Market Commentary Monday, September 23, 2019

September 23, 2019

EXECUTIVE SUMMARY

Sentiment Improves – Stocks Decline
FOMC Meeting – 25 Basis Point Cut in the Fed Funds Rate
FOMC Outlook – Modest Improvement in GDP Growth Estimates
Powell Q&A – Upbeat Fed Chair
Rates – Low Interest Rates Supportive of Stocks
Earnings & Dividends – Corporate Profits and Payouts Likely to Increase
OECD Outlook – Risks Aplenty But 2.0% Estimated U.S. GDP Growth for 2020
TPS Outlook – No Reason Not to Be Optimistic About Equities
Stock Updates – GM, MSFT, STX, GLW & FDX

Market Review

With the apparent easing of tensions in the U.S.-China trade skirmish again giving way to renewed concerns that even an interim deal may be hard to come by, equities suffered a lousy end to a less-than-stellar week. Of course, while most would blame Middle Kingdom officials returning home, cancelling a planned trip to farms in Montana and Nebraska, we might argue that the poor five days was due to folks deciding that they sort of liked stocks again.

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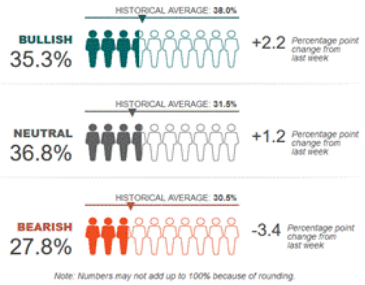
THE PRUDENT SPECULATOR
Folks Finally More Optimistic: Stocks Sink

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 9/18/2019

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.

September 19, 2019 - Optimism among individual investors about the short-term direction of the stock market improved for the third consecutive week. Bullish sentiment, expectations that stock prices will rise over the next six months, rose 2.2 points to 35.3%. Even with the increase, optimism remains below its historical average of 38.0% for the 30th time this year and the 18th time in 19 weeks. Bearish sentiment, expectations that stock prices will fall over the next six months, fell 3.4 points to 27.8%. Pessimism is below its historical average of 30.5% for the first time in seven weeks. The continued improvement in optimism and decrease in pessimism is occurring as volatility in stock markets has calmed down from last month. Bullish and neutral sentiment continue to be at their highest levels and bearish sentiment is at its lowest level since July 31, 2019.

AAII Bullish Sentiment rose to its highest level since the end of July and mutual and exchange traded fund investors in the latest calcs from Investment Company Institute finally plowed more money into domestic stocks than they redeemed…just in time for the U.S. equity markets to skid!

Combined Estimated Long-Term Fund Flows and ETF Net Issuance

Millions of dollars

Week Ended	9/11/2019	9/4/2019	8/28/2019	8/21/2019	8/14/2019
Total Equity	7,549	-4,106	-9,506	-14,007	2,437
Domestic	8,596	-4,389	-5,324	-9,384	3,109
World	-1,047	283	-4,182	-4,623	-672
Hybrid	-697	-1,138	-1,412	-744	-2,739
Total Bond	13,013	6,925	7,952	3,949	10,038
Taxable	11,731	5,707	5,993	1,874	8,150
Municipal	1,282	1,218	1,959	2,074	1,888
Commodity	-396	914	1,745	618	307
Total	19,469	2,594	-1,220	-10,184	10,043

Source: Investment Company Institute

After all, sentiment and fund flow numbers were quite pessimistic the three weeks prior when the equity markets generally enjoyed handsome gains. It doesn't always happen that stocks zig when investors zag, of course, but history shows that many are miserable market timers as when Wall Street holds a sale, few show up. The inverse is true, too, as most feel more comfortable about stocks after a sizable advance has occurred. No doubt, there is plenty of evidence to support the assertion that the only problem with market timing is getting the timing right!

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THE PRUDENT SPECULATOR
Few Come Close to Beating the Indexes

Since 1994, DALBAR's Quantitative Analysis of Investor Behavior has measured the effects of investor decisions to buy, sell and switch into and out of mutual funds over short and long-term timeframes. As the latest evidence (as of 12.31.18) reveals, folks are lousy market timers.

	Average Equity Fund Investor (%)	Average Fixed Income Fund Investor (%)	Average Asset Allocation Fund Investor (%)	S&P 500 (%)	BloombergBarclays Aggregate Bond Index (%)	Inflation (%)
20 Year	3.88%	0.22%	1.87%	5.62%	4.55%	2.17%
10 Year	9.66%	0.70%	4.53%	13.12%	3.48%	1.82%
5 Year	3.96%	-0.40%	1.50%	8.49%	2.52%	1.56%
3 Year	5.58%	-0.11%	1.84%	9.26%	2.06%	2.04%
12 Month	-9.42%	-2.84%	-6.97%	-4.38%	0.01%	1.93%

Outside of the twists and turns on the trade front, and wild gyrations in the energy markets after the attack on Saudi oil facilities, the big news last week was the September Fed Meeting, with the FOMC Statement including:

Information received since the Federal Open Market Committee met in July indicates that the labor market remains strong and that economic activity has been rising at a moderate rate. Job gains have been solid, on average, in recent months, and the unemployment rate has remained low. Although household spending has been rising at a strong pace, business fixed investment and exports have weakened. On a 12-month basis, overall inflation and inflation for items other than food and energy are running below 2 percent. Market-based measures of inflation compensation remain low; survey-based measures of longer-term inflation expectations are little changed.

Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability. In light of the implications of global developments for the economic outlook as well as muted inflation pressures, the Committee decided to lower the target range for the federal funds rate to 1-3/4 to 2 percent. This action supports the Committee's view that sustained expansion of economic activity, strong labor market conditions, and inflation near the Committee's symmetric 2 percent objective are the most likely outcomes, but uncertainties about this outlook remain.

Interestingly, Jerome Powell & Co. actually raised, albeit modestly, their outlook for GDP growth this year,…

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THE PRUDENT SPECULATOR
Better GDP Growth & Lower Rates

The Fed bumped up its GDP growth (yes growth!) projections for 2019 and 2021 by 0.1%, though the longer-run estimate remained at 1.9%. The outlook for the Federal Funds rate fell in 2019, 2020 and 2021.

Table 1. Economic projections of Federal Reserve Board members and Federal Reserve Bank presidents, under their individual assumptions of projected appropriate monetary policy, September 2019
Advance release of table 1 of the Summary of Economic Projections to be released with the FOMC minutes

Percent

Variable	Median[1]					Central Tendency[2]					Range[3]				
	2019	2020	2021	2022	Longer run	2019	2020	2021	2022	Longer run	2019	2020	2021	2022	Longer run
Change in real GDP	2.2	2.0	1.9	1.8	1.9	2.1–2.3	1.8–2.1	1.8–2.0	1.7–2.0	1.8–2.0	2.1–2.4	1.7–2.3	1.7–2.1	1.6–2.1	1.7–2.1
June projection	2.1	2.0	1.8		1.9	2.0–2.2	1.8–2.2	1.8–2.0		1.8–2.0	2.0–2.4	1.5–2.3	1.5–2.1		1.7–2.1
Unemployment rate	3.7	3.7	3.8	3.9	4.2	3.6–3.7	3.6–3.8	3.6–3.9	3.7–4.0	4.0–4.3	3.5–3.8	3.3–4.0	3.3–4.1	3.3–4.2	3.6–4.5
June projection	3.6	3.7	3.8		4.2	3.6–3.7	3.5–3.9	3.6–4.0		4.0–4.4	3.5–3.8	3.3–4.0	3.3–4.2		3.6–4.5
PCE inflation	1.5	1.9	2.0	2.0	2.0	1.5–1.6	1.8–2.0	2.0	2.0–2.2	2.0	1.4–1.7	1.7–2.1	1.8–2.3	1.8–2.2	2.0
June projection	1.5	1.9	2.0		2.0	1.5–1.6	1.9–2.0	2.0–2.1		2.0	1.4–1.7	1.8–2.1	1.9–2.2		2.0
Core PCE inflation[4]	1.8	1.9	2.0	2.0		1.7–1.8	1.9–2.0	2.0	2.0–2.2		1.6–1.8	1.7–2.1	1.8–2.3	1.8–2.2	
June projection	1.8	1.9	2.0			1.7–1.8	1.9–2.0	2.0–2.1			1.4–1.8	1.8–2.1	1.8–2.2		
Memo: Projected appropriate policy path															
Federal funds rate	1.9	1.9	2.1	2.4	2.5	1.6–2.1	1.6–2.1	1.6–2.4	1.9–2.6	2.5–2.8	1.6–2.1	1.6–2.4	1.6–2.6	1.6–2.9	2.0–3.3
June projection	2.4	2.1	2.4		2.5	1.9–2.4	1.9–2.4	1.9–2.6		2.5–3.0	1.9–2.6	1.9–3.1	1.9–3.1		2.4–3.3

Source: Federal Reserve, September 18, 2019

…which makes sense, we suppose, given that the latest economic numbers ranged from excellent in regard to housing,…

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THE PRUDENT SPECULATORS
Best Housing Numbers of the Year

No doubt, low mortgage rates together with a strong labor market are key catalysts as housing starts for August jumped to 1.364 million, exceeding expectations by a wide margin and hitting the highest level in more than a dozen years. Meanwhile, sales of existing homes rose to the best tally of the year, climbing to a better-than-expected 5.49 million, though supply fell and the median sale price inched lower to $278,200.

…to surprisingly good in regard to industrial production,…

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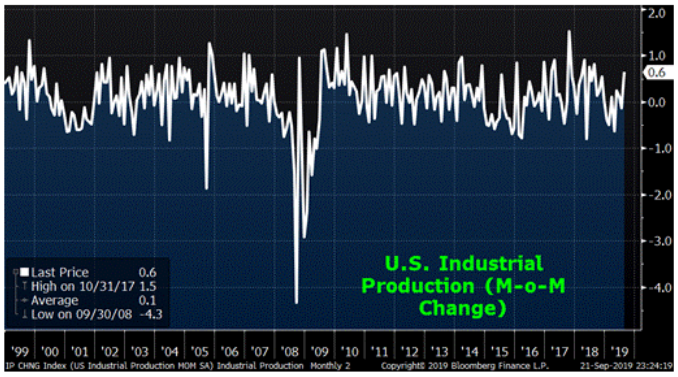
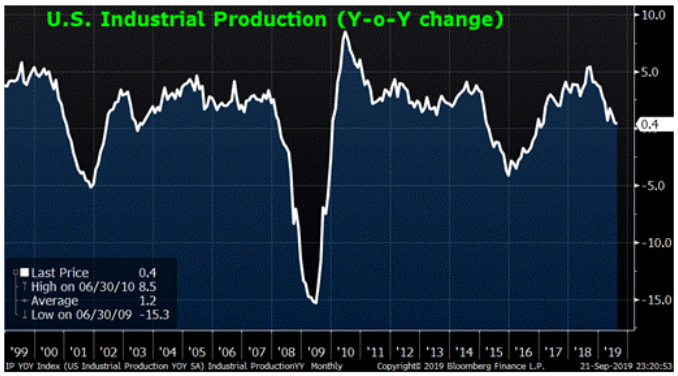
Strong M-o-M Industrial Production





Output at the nation's factories, mines and utilities rebounded sharply in August, blowing away expectations with a 0.6% month-over-month increase, the best showing of the year. Manufacturing improved by 0.5%, while mining climbed 1.4% and utilities gained 0.6%. Of course, on a year-over-year basis, the advance in overall industrial production was just 0.4%, which actually is below the 20-year norm of 1.2%.

…to OK in regard to East Coast factory activity.

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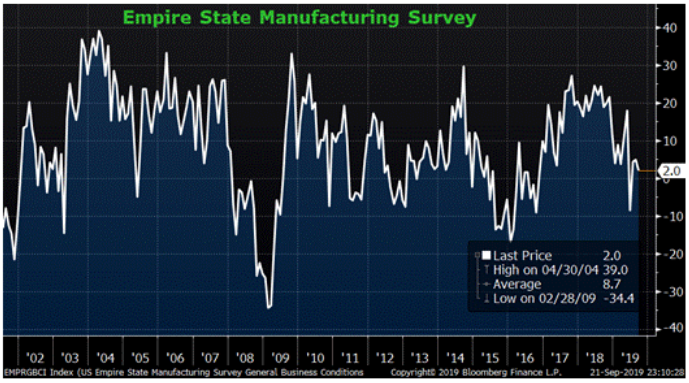
Mixed Manufacturing Stats



Though the tally was much improved over where it stood three months ago, the latest read on factory activity in the New York area came in worse than expected at 2.0 for September, dropping from the 4.8 reading posted in August. It was a different story for the Philadelphia Fed's September measure of manufacturing activity in the mid-Atlantic region, which topped forecasts with a tally of 12.0, nicely above the historical norm.

To be fair, those numbers are generally backward looking, and the latest forward-looking data point from the Conference Board was hardly robust,…

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THE PRUDENT SPECULATOR
Forward-Looking August LEI Unchanged

The forward-looking index of Leading Economic Indicators was flat on a month-over-month basis in August, with the Conference Board stating, "The recent trends in the LEI are consistent with a slow but still expanding economy, which has been primarily driven by strong consumer spending and robust job growth." Housing permits and the Leading Credit Index offset the weakness in the index from the manufacturing sector and the interest rate spread.

…but Federal Reserve Chair Jerome H. Powell sounded fairly upbeat at the press conference that followed the FOMC Meeting on Wednesday,…

GREG ROBB. Thank you, Chairman Powell. Greg Robb from MarketWatch. I'm kind of hearing two things from you. You're saying that the economy is doing well, but there's this sense with people that the economy is actually starting to slow now. And people are—more and more you talk—there's talk about recession, and even the Fed thinks the downside risks are rising. So, is the economy over the next year—between now and the end of next year—do you think GDP growth is going to hold steady and the unemployment rate. Could you talk about just—how do you see the economy evolving over the next year?

CHAIR POWELL. ***You know, so, I think, and my colleagues and I think all think that the most likely case is for continued moderate growth, continued strong labor market, and inflation moving back up to 2 percent. And I think that's, by the way, widely shared among forecasters.*** *You know, the issue is more the risks to that. You have downside risks here, and we've talked about them. It's that global growth will have an effect on U.S. growth over time, less so than for many other economies, but still, there's a sector of our economy that's exposed to that. Trade policy uncertainty also has—apparently has an effect. So—and you can see some weakness in the U.S. economy because of all that. But nonetheless, so the job of monetary policy is to adjust both to ensure against those downside risks but also to support the economy in light of the existing weakness that we do see.* ***So, we're not—as I mentioned—we're not, we don't see a recession. We're not forecasting a recession. But we are adjusting monetary policy in a more accommodative direction to try to support what is in fact a favorable outlook.***

…even as it would appear that the Fed is likely to keep interest rates lower for longer,…

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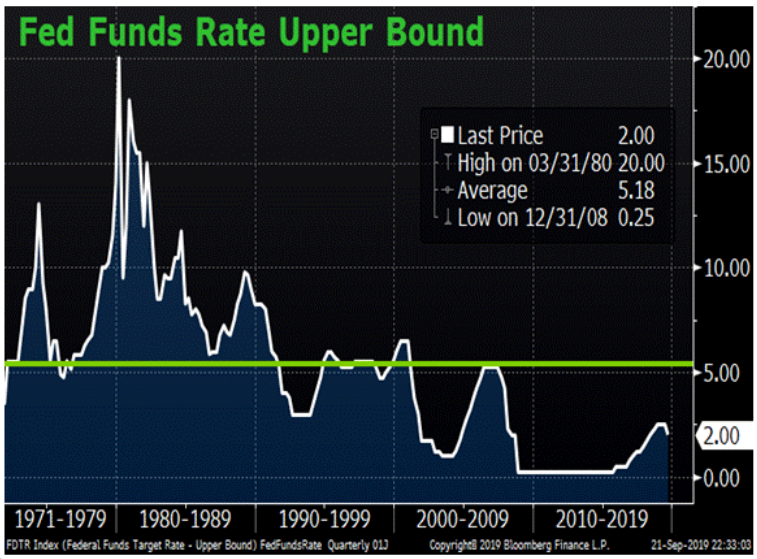
THE PRUDENT SPECULATOR
FOMC Fed Funds Rate Targets: Sept 2019

While slowing economic growth has led to investor consternation, the Federal Reserve remains highly accommodative with the upper bound for the Fed Funds rate having just been cut to 2.0% and even the highest FOMC Participant long-run target projection now at only 2.875%.

FOMC Participants' Fed Funds Rate Target Level Number with each projection				
Midpoint of Target Range	2019	2020	2021	Longer Run
3.375				
3.250				
3.125				
3.000				
2.875				2
2.750				
2.625			1	2
2.500				
2.375		1	5	5
2.250				
2.125	5	6	4	4
2.000				
1.875	5	2	3	3
1.750				
1.625	7	8	4	1

Source: Federal Reserve, September 18, 2019



Source: Bloomberg

…which, in our view, makes the earnings and dividends produced by stocks all the more appealing,…

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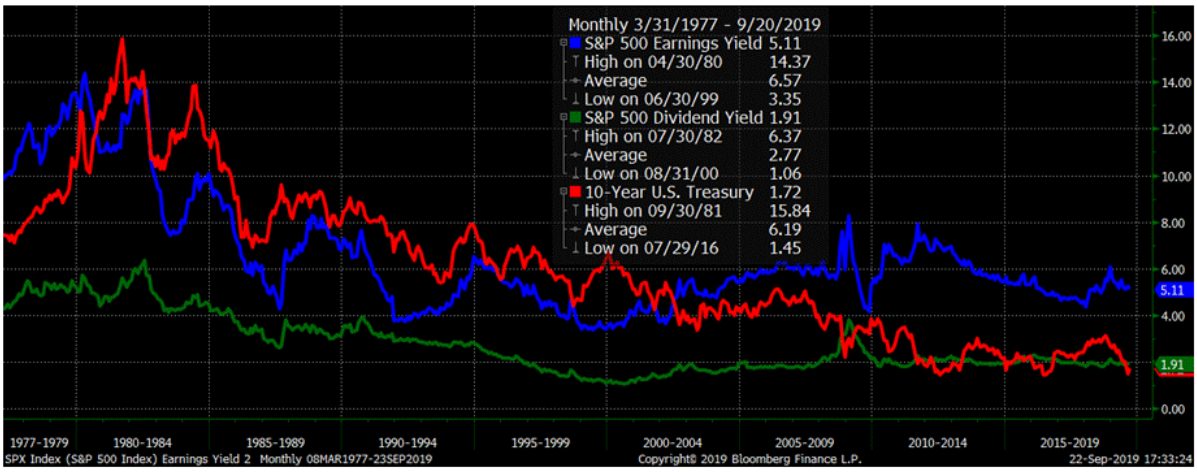
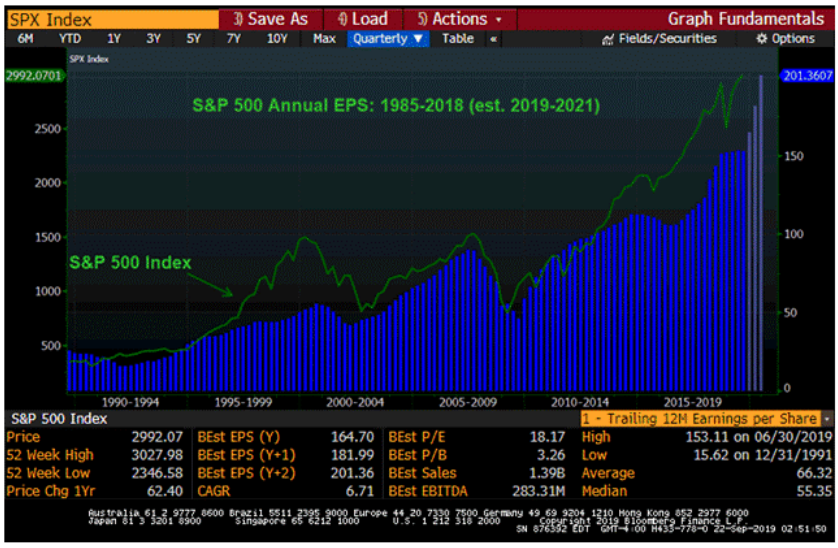
Interest Rates Very Supportive of Stocks

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 5.11%.



…especially when bottom lines,…

Certainly, we understand that analysts are often overly optimistic in their projections, but sizable year-over-year earnings expansion is expected in '19, with further growth likely in '20 and '21.



S&P 500 Earnings Per Share

Quanter Ended	Bottom Up Operating EPS 3 Month	Bottom Up Operating EPS 12 Month
ESTIMATES		
12/31/2020	$48.01	$180.64
9/30/2020	$46.37	$175.01
6/30/2020	$44.66	$169.59
3/31/2020	$41.60	$165.07
12/31/2019	$42.38	$161.46
9/30/2019	$40.95	$154.11
6/30/2019	$40.14	$154.54
ACTUAL		
3/31/2019	$37.99	$153.05
12/31/2018	$35.03	$151.60
9/30/2018	$41.38	$150.42
6/30/2018	$38.65	$140.37
3/31/2018	$36.54	$132.23
12/31/2017	$33.85	$124.51
9/30/2017	$31.33	$118.56
6/30/2017	$30.51	$115.92
3/31/2017	$28.82	$111.11
12/31/2016	$27.90	$106.26
9/30/2016	$28.69	$101.42
6/30/2016	$25.70	$98.17
3/31/2016	$23.97	$98.61
12/31/2015	$23.06	$100.45

Source: Standard & Poor's. As of 9.18.19

…and payouts are likely to continue to show solid growth over the next couple of years.

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THE PRUDENT SPECULATOR
Dividends Provide Handsome Income

While dividends are never guaranteed, the historical evidence suggests that Corporate America has a long history of raising quarterly payouts, whereas the coupons on most debt instruments are fixed.

COUNT OF S&P 500 DIVIDEND ACTIONS	INCREASES	INITIATIONS	DECREASES	CESSATIONS
2019 (as of 9.19.19)	258	6	6	0
2018	374	6	3	0
2017	351	5	9	2
2016	344	7	19	2
2015	344	7	16	3
2014	375	8	8	0
2013	366	15	12	0
2012	333	15	11	1
2011	320	22	5	0
2010	243	13	4	1
2009	151	6	68	10
2008	236	5	40	22
2007	287	11	8	4
2006	299	6	7	3

Source: Standard & Poor's.

S&P 500 DIVIDENDS PER SHARE	
2020 (Est.)	$62.37
2019 (Est.)	$58.44
2018	$53.86
2017	$50.47
2016	$46.73
2015	$43.49
2014	$39.44
2013	$34.99
2012	$31.25
2011	$26.43
2010	$22.73
2009	$22.41
2008	$28.39
2007	$27.73
2006	$24.88

Source: Bloomberg. As of 9.20.19

To be sure, all is not unicorns and rainbows, as plenty of downside risks remain,…

Key messages

The global outlook continues to darken

- Growth continues to slow in advanced and emerging economies
- Investment is taking a hit as high policy uncertainty feeds a collapse in trade growth and a manufacturing slump
- Consumption is holding up but is threatened by slowing job growth

Trade and political tensions fuel risks of persistent low growth

- Escalating trade restrictions are entrenching uncertainty, endangering future growth
- A no-deal Brexit would hurt an already weak UK economy and create disruptions across Europe
- High private debt of deteriorating quality could amplify the effects of shocks

Governments can reverse the spiraling costs of uncertainty and invest more

- Halt the surge in trade-distorting tariffs and subsidies and restore predictable rules for business
- Limit the reliance on overstretched monetary policy, think fiscal and structural
- Escape the trap of persistent weak growth: undertake public investment

19

…but even the arguably pessimistic Organisation for Economic Co-operation and Development (OECD), which was out with its latest Interim Outlook last week, is still calling for 2.0% U.S. and 3.0% global GDP growth next year.

OECD Global Growth: 3.0% in 2020

GDP growth projections downgraded

OECD Interim Economic Outlook projections

%, year-on-year. Arrows indicate the direction of revisions since May 2019.

downward by 0.6 pp and more | downward by 0.3 to 0.6 pp | downward by less than 0.3 pp | no revision | upward

	2018	2019	2020		2018	2019	2020
World	3.6	2.9	3.0	G20	3.8	3.1	3.2
Australia	2.7	1.7	2.0	Argentina	-2.5	-2.7	-1.8
Canada	1.9	1.5	1.6	Brazil	1.1	0.8	1.7
Euro area	1.9	1.1	1.0	China	6.6	6.1	5.7
Germany	1.5	0.5	0.6	India[1]	6.8	5.9	6.3
France	1.7	1.3	1.2	Indonesia	5.2	5.0	5.0
Italy	0.7	0.0	0.4	Mexico	2.0	0.5	1.5
Japan	0.8	1.0	0.6	Russia	2.3	0.9	1.6
Korea	2.7	2.1	2.3	Saudi Arabia	2.2	1.5	1.5
United Kingdom	1.4	1.0	0.9	South Africa	0.8	0.5	1.1
United States	2.9	2.4	2.0	Turkey	2.8	-0.3	1.6

Note: Difference in percentage points based on rounded figures. The European Union is a full member of the G20, but the G20 aggregate only includes countries that are also members in their own right.
1. Fiscal years starting in April.
Source: OECD Economic Outlook database; and OECD calculations.

4

So, while we know that September and October historically have been volatile months and we are always braced for downside movements, we see no reason to alter our enthusiasm for the long-term prospects of our broadly diversified portfolios of what we believe to be undervalued stocks. We think that the U.S. economy will continue to muddle along, the Federal Reserve will remain friendly and interest rates will reside at historically low levels for the foreseeable future. With equity valuations reasonable, dividend yields generous and investor sentiment not overly enthusiastic, we assert that those who share our multi-year time horizon should stick with stocks, despite the sizable gains in the major indexes turned in thus far in 2019.

Stock Updates

Chris Quigley and Jason Clark offer updates on a few of our 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/.

Shares of auto and truck maker **General Motors** (GM – $37.36) sank almost 4% last week after 48,000+ union employees walked off the job at midnight on Sunday, September 15. GM management has been negotiating with the union since the summer, but numerous reports said

the two sides were far apart. Friday, a United Auto Workers (UAW) leader essentially said that some progress had been made, but there were still unresolved issues. Union workers are walking picket lines outside 55 of GM's domestic plants.

There are numerous estimates around the investment community that the strike is costing GM upwards of $100 million per day. Certainly, near-term revenue numbers will be hit hard because GM records wholesale sales to dealers, but the company had several weeks more supply than usual in the dealer chain, which should keep things OK with customers, and we would think that GM would be able to quickly ramp up any needed production once an agreement is reached.

As readers are likely aware, we strive to stay neutral in situations like this, focusing our attention on how actions and reactions impact our investment thesis. That said, we know for our investment in GM that a the strike won't be good in the near term, but GM doesn't want to enter a long-term contract that could cripple the company in an eventual downturn and impact its ability to spend more on the automotive technology of the future. The UAW has been pressured by a shrinking membership base, which it is looking to protect if a downturn comes, even as the union is in the midst of a federal corruption investigation involving some of its leadership.

GM's last UAW strike occurred in 2007 and lasted only a couple of days. This strike is obviously already longer, but GM is in a much better financial position today than it was back then, so one would think workers expect the company to offer a few more concessions. Additionally, the UAW is very displeased over GM's late-2018 announcement that it would move four U.S. based plants to "unallocated" status. If we look back even further, the UAW went on strike against GM in 1970 for more than two months, but we do not see this one lasting that long as the union back then had approximately 400,000 GM workers (estimates peg UAW members working for the big Detroit three automakers at less than 150,000 today) and since 2007, new hires do not get retiree healthcare or a pension. Additionally, it seems that UAW strike pay is $250 a week, with many employees normally making five to seven times that per week, so one would think the rank and file will be hard pressed to walk the picket lines for too long.

All things considered, we would use any further GM share price downturn from the strike as an opportunity to add to current positions or to initiate a purchase. We continue to believe that GM is executing on its core business well and we still like its cost control initiatives, ability to generate free cash flow, generous capital return programs, and electric and autonomous vehicle programs. The stock trades for 5.4 times earnings and yields 4.1%, while we think that an economic downturn actually might be the catalyst to boost the stock when investors realize that earnings are not as cyclical as in the past. Our current Target Price for GM is $53.

Before retreating late in the week with the rest of the tech sector, computing giant **Microsoft** (MSFT – $139.44) rose to all-time highs after the company said that it would increase its dividend by $0.05 per quarter to $0.51, an 11% increase over the previous dividend. Additionally, MSFT's new share repurchase program will swell to $40 billion, though the program has no end date. The company's annual shareholders meeting will be December 4.

MSFT returned $7.7 billion to shareholders via dividends and share repurchases last quarter, a figure we expect will grow given that Microsoft's size and scale make big acquisitions difficult due to antitrust enforcement. In addition, we think MSFT's valuation is still not excessively expensive, as the stock sports a 3.6% free cash flow yield and a 1.5% dividend yield. Analysts expect the company's EPS growth rate to be at least 11% for each of the next three fiscal years, with earnings growing from $3.88 per share in 2018 to an estimated $6.74 in fiscal 2022, and MSFT still scores well in our quantitative framework. Our Target Price for MSFT has been boosted again, this time to $153.

Hard disk drive maker **Seagate Technology PLC** (STX – $52.40) fell 6.7% last week after comments made at the company's Analyst Day on Thursday. STX also updated its guidance. Seagate expects adjusted EPS around $0.99 +/- 5% for fiscal Q1, as a result of changing the useful lives of STX's Capital Equipment (from 3-5 years to 3-7 years). The change lowers depreciation expense and results in a positive impact around $0.09. STX expects Q1 revenue to be $2.55 billion +/- 5%.

Prompting the drop, CFO Gianluca Romano said, "Based on our product road map, based on our outlook for the demand of those products, we expect revenue to grow between 2% and 6%; we expect operating margin to be in the 13% to 16% of revenue range; CapEx, that we already guided at our last earnings release, to be between 6% and 8% of revenue; and we want to still commit for at least 50% return to shareholder of our free cash flow. Our first priority is to support the business… Our second priority is dividend… Our third priority is the share repurchase program. We have an open authorization. At the end of fiscal year '19, we still had more than $2 billion available."

STX CEO Dave Mosley said, "I think the pivot in the platforms is one of the big takeaways. We think we've got the company in the right fighting shape for what's coming in the growth of data. When I say sustainability, I think integrity and I think long term. We have to do what our customers need. We have to do what the market needs in a very predictable fashion. It's important for us to continue to drive our technology. Imagine if it slows down, imagine the impact that that has. It's important for us to stay focused. So sustainability ties through all those presentations. Customers, technology investment, financial strength… There is growth coming. The growth that will fundamentally drive us is the growth of data. We're excited about it actually, and the decentralization of that data will probably drive more devices than we know… We are building products for FY '25 today. For that 17 zettabytes that needs to be installed, that's products that are coming up for our factory lines today. And that all gets down to, we understand our fundamental value creation, we understand what a good investment back-end Seagate is, we make those investments and then we return the rest to the shareholders. That's why I believe Seagate is built for sustainability and built to last."

We like the company's strong cash flow and solid balance sheet. We also like STX's 4.8% yield, which will increase next year to $0.65 per share quarterly (from $0.63) and think that while the long-term growth target is a little on the low end, there's plenty of room to outperform. Our Target Price for STX now resides at $59.

Electronic components maker **Corning** (GLW – $27.76) provided an update on Monday for its Q3 2019 guidance, which included outlook reductions in two of its five business segments. The press release stated that its Display Technologies segment is now expected to see a high-single-digit volume decline, as a result of reduced customer utilization. Corning expects display glass volume to increase "slightly" for the full year, driven by the company's ramp-up of its Gen 10.5 manufacturing capacity. Corning's Optical Communications segment is seeing customer reductions in capital spending on cable deployments and home fiber service, which is expected to result in a year-over-year decline by a low-teen percentage. Corning's full-year forecast for the segment now stands at a 3% to 5% y-o-y decline.

Certainly, it wasn't great news and it was poorly received by investors, with shares forced lower by about 8% for the week. Corning's business is sensitive to customer demand in many areas. While we generally appreciate diversification to the extent that any management team can keep control of its businesses, it also makes it more difficult to consistently achieve results across the entire firm. The last few years for GLW have been choppy, both for the stock and for earnings, after GLW spent the better part of 2015-2017 on a tear. We think there are significant growth opportunities in each of GLW's five business segments, and it'll likely take time to get everything up to speed. We continue to think GLW offers best-in-class products with a strong management team that has achieved stated long-term goals consistently. GLW yields 2.9% and trades at 16.5 times NTM adjusted EPS expectations. Our Target Price has been trimmed to $41.

Shares of air freight and logistics leader **FedEx** (FDX – $148.78) dropped more than 14% last week, after the company reported fiscal Q1 2020 results and 2020 guidance that trailed analyst expectations. FDX earned $3.05 per share last quarter (vs. $3.15 est.) and had revenue of $17.048 billion (vs. $17.063 billion est.). FDX slashed its EPS outlook to between $11.00 and $13.00 from the previous estimate between $14.00 and $15.85.

Chairman Fred Smith updated investors on recent macro trends, "Over the summer, these challenges increased somewhat due to the decision to not renew our largest Amazon contracts and deepening trade disputes. While the Amazon contracts represented only a small proportion of our revenues, the nature of our businesses is such that near-term profits will be adversely affected since the last bit of volume has significant flow-through to the bottom line. However, we have closed additional business to replace this traffic, which is being onboarded, and we are taking out significant costs, which were unique to Amazon's requirements. Also, the global macro economy continues to soften, and we are taking steps to reduce capacity. Specifically, we will retire 20 MD-10-10 aircraft over the current and next fiscal year, which will eliminate that fleet type from our air operations. We are highly likely to also retire the remaining 10 A310 aircraft this year, which will also lead to the elimination of that fleet type. In addition, we are parking the equivalent capacity of 7 MD-11 aircraft this fiscal year. Accordingly, assuming no recession, we will continue the initiatives announced in May and June with confident optimism about FedEx' long-term future competitive position and industry leadership."

CMO Brie Carere added, "Comparing to where we were in June, our overall outlook for U.S. economic growth is down 20 basis points, currently at 2.3% for real GDP. Our outlook has changed despite consumer-driven growth of 2% in the U.S. in Q2 of CY '19. This change is because the industrial sector remains sluggish due to an inventory buildup and increased

geopolitical trade tensions. From a global perspective, economic growth has decreased as the developed world outside of the U.S. sees weaker growth and both domestic and external factors weigh on emerging markets. Q2 CY ’19 global trade volumes declined year-over-year, which is the first decline since 2009. This decline, coupled with JPMorgan’s global PMI manufacturing export orders index falling from 47.5 in August, from 49 in May, leads us to expect global trade volumes will contract this year on an annual basis for the first time since 2009. As we have stressed before, a zero tariff, zero subsidy global trade environment is the most powerful economic growth engine there is, we will continue to push for policies that stimulate rather than depress global trade.”

COO Raj Subramaniam said, “The global economic and trade environment remains very uncertain. Despite this uncertainty, FedEx remains committed to delivering long-term profitable growth. We are taking decisive actions to address three topics. Number one, reducing capacity, especially in our intercontinental network and overall directional costs in our Express business; number two, completing TNT integration; and number three, leveraging our infrastructure at FedEx Ground and making targeted investments that allow us to successfully go all-in on e-commerce.”

In the Q&A session, an analyst from Barclays suggested that FedEx management might not be challenging the things that aren’t working like LTL and falling margins in the Express business. Mr. Smith countered that suggestion with a long-winded reply, which we trimmed for clarity, “Let’s talk about LTL. I believe the better way to put that is there is 1 LTL carrier that does better than we do. And that’s Old Dominion…which operates a network that has somewhere around 200-odd stations versus our 360 that don’t deliver every day to every part of the United States. And they’ve been very brilliant in finding a niche. And obviously, we benchmark them carefully as our other competitors, which gets to your point, do we ever think about doing things differently. And the answer to that question is we think about doing things differently constantly.

“Secondly, in the Express business, there is a belief, including you, Brandon, that somehow, our Express operation in the United States is not profitable. Our Express operation in the United States is very profitable. And we have some of the best industrial engineers and operating — operations research people in the country. There has been this constant mantra for 10 years that, oh, we ought to put Express and Ground together. Well, my goodness. We’ve gained market share in Ground for 19 out of 20 years. And Brie and Raj just told you, we think it’s going to continue, and our competitive advantage is going to improve. We’re very convinced that the way that we are operating is the preferred way. And yes, we look at it every day.

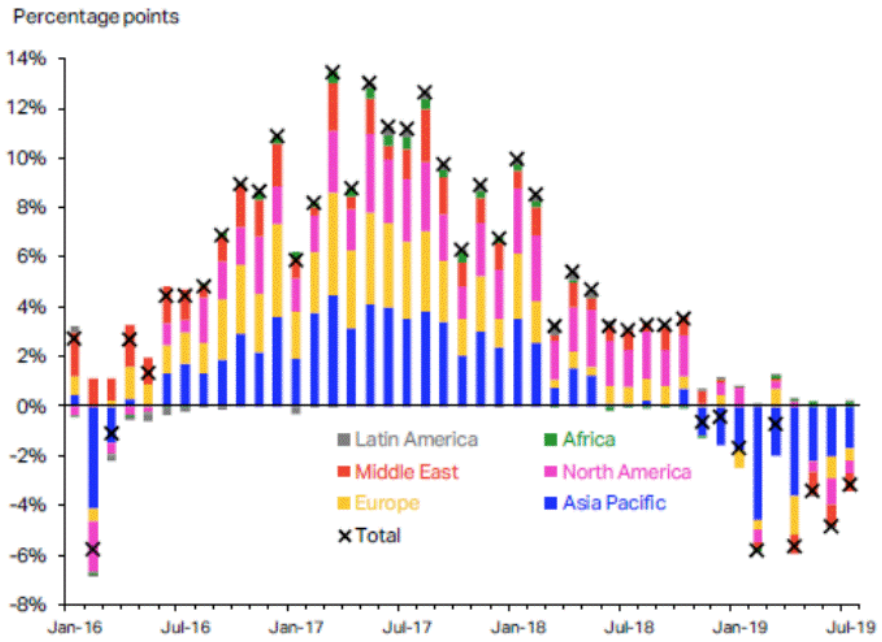
“The third thing, I guess, people fired up and, I guess, what Scott Group just mentioned is about CapEx is we’re profligate in terms of CapEx. The reality is about $0.60 out of every $1 we’re spending on CapEx are to modernize the Express hubs, to put in this new technology. We can’t get people in Indianapolis and Memphis to work. They’re not out there, plus it improves the productivity, so the failure to do it would be very dire. And as [CFO] Alan Graf has said and we’ve said over and over again, every time we bring on a 767 and to a much lesser degree, the 777 because we’re not buying many of them. It’s accretive to earnings. The reliability goes up. So could we stop buying 767s and 777s? Yes. But why don’t we stop buying them? Because we

put a chart on the earnings — the IR website today that showed the synergy between the 3 major operating companies. 80% of our customers buy all 3 of the services.

"FedEx will unquestionably be the low-cost producer in the domestic Express business because of the fleet modernization. And that includes any new entrants into the business. Yes, we have far — higher pilot cost and AMT cost perhaps than the third-party providers. We think that's a good thing, but our total productivity and cost per ton-mile are down 2% over the past 10 years in this year's dollars. I'm not talking about inflated dollars. I'm talking about 2019 dollars are 2% less than 2009 dollars. So the fleet modernization, yes, we could stop it, and yes, we could stop that CapEx, but the competitive positioning against our major competitors. And the last thing I'm going to say is we basically compete in an ecosphere that's got 5 entities in it. There's UPS. There's DHL. There's the U.S. Postal Service. And now increasingly, there's Amazon. That's who we wake up every day trying to think about how we compete against and give the best services to our sales force. It reminds me of the days in the service where you run all these fake maneuvers one thing or another. It's a lot different when you've got competition on the other side. We try to beat these folks, the UPS, and in particular has a very strong retail presence, and both UPS and DHL have significant forwarding presences. We decided that we would basically cover those portfolio gaps with more focused capabilities. And that's why we operate differently. We carry retail freight on our Purple tails and interline it, we don't have a huge forwarding operation. And we have a retail network that is smaller than UPS store or franchise network, but utilizes partners, as Brie talk to you about Walgreens and, more recently, Dollar General and some others. The reason I'm going on about this, I'm not quite sure about how those mantras got started that we're hardheaded or we're not willing to look. We'll look at anything. But what we can't do is to change the reality of the math. We can't make the competition go away. I wish they would. Just leave the field. They're very good operators. And the third thing that we have to deal with is the macroeconomic environment. And by the way, there is no company and no person that has been more vocal in our opposition to the trade policies that we are pursuing. Now to be fair, I think it's not just the U.S. I think China is also pursuing bad trade policy. So you're taking a system. Over the last 7 years has drawn more people out of poverty than in the entire previous history of the world and essentially putting in all at risk. These numbers on these macroeconomic production indicators, we didn't make those up. That's what's going on. I apologize for the length of the response, but it's to this continuing drumbeat that somehow, we're not willing to look at something and you take selective things like your LTL operation isn't as good as 'all the others.' It's not as good as one, and it's not as good as the other ones in terms of margins for the reasons that I gave you. It's important to look at this thing with those context in mind. Next question."

There's a lot to unpack there, but the gist to us is that while FDX breaks up its segments differently than UPS or **Deutsche Post's** (DPSGY – $33.11) DHL unit might, it's no less interconnected. The operating environment has not been friendly to FDX's Express business in particular, as management has been vocal about and data from the IATA through July agrees. An IATA cargo report through July and released on September 5 showed that year-over-year Freight-Tonne-Kilometers (FTK) fell around the world each month since November 2018 and shipments between the U.S. and Asia have dropped a meaningful 5% year-over-year with few signs of near-term improvements, in our view.

Chart 2: Regional contributions to y-o-y FTK growth



Sources: IATA Economics, IATA Monthly Statistics

Capacity is usually another hot topic for airlines, whether palletized cargo or the self-loading cargo variety, and FDX is again making fleet changes to match demand. When FedEx ordered the 767s, the intent was to use them to replace MD-10s with a one to one ratio. FDX planned to have only 19 of 64 MD10s still active by the end of 2018. However, the actual active count at the end of last year was 32. In addition to the 20 MD-10s that will be retired this year, the remaining 10 Airbus A310s will go too (only three of which were active). We think that FDX's decision to resume retirements should be considered smart fleet planning rather than an ominous sign about the health of the Express business. We also want to note that it remains profitable to fly cargo planes for longer (in terms of manufacturing date) than passenger air frames, as the utilization is much lower. Lease rates for MD-11Fs were between $85,000 and $115,000 per month earlier this year, according to data from IBA/ISTAT, while the much-younger 777Fs costs between $700,000 and $1,250,000 per month. The gap in rates could be made up in fuel efficiency by a passenger airline, which tend to spend half or more of each 24-hour day in the air. Cargo planes, on the other hand, might fly three hours from Memphis, spend all day on the ground and return to full to the hub during the night. Utilization, and therefore fuel costs, don't justify brand new planes. Plus, cargo won't complain if you put it in a 41-year-old MD-10 versus a just-delivered 777. While the difference in lease prices is large, and that gap can be bridged with factors like crews, additional load (FDX usually has volume restrictions rather than weight), maintenance costs and reliability. It's fairly easy to nitpick at FDX's fleet plans on a short-term basis,

especially having the benefit of hindsight, but we think that the long-term course is correct and true.

We think that FDX's big drop last week was more due to the impacts of global trade, than its fleet decisions or competitive position in the cargo market. Even though we think that the headwinds are outside FedEx's control, the company still has to weather the turbulence and make long-term strategic plans that it sees best for the business many years from now. Mr. Smith has been at FedEx since 1977, when he founded the firm, and owns about 7.5% of outstanding shares. Having weathered a variety of presidents, geopolitical issues, trade crises, wars and other major events, we would be surprised if this one in particular was the one that did FDX in. We think that FedEx's strong balance sheet, modest dividend yield and position as an industry leader are things for long-term investors to like. FDX trades at a reasonable 12.5 times the midpoint of the revised EPS guidance, with most expecting fiscal 2020 (ended May 2020) to be a trough year for the bottom line. NTM earnings and EPS expectations for the next three fiscal years presently stand at $12.79, $14.50 and $16.81, respectively. Our Target Price for FDX has been cut to $258, but we remain long-term fans of the company and its stock.