period of time and we plan to participate in the demonstration project aided by the learnings from our Allure PDP products. Now more broadly the renewed focus nationally on what the next phase of access to affordable quality healthcare will be, has generated significant attention in recent weeks. This is an important discussion and we will continue to be an active participant. That said regardless of what shape and form the next stage of healthcare takes, we remain

confident that the private sector will play an essential role in both shaping and executing that next stage."




While there's uncertainty from a policy perspective, we are confident that management can successfully navigate the changes. The CVS leadership team is experienced and has an arsenal of information to shape policy. Despite the growing competitive landscape, we continue to believe that CVS is a free-cash-flow generating behemoth with strong potential to evolve its business to a broader health care delivery model. Shares remain highly discounted, trading at just 8.3 times NTM earnings and with a 3.5% yield. Our Target Price is $107.