Market Commentary Monday, August 5, 2019

August 4, 2019

EXECUTIVE SUMMARY

Buckingham Back Home – Post-*Forbes Cruise* Market Whack
Income Comparisons – Stocks Extraordinarily Attractive Relative to Fixed Income
TPS 634 – August Edition of *The Prudent Speculator* Emailed
Last Week's Laggards – 25 Undervalued Stocks Hit Hard Over the Latest 5 Days
Stock Updates – PFE, MCK, CMI, RDS/A, AMGN, NTR, HFC, COF, AAPL, PRU, GLW, NTAP & MRK

Market Review

Greetings from Orange County, California, where your Editor has returned home following the latest *Forbes Cruise*. While the time at sea was unusually smooth in terms of the equity markets, the waters certainly turned turbulent over the week just ended, with the broadly diversified U.S indexes skidding more than 3% after the latest escalation in the trade battle with China and disappointment that the Federal Reserve was not more dovish in its comments following the first cut in the Fed Funds rate in more than a decade.

Despite the downturn, which looks likely to persist as trading begins this week, given big declines in the equity futures on Sunday evening, we continue to find stocks to be very attractive, especially given the major plunge in interest rates last week…

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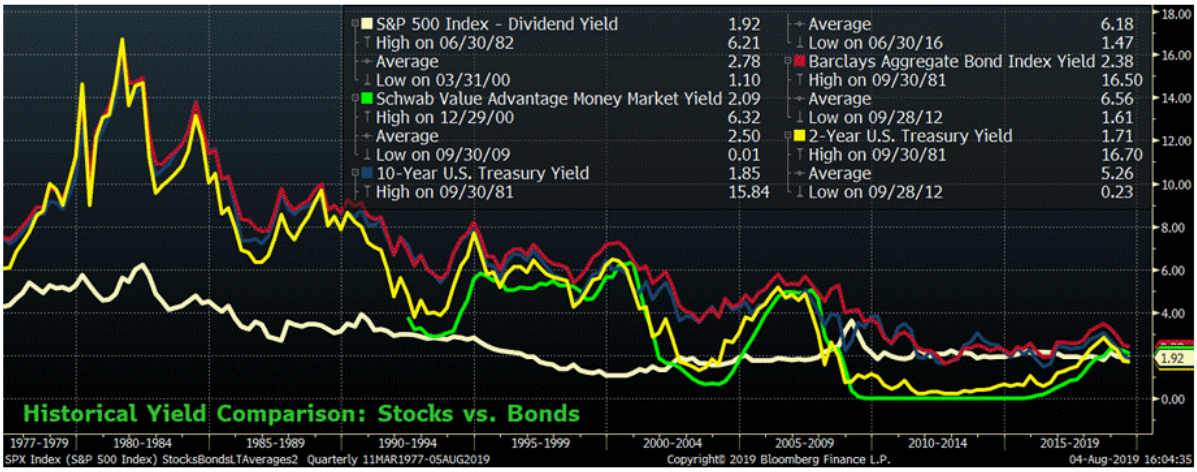
Equity vs. Fixed Income Yields

Though stocks are not necessarily a substitute for bonds, U.S. Treasuries and money market funds, the current payout on the S&P 500 (1.92%) is very generous versus that available from fixed income. And, now is one of the rare periods where the yield on stocks exceeds the yield on the 10-year Treasury, while the comparison to the four-decade average yields for all of the securities below very much favors equities.



We offer our latest thinking on the markets in the August edition of *The Prudent Speculator*, which was emailed to readers a short while ago, but for those looking to put new money to work, we naturally are drawn to the stocks that were hit the hardest last week.

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THE PRUDENT SPECULATOR
Largest Losers: 7.26.19 – 8.2.19

Latest Week's Laggards

Symbol	Common Stock	Latest Week TR	8.2.19 Price	Target Price	Sector	P/E	P/S	P/TBV	ROCE	EV/ EBITDA	FCF Yld	Debt/ TE (%)	Div Yld	Mkt Cap
NTAP	NetApp	-22.1%	$46.04	$76.02	Technology Hardware	10.2	1.8	nmf	69.5	6.3	10.1	nmf	4.2%	11,051
PRU	Prudential Financial	-14.2%	$88.56	$133.83	Insurance	7.5	nmf	0.6	7.5	nmf	nmf	nmf	4.5%	35,955
GLW	Corning	-13.3%	$29.29	$42.77	Technology Hardware	15.0	1.9	2.9	12.4	9.7	-0.7	82%	2.7%	22,872
BHF	Brighthouse Financial	-12.0%	$34.60	$73.84	Insurance	4.9	nmf	0.3	1.4	nmf	nmf	nmf	0.0%	4,007
PFE	Pfizer	-11.0%	$38.00	$46.16	Pharma, Biotech	12.4	3.9	nmf	17.8	11.8	6.1	nmf	3.8%	211,277
ING	ING Groep NV	-10.9%	$10.30	$18.30	Banks	6.8	nmf	0.7	9.0	nmf	nmf	nmf	6.0%	40,134
TNP	Tsakos Energy Navigation	-10.6%	$2.96	$4.80	Energy	nmf	0.5	nmf	-11.1	7.9	nmf	nmf	6.8%	259
CMI	Cummins	-9.2%	$158.68	$200.89	Capital Goods	9.9	1.0	4.0	33.5	6.9	9.4	31%	3.3%	25,038
GT	Goodyear Tire & Rubber	-9.1%	$12.73	$24.05	Automobiles & Components	7.8	0.2	0.7	9.6	5.5	-2.1	155%	5.0%	2,960
FL	Foot Locker	-9.0%	$39.36	$75.86	Retailing	8.2	0.5	1.8	21.3	6.3	11.7	121%	3.9%	4,318
WHR	Whirlpool	-9.0%	$135.58	$199.32	Consumer Durables	8.7	0.4	nmf	35.7	9.1	4.6	nmf	3.5%	8,613
HAL	Halliburton	-8.8%	$21.00	$54.09	Energy	14.1	0.8	2.8	14.5	7.5	1.3	168%	3.4%	18,395
SIEGY	Siemens AG	-8.7%	$51.47	$83.31	Capital Goods	17.1	1.8	14.0	9.8	10.6	3.8	483%	3.1%	87,499
MRVL	Marvell Technology Group	-8.4%	$25.03	$28.00	Semiconductors	24.5	5.7	nmf	-6.2	57.3	3.4	nmf	1.0%	16,545
COF	Capital One Financial	-8.0%	$89.85	$122.74	Diversified Financials	8.0	nmf	1.2	11.3	nmf	nmf	nmf	1.8%	42,259
ALB	Albemarle	-7.9%	$68.68	$127.21	Materials	12.6	2.1	4.2	18.6	8.2	-4.2	87%	2.1%	7,277
TOT	Total SA	-7.9%	$49.39	$90.12	Energy	10.9	0.7	1.3	10.0	5.3	9.2	43%	4.8%	131,717
TPC	Tutor Perini	-7.7%	$12.23	$21.90	Capital Goods	6.5	0.1	0.5	5.4	5.0	-16.6	81%	0.0%	614
RDS/A	Royal Dutch Shell PLC	-7.3%	$58.41	$94.19	Energy	10.7	0.3	1.3	10.5	5.9	11.4	45%	5.5%	235,959
BHP	BHP Group Ltd	-7.3%	$52.05	$63.25	Materials	15.6	3.3	nmf	10.1	nmf	8.8	nmf	4.2%	123,970
MU	Micron Technology	-7.2%	$44.08	$66.63	Semiconductors	4.8	1.8	1.4	31.5	2.8	12.1	11%	0.0%	48,656
CMA	Comerica	-7.1%	$67.89	$105.14	Banks	8.7	nmf	1.5	16.3	nmf	nmf	nmf	3.9%	10,140
KEY	KeyCorp	-7.1%	$17.20	$26.50	Banks	9.7	nmf	1.4	11.4	nmf	nmf	nmf	4.3%	17,254
IP	International Paper	-7.0%	$42.14	$66.97	Materials	7.7	0.7	4.5	22.3	6.6	13.5	284%	4.7%	16,554
SYMC	Symantec	-7.0%	$21.15	$32.10	Software & Services	13.3	2.8	nmf	0.6	15.6	9.6	nmf	1.4%	13,075

As of 8.2.19. 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

With so many market-moving second quarter numbers to discuss, we dedicate the balance of this missive to Chris Quigley and Jason Clark offering updates on numerous companies that had news last week that was of sufficient importance to trigger a review of their Target Price. 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/,

Despite posting decent Q2 results, which included the bottom-line outpacing expectations by 6%, shares of **Pfizer** (PFE – $38.00) were hammered last week, falling 11% on the news that the global pharma giant would merge its Upjohn unit with Mylan. Upjohn manufactures older brands like Lipitor and Viagra, while Mylan is best know for making generic drugs and for its EpiPen. PFE shareholders will end up owning 57% of the combined entity. After the spinoff, Upjohn will make a $12 billion payment to Pfizer.

Analysts offered mixed views on the go-forward PFE, with some saying it was a smart choice to further focus on growth drivers, while Mylan as a stand-alone company was very inexpensively valued, and others were concerned about the lost revenue, cash flow and profits. No doubt, additional work and close monitoring on our end is going to have to be done as more information

about the legacy Pfizer and the new company becomes available. The disposal of products at Pfizer that are decelerating in sales, and often have low margins, is going to keenly put the focus on the growth profile of the firm, which if executed well should bring higher multiples to the valuation. For the Mylan/Upjohn combo, we see some definite positives for Mylan's products as Upjohn is already established in a number of global growth markets.

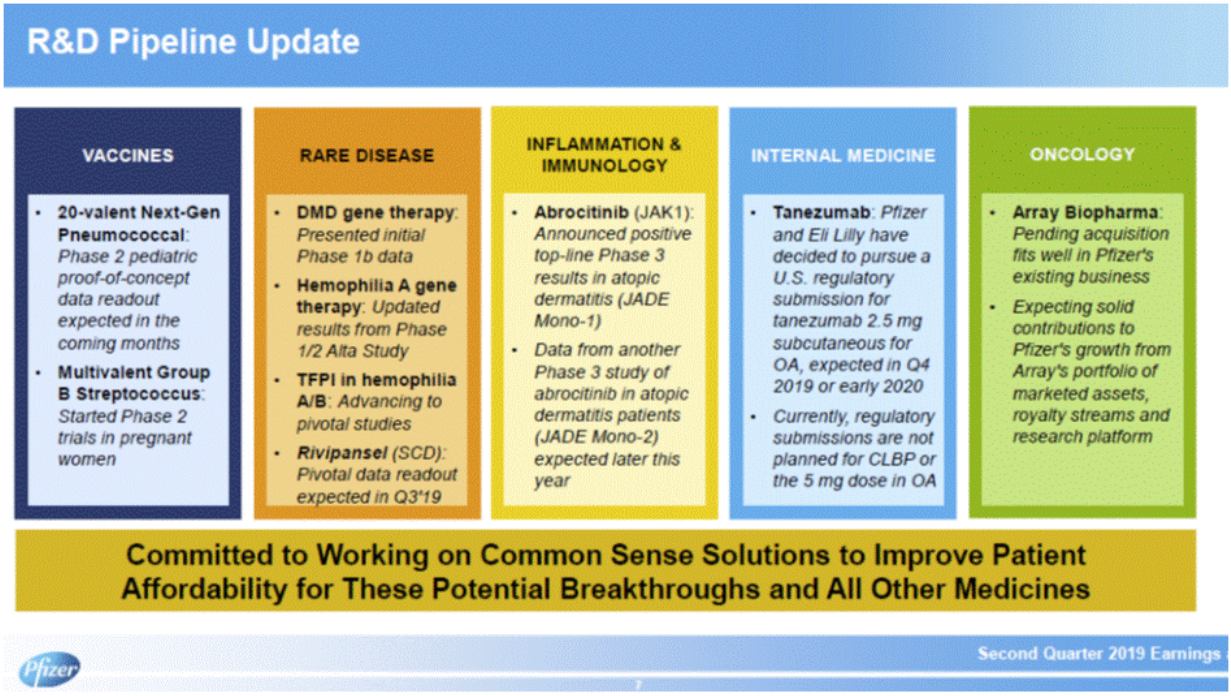
Concerning the Mylan and Upjohn union, Pfizer CEO Dr. Albert Bourla stated, "We are creating a new champion for global health—one poised to bring world-class medicines to patients across a wide range of therapeutic areas. I believe that Mylan's unique profile and strategy has made it the obvious partner of choice in creating this powerful combination. By bringing Mylan's growth assets to Upjohn's growth markets, we will create a financially strong company with true global reach. I'm also excited about the management team, which combines strong executive talent from both companies, whose commitment to improving global health for patients and to delivering returns to shareholders are great assets for the new company. For Pfizer, this transaction represents our sharpened focus on innovative medicines and is a testament to our purpose – breakthroughs that change patients' lives. At the same time, we'll maintain the financial flexibility to advance our strong pipeline, invest for growth and continue to return capital to our shareholders."

PFE also updated its full-year 2019 guidance as its Consumer Healthcare joint venture with GlaxoSmithKline was formed on 8.1.19. Pfizer now expects revenue to come in between $50.5 billion and $52.5 billion, with adjusted EPS from $2.76 to $2.86.

Concerning Q2 and the go-forward for PFE, Dr. Bourla commented, "We reported solid second-quarter 2019 financial results, with total company revenues up 2% operationally. Performance was primarily driven by 6% volume-driven operational growth in our Biopharma business, including continued growth of key brands such as Ibrance, Eliquis and Xeljanz as well as in emerging markets. This growth was partially offset primarily by the impact of generic and biosimilar competition for products that have lost marketing exclusivity, as well as the expected decline of Upjohn revenues in China."

Dr. Bourla concluded, "Today's announcement that proposes a combination between Upjohn and Mylan N.V. (Mylan) in a Reverse Morris Trust transaction marks an important milestone in Pfizer's evolution to be a more focused, global leader in science-based, innovative medicines that delivers breakthroughs that change patients' lives and creates sustainable value for shareholders. The proposed transaction would unlock value by giving Pfizer shareholders majority ownership of a new company that brings together highly complementary businesses under a management team focused on leveraging scale, capabilities and geographic reach while maximizing revenue growth opportunities and free cash flow potential. Following the close of the proposed transaction, I expect Pfizer will be positioned to deliver revenue and Adjusted diluted EPS growth through the mid-2020s that is among the industry leaders while continuing to allocate significant capital directly to shareholders, primarily through dividends."

PFE – Favorable Drug Pipeline



Over the last number of quarters, we have expressed concerns about generic competition for some of Pfizer's older drugs and how the company could focus on the long-term growth drivers, while trying to squeeze the most out of the older products. The Mylan/Upjohn merger addresses those concerns, and now it will come down to execution, financial structure, valuation and capital return plans for shareholders to drive our decision on what we will do with the shares of the combo that we will eventually inherit. As for PFE, we still believe that the market under-appreciates the company's emerging pipeline of products and management's increasing confidence in its organic growth potential, which will now be the focal point. We continue to like the strong balance sheet and capital return programs, though we acknowledge that they both could change. Our initial belief is that the Consumer Healthcare JV with Glaxo, the spinoff of Upjohn and the focus on growth is going to unlock value for shareholders. Our Target Price for PFE is presently $46.

Despite operating in an industry that seemingly faces constant negative headlines, concerning subjects like cutting prescription drug costs, the opioid crisis and competitive threats, shares of **McKesson** (MCK – $148.13) continued their recent ascent last week after the company reported better-than-expected fiscal Q1 2020 financial results. The medical and healthcare product distributor posted adjusted EPS of $3.31, versus consensus estimates of $3.03, while revenue of $55.7 billion came in some 3% above forecasts. Strong U.S. Pharma and solid Medical-Surgical

performance aided the quarterly results. Management also announced an increase in the company's quarterly dividend by 5% to $0.41 per share.

"McKesson is off to a strong start in fiscal 2020, and our first-quarter earnings performance exceeded our expectations," said CEO Brian Tyler. "Based on the momentum from our first-quarter results and our confidence in the full year outlook, we are raising our previous guidance range for fiscal 2020 and now expect Adjusted Earnings per diluted share of $14.00 to $14.60."

There continue to be no shortage of stiff headwinds for MCK and its operations, from the ramifications of the opioid epidemic to potential competition from Amazon and the increasing possibility for drug pricing legislation to come out of D.C. Certainly, any of those could squeeze MCK in some business areas, but we continue to believe that the stock price greatly discounts a tremendous amount of bad news, given that current analyst EPS estimates for fiscal '20, '21 and '22 now stand at $14.32, $15.47 and $17.14, respectively. MCK still plays an important role in getting medical supplies and medicines from manufacturers to pharmacies, clinics and hospitals, while continued integration of acquisitions and pending improvements in its health care IT business should help drive growth. MCK trades for 10.2 times NTM earnings expectations and our Target Price now stands at $197.

Shares of **Cummins Inc.** (CMI – $158.68) fell more than 9% last week after the engine designer and manufacturer reported Q2 results that were below expectations and said that the company sees full-year 2019 revenue growth as flat, versus the previous expectation of zero to four percent growth. For Q2, adjusted EPS was $4.27, versus consensus analyst estimates of $4.42. CMI's quarterly revenue of $6.22 billion fell 2% short of forecasts. Overall, North America was a strong market in the quarter, while Europe and China endured weakness.

CEO Tom Linebarger explained, "We achieved record revenues, EBITDA, and operating cash flow in the first half of 2019, extending our track record of raising performance cycle over cycle. While we do expect to see a moderation in demand in the second half of the year, our financial strength combined with our diversified geographic and end market exposure will enable us to generate strong profits, continue to invest in future growth, and return cash to shareholders."

The Board of Directors approved a 15% increase in the company's quarterly cash dividend from $1.14 per share to $1.311, pushing the yield to 3.3%. If things don't materially worsen, CMI could end up generating upwards of $3 billion of operating cash flow for full-year 2019. Management pledged that it would return 75% to shareholders this year. With the dividend set to be about $750 million this year and the completed buybacks in the first half of 2019, CMI could repurchase more than $1 billion of its stock on the open market during the second half of the year.

While we may have seen the peak in near-term global truck demand, we continue to believe that Cummins will increasingly enjoy long-term benefits from its overseas exposure (especially via emerging economies), as its leading-edge technology in truck engines helps it gain market share. We also are constructive on management aggressively pursuing next-generation technologies, such as electrical powertrains. Shares of CMI are currently trading at 10.8 times NTM adjusted EPS expectations. We have trimmed our Target Price to $201, but we remain fans of Cummins.

Integrated oil and gas firm **Royal Dutch Shell PLC** (RDS/A – $58.41) reported earnings per share of $0.86, versus the $1.20 estimate, in fiscal Q2 2019. RDS/A had revenue of $90.5 billion, versus the $91.5 billion estimate. Shares slipped 6.5% on the surprise miss, which was a result of the integrated gas division posting a 25% drop in profit and lower earnings in each of the company's segments.

CEO Ben van Beurden said there were three drivers for the lower earnings, "First, the macro environment. Our Q2 results reflect lower realized oil, gas and LNG prices. The second driver is the underlying asset performance. And this quarter, we experienced some underperformance and operational issues as well as some planned maintenance events. The third and final driver are the one-offs and the unusual items that we have experienced this quarter, and that totaled around $500 million. For example, in Q2, we signed a Heads of Agreement with the government of Trinidad and Tobago, which will impact our earnings this quarter."

CFO Jessica Uhl added, "In Q2, we delivered key milestones from our portfolio such as the start-up of Appomattox and first LNG from Prelude, and we continue to high-grade our portfolio, aligned with our intentions for Management Day. This quarter, we delivered resilient earnings growth in our customer-facing marketing businesses with good trading results. We also experienced more challenging macro conditions across other parts of our business. And at the same time, we did not reach the full potential of some of our assets. We will respond appropriately to further strengthen and grow our cash flows from these assets. Finally, this quarter saw bookings in relation to various settlements impacting our earnings. The key is to look at the overall trends and outlook. And with the resilience of our Upstream and customer-facing businesses and their ability to generate cash, this supports the delivery of our 2020 outlook, which remains unchanged."

Shares trade for 11.3 times forward earnings expectations and offer a hefty dividend yield of 5.5%. Shell has spent $9.3 billion on share repurchases since July 2018 and authorized another $2.75 billion chunk of the $25 billion share buyback plan that's expected to conclude by the end of next year. We continue to believe that global energy demand will increase over the long term, as usage in emerging economies should continue to rise. We note that exposure to integrated oil names like Royal Dutch offers the opportunity to partake in numerous aspects of the energy stream, though 87% of the company's revenue comes from the Downstream segment. Integrated Gas and Upstream revenue streams add some diversification. Our Target Price has been reduced to $94.

Shares of **Amgen** (AMGN – $187.22) jumped almost 7% last week. While the biotech name reported Q2 results that edged out consensus analyst expectations on the top- and bottom-lines, the real catalyst was the announcement during the company's earnings call that a cancer drug that Amgen is developing is seeing strong results in a trial.

"With our newer products generating strong volume gains globally and many first-in-class medicines advancing through our pipeline, we are well positioned to serve patients and deliver long-term growth for our shareholders," added CEO Robert A. Bradway.

AMGN generated $1.3 billion of free cash flow in Q2. The company repurchased 13.1 million shares of common stock at a total cost of $2.3 billion during the quarter (and now has $4.7 billion remaining under its stock repurchase authorization). For full-year 2019, Amgen now sees total revenue in the range of $22.4 billion to $22.9 billion, and adjusted EPS in the range of $13.75 to $14.30.

We continue to like the potential of the pipeline of new products, strong free-cash-flow generation, solid financial footing and 3.1% 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. Shares now trade at 13.1 times NTM adjusted EPS expectations. Our Target Price for AMGN has been lifted to $226.

Nutrien Ltd (NTR – $53.52) reported earnings per share of $1.58, versus the $1.56 estimate, in fiscal Q2 2019. NTR had revenue of $8.4 billion, versus the $8.0 billion estimate. Shares moved up 7.3% following the announcement, led by a 42% year-over-year jump in EBITDA in the Potash business and a 17% increase in the Nitrogen business's EBITDA.

NTR CEO Chuck Magro added, "We expect to grow retail earnings by around 60% over the 5-year period, driven by a combination of organic and inorganic growth initiatives and we have set clear performance targets in each of these areas. As previously announced, we entered into an agreement to purchase Ruralco Holdings, the third largest ag retailer in Australia. We continue to work through the regulatory approval process and expect to close this transaction late in the third quarter. The retail acquisitions completed in 2019 will make a much greater contribution to our earnings next year. In potash, we see opportunity to increase earnings in a relatively stable potash price environment through volume growth and further cost reductions. We have 5 million tonnes of production capability that we can bring online as demand grows, which is an opportunity that does not exist for any other potash producer. In nitrogen and phosphate, we continue to optimize our network and improve our cost positions. We are completing a number of smaller nitrogen expansion projects that offer attractive returns for our shareholders. Nutrien's integrated business model is designed to withstand events, such as what happened this spring. It is also designed to capitalize on a long-term recovery in the ag markets, which we are starting to see positive signs in the second half of 2019. We are a company focused on delivering, and we remain committed to building on a track record of performance for all of our stakeholders."

Nutrien lowered EBITDA guidance from a range of $2.80-$3.20 to $2.70-$3.00, while the revenue range went from $4.4 billion – $4.9 billion to $4.35 billion – $4.7 billion. NTR has repurchased approximately 6% of outstanding shares in the first half of the year (36 million shares) and 11% of outstanding shares over the past 18 months. While we never like a guidance whack, we understand the U.S. had its worst planting season in recent history, the company expects a strong rebound in 2020. Indeed, earnings presently are expected to grow to $3.41 in 2020 and $3.75 in 2021. Our Target Price has been increased to $66.

Oil and gas refiner **HollyFrontier** (HFC – $51.13) earned $2.18 per share in fiscal Q2 2019 (vs. $1.66 est.). HFC had revenue of $4.8 billion, versus the $4.3 billion estimate. HFC's strong beat sent shares up 4.9%, with improved refinery utilization, expanding diesel and gasoline margins, and healthy cash flow.

CFO Jim Stump commented, "For the first quarter, our crude throughput was 453,000 barrels per day, within our guidance of 445,000 to 455,000 barrels per day. Crude throughput was impacted by the 2-week precautionary shutdown at our Tulsa Refinery due to flooding in the Tulsa area. Our consolidated operating cost of $5.73 per throughput barrel was $0.16 lower versus last year. A few guidance items for 2019. We continue to expect to spend between $470 million and $510 million for both stand-alone capital and turnarounds in our Refining and Marketing business, $40 million to $50 million at HollyFrontier Lubes and Specialties and $30 million to $40 million of capital at HEP."

CEO George Damiris added, "Looking forward, we will continue our focus on improving reliability across our refining system and successfully integrating Sonneborn, further strengthening our earnings profile."

We continue to like having our exposure to HFC especially as the stock trades for 10.8 times NTM adjusted earnings expectations and offers a dividend yield of 2.6%. HFC returned $245 million to shareholders via dividends and share repurchases. We also like that Holly's refinery

capabilities give the firm flexibility to tailor output more towards higher margin products as opportunities allow, especially considering that there is no scheduled downtime until late September. Our Target Price for HFC has been raised to $74.

Shares of **Capital One Financial** (COF – $89.85) tumbled after the financial services giant revealed that it had a major data breach. Via press release, the company said, "On July 19, 2019, it determined there was unauthorized access by an outside individual who obtained certain types of personal information relating to people who had applied for its credit card products and to Capital One credit card customers. Capital One immediately fixed the configuration vulnerability that this individual exploited and promptly began working with federal law enforcement. The FBI has arrested the person responsible and that person is in custody. Based on our analysis to date, we believe it is unlikely that the information was used for fraud or disseminated by this individual. However, we will continue to investigate. Based on our analysis to date, this event affected approximately 100 million individuals in the United States and approximately 6 million in Canada."

The data that was leaked included 140,000 Social Security numbers and 80,000 linked bank account numbers. While shares dipped on the news, we think shareholders are unlikely to see any long-term major repercussions. Equifax, the credit reporting firm, revealed a massive breach that affected roughly one in two Americans. And for its complacency, the firm received what we believe was less than a slap on the wrist. It was virtually nothing, considering that an errant or misstated credit score could cost a consumer hundreds or thousands of dollars. So, with limited consumer blowback and scant government action, COF joins the long list of data breaches that have happened at major companies like Marriott (500 million records), Facebook (540 million), eBay (145 million), **Target** (TGT – $81.52) (110 million) and **JPMorgan Chase** (JPM $112.93) (76 million). Certainly, the breaches can have devastating consequences for consumers and we note that COF made an offer for free credit monitoring (http://press.capitalone.com/phoenix.zhtml?c=251626&p=irol-newsArticle&ID=2405043), but we have tweaked our Target Price lower by only a tad to $123.

Technology hardware designer and manufacturer **Apple** (AAPL – $204.02) earned $2.18 per share in Q3 2019 (vs. $2.10 est.). AAPL had revenue of $53.8 billion, versus the $53.4 billion estimate. Shares have risen more than 30% this year, with 2% more tacked on after the earnings release. However, the U.S.-China tariff battle sent shares down 2% on Friday, as President Trump warned that another round of tariffs would go into effect on September 1, and not even Apple would be granted relief from them. There was significant conjecture that the cost of iPhones in the U.S. would rise significantly as a result.

In regard to the quarterly numbers, CEO Tim Cook explained, "We saw significant improvement in year-over-year iPhone performance compared to last quarter, very strong performances for both Mac and iPad and absolutely blowout quarter for Wearables, where we had accelerating growth of well over 50% and a new high watermark for services where we set an all-time revenue record of $11.5 billion. Geographically, we're happy with our performance across the board, including a return to growth in Mainland China. We accomplished these results despite strong headwinds from foreign exchange, which impacted our top line growth rate by 300 basis points compared to a year ago."

CFO Luca Maestri added, "We ended the quarter with almost $211 billion in cash plus marketable securities. We retired $3 billion of term debt and reduced commercial paper by $2 billion during the quarter, leaving us with total debt of $108 billion. As a result, net cash was $102 billion at the end of the quarter, and we continue on our path to reaching a net cash neutral position over time. As we move ahead into the September quarter, we expect revenue to be between $61 billion and $64 billion. This guidance includes almost $1 billion of year-over-year negative impact from foreign exchange. We expect gross margin to be between 37.5% and 38.5%. We expect OpEx to be between $8.7 billion and $8.8 billion. We expect OI&E to be about $200 million, and we expect our tax rate to be about 16.5%. Also today, our Board of Directors has declared a cash dividend of $0.77 per share of common stock payable on August 15, 2019, to shareholders of record as of August 12, 2019."

AAPL reported the Services segment gross margin to be 64.1%, growing from 63.8% last quarter. Analysts seemed to be encouraged by the growth in Services revenue (and away from hardware), yet we caution that a good portion of Services revenue is still tied to iPhone. We suppose there aren't many people that would want to shop at the App Store with an Android phone, so it remains highly important for the foreseeable future that Apple keeps users happy in its ecosystem. Even though Apple is once again nearing all-time highs, we think that the valuation remains reasonable, with metrics like a forward price to earnings ratio of 16.4, a free cash flow yield of 6.1% and a dividend yield of 1.5%. We have ratcheted our Target Price for AAPL up to $238.

Shares of **Prudential Financial** (PRU – $88.56) fell more than 14% last week after the financial services company reported disappointing Q2 results. PRU posted adjusted EPS of $3.14, versus consensus analyst expectations of $3.23. Results were aided by strong variable investment income and net favorable underwriting results. The Group, Retirement, PGIM and Life Planner segments performed better than expected, while Individual Life, Gibraltar and Corporate segments were weaker than expected.

CEO Charles Lowrey commented, "During the second quarter, we generated an adjusted return on equity within our 12-14% target and continued to accelerate our strategy, while delivering on our purpose as a company to provide better financial outcomes to more people. Although the recent decline in interest rates and our revised mortality assumptions may trim near-term earnings momentum, we remain confident in our planned initiatives for growth."

As mentioned by Mr. Lowrey, PRU adjusted its mortality assumptions as part of its just-completed actuarial review, which is expected to lower individual life operating income in the nearer-term. This hurdle should be more than offset by the company's plans to lift margins at its financial wellness platform, but these gains will only be realized gradually over the next few years. Further, headwinds will remain in the near-term for PRU with lower interest rates and anticipated higher technology spending.

Key Messages

Focused on accelerating strategy	Making lives better by solving financial challenges of the changing world On track to achieve our operating and intermediate term financial targets Working to connect track record of operating fundamentals with financial outcomes
Business fundamentals drive attractive ROE and book value growth	Year-to-date adjusted operating return on equity of 12.9% Record high adjusted book value per share of $97.15 Record PGIM Assets Under Management and Retirement Account Values
Maintaining strong capital position	Distributed over $900 million to shareholders, including dividends with a 4.1% yield on adjusted book value Continue to hold capital above AA level Holding company highly liquid assets of $4.9 billion

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That said, 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. Even with downward adjustments, analysts presently expect PRU to deliver adjusted EPS of $12.38, $13.41 and $14.70 in 2019, 2020 and 2021, respectively. PRU shares now trade at less than 7 times NTM adjusted EPS expectations and 58% of book value, while offering investors a 4.5% dividend yield. All things considered; we have pared our Target Price for PRU to $134.

Electronic components maker **Corning** (GLW – $29.29) earned $0.45 per share in fiscal Q2 2019 (vs. $0.44 est.). GLW had revenue of $3.0 billion, versus the $3.0 billion estimate. Since the release, shares have fallen more than 10%, as a slowdown in the Optical segment resulted in a guidance haircut. GLW now expects to show "low-to-mid single digits" growth in the optical segment, versus the previous 10% growth forecast, while lower global auto production and soft television sales are additional headwinds.

"So the good news is, even in this environment, we are growing. And when markets improve, we'll grow even more. We are confident in our long-term growth prospects. The successful execution of our Strategy and Capital Allocation Framework adds to our confidence. We face

challenges along our path to grow throughout our 2016 to 2019 plan, but we addressed those challenges and met or exceeded all our goals. In so doing, we created a bigger stronger company, and we created a strong foundation for significant additional growth," said CEO Wendell P. Weeks. "Across our markets, our relationships with industry-leading customers are creating new opportunities for collaboration, and our strategic investments are paying off. We're capturing opportunities in generating significant top and bottom-line growth in multiple businesses. I look forward to sharing our progress against our new objectives over the next 4 years."

The Environmental Technologies segment is expected to surpass previous full-year growth expectations of 10%. With glass pricing better than expected, the Display Technologies segment revenue outlook is expected to be low- to mid-single digits. Optical Communications revenue is expected to grow twice as fast as the passive optical market (despite the lowered guidance). And the Specialty Materials and Life Sciences segments are expected to meet full-year growth expectations in the low- to mid-single digit range, and faster than the overall market.

While GLW's 2019 outlook is a mixed bag, we think that our longer-term thesis remains intact, with significant growth opportunities presenting themselves in each of GLW's five business segments. We continue to think GLW offers best-in-class products with a strong management team that has achieved stated goals consistently. GLW yields 2.7% and trades at 14.9 times NTM adjusted EPS expectations. Our Target Price has been trimmed to $43.

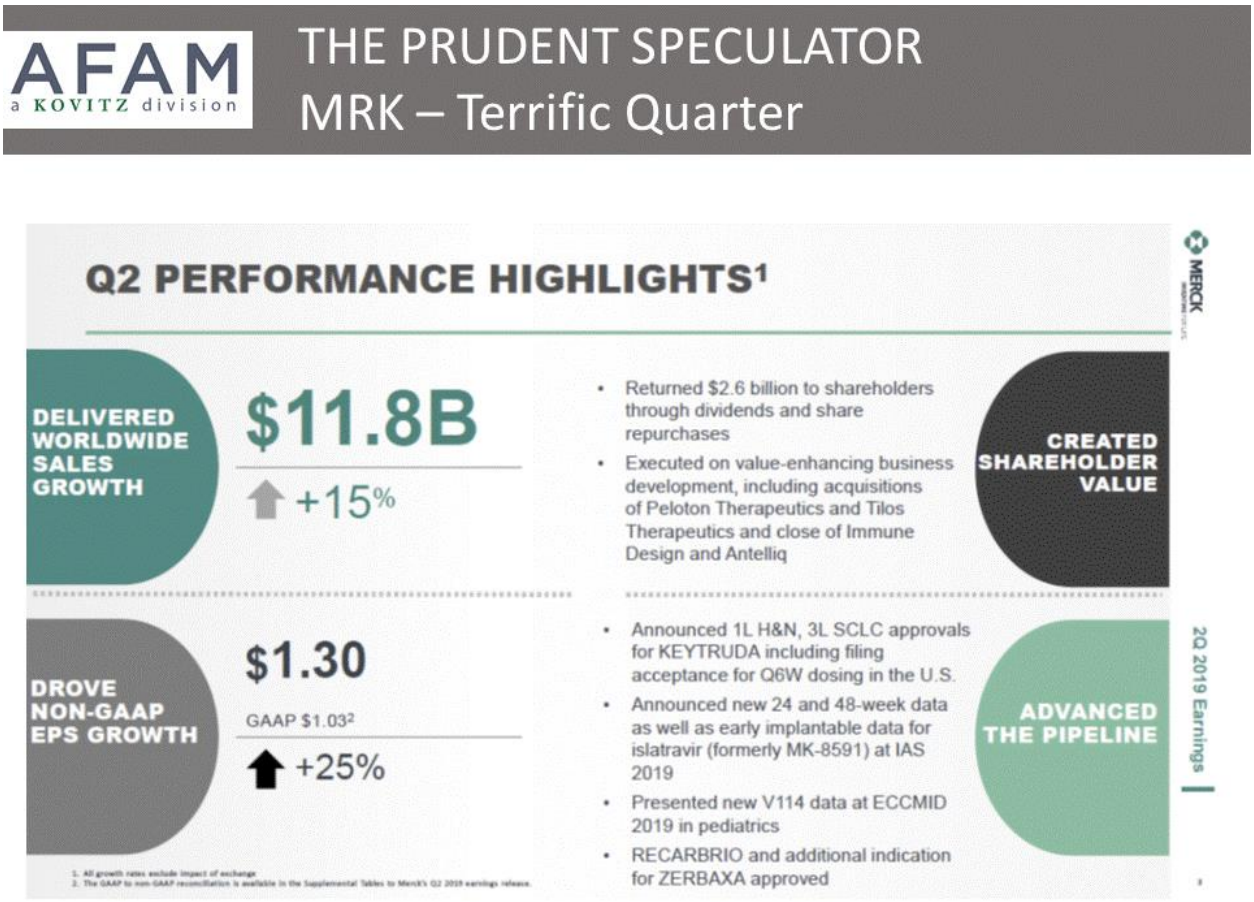
Our most recent recommendation **NetApp** (NTAP – $46.06) posted a soft preliminary fiscal Q1 2020 and disastrous outlook for the balance of the year. In Q1, NTAP earned $1.22 per share (vs. $1.26 est.) on sales of $1.59 billion (vs. $1.64 billion est.). The company's guidance for 2020 reflected a 5% to 10% revenue decline, compared with May's estimate of low single-digit growth. Shares ended the week down a dismal 22%.

CEO George Kurian said, "Our shortfall was primarily due to lower IT hardware spending related to macro concerns at our largest customers and to a lesser extent, execution issues in the Americas. However, we believe we can gain share by increasing sales coverage and accelerating our participation in the growing private cloud and cloud data services markets. We have a strong business model from the gross margin and cost structure improvements that we've made over the last several years. We will continue to be disciplined in managing our expenses, while adding the sales capacity needed to return the business to growth and to achieve our long-term top line goals. And we remain committed to our capital allocation policy of returning cash to shareholders through share buyback and a quarterly dividend. We will provide more information when we report our full first quarter results and the outlook for Q2 and the year."

"While we are disappointed that our preliminary results for the first quarter are lower than we had previously anticipated, we remain confident in our long-term strategy and the health of our business model," continued Mr. Kurian. "Our customer conversations indicate that our hybrid multi-cloud portfolio of solutions is the right one. We believe we can return to growth over time by prudently reallocating investments to expand sales coverage and accelerate our participation in the growing Private Cloud and Cloud Data Services markets."

The latest developments weren't what we, nor apparently Wall Street, had expected. However, we think the company still offers a unique exposure in our broadly diversified portfolios and we remain committed long-term shareholders. It helps, too, to know that some of our largest, long-term winners over the years have taken big hits early in our ownership. We think the business model remains attractive, as does the reasonable valuation (with a forward P/E near 11) and EPS north of $4 expected for each of the next three fiscal years. The company has a strong balance sheet and the just-hiked dividend yield is a generous 4.2%. That said, we have knocked our Target Price for NTAP down to $76.

Shares of **Merck** (MRK – $84.47) increased almost 4% last week after the global pharma giant reported Q2 financial results that were much better than expected on both the top and bottom line. MRK turned in adjusted EPS of $1.30, versus consensus expectations of $1.16. Revenue for the quarter was $11.76 billion, compared to forecasts calling for $10.96 billion. MRK's key growth driver Keytruda experienced sales growth of 58% to $2.6 billion (excluding foreign currency impact sales grew 63%) versus Q2 2018. Merck also enjoyed strong trends in vaccines, with sales growing 33% YoY.



"Our science-led strategy and execution across our key growth pillars have driven another quarter of accelerating revenue growth with strength across our global portfolio," said CEO Kenneth C. Frazier. "We remain confident that our innovative products and significant pipeline

opportunities will continue to deliver strong results and provide sustainable value to patients and shareholders." Merck also announced that it was raising its full-year 2019 revenue range to $45.2 billion to $46.2 billion. Additionally, the company said it was narrowing and raising its full-year adjusted EPS guidance to a range of $4.84 to $4.94.

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 as we still believe the market doesn't fully appreciate Keytruda, especially in earlier lines of therapy. The continuing successful data on Keytruda in several indications offers Merck significant growth potential and reinforces the strong pricing power for the drug. MRK also has a wide lineup of high-margin drugs outside of Keytruda, 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. The current dividend yield is 2.6%. We have edged our Target Price up to $90.