Market Commentary Monday, September 30, 2019

September 29, 2019

EXECUTIVE SUMMARY

TPS 636 – October Newsletter Coming Thursday
Target Prices – New Listing to be Posted Tomorrow
Week in Review – Trade News Drives Ups & Downs but Value Trumps Growth
Impeachment History – Nixon & Clinton Perspectives
Econ Update – Statistics Still Solid
TPS Outlook – No Reason Not to Be Optimistic About Equities
Stock Updates – TOT, CCL, JBL & MU

Market Review

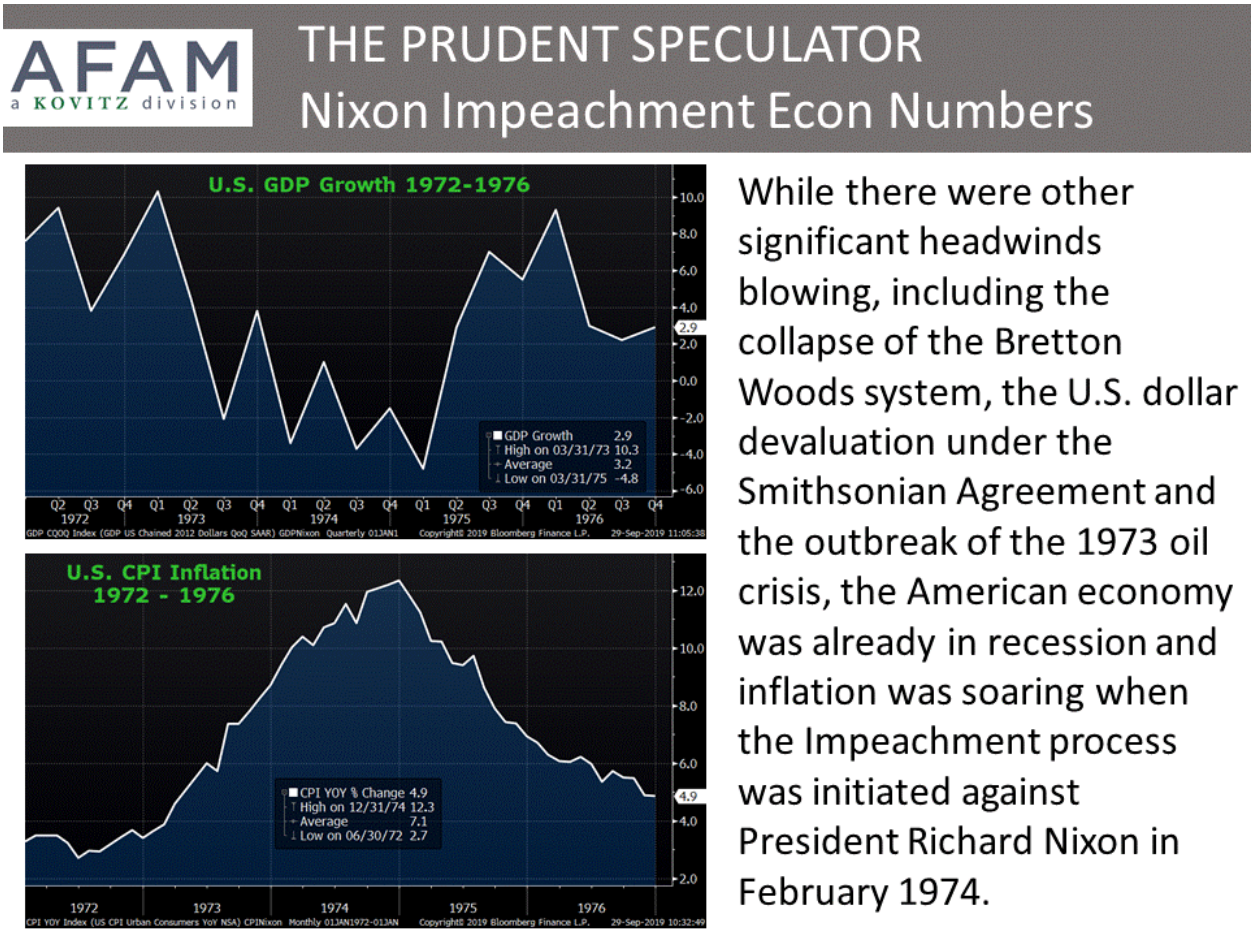
Work is underway on the October edition of *The Prudent Speculator*. If all goes according to Hoyle, *TPS 636* will be emailed out by Thursday morning, October 3. We will work to post updated Target Prices on Tuesday, October 1.

Once again, the equity markets see-sawed last week on developments on the trade front, rallying on Wednesday when President Trump suggested that an agreement with China could come "sooner than you think," before skidding on Friday after new broke that the White House was considering delisting Middle Kingdom companies from the U.S. stock exchanges and limiting investor exposure to the Chinese market in government pension funds. When all was said and done, the broad-based S&P 500 and Russell 3000 benchmarks dropped 0.98% and 1.17%, respectively, while Value trumped Growth by a score of -0.66% to -1.68% on the Russell 3000 Value and Growth indexes.

There was another big news story last week out of Washington, as House Speaker Nancy Pelosi announced an impeachment inquiry into whether President Trump interacted improperly with his Ukrainian counterpart. Obviously, there is no way of knowing how the drama on Capitol Hill will play out as the impeachment proceedings are just beginning and per the House.gov website, "The Constitution gives the House of Representatives 'the sole Power of Impeachment' (Article I, Section 2) of federal officers and gives the Senate 'the sole Power to try all Impeachments' (Article I, Section 3)." That second part is key, as conviction requires a two-thirds majority of the Senate, which as of this writing would seem an unlikely occurrence in this case.

Naturally, investors have interest in what has happened in previous instances of presidential impeachment. While *The Wall Street Journal* pointed out, "When Andrew Johnson was impeached in 1868, stocks did very little while bonds rallied, according to calculations by Craig Botham, an economist at Schroders," some might argue the current situation more closely

resembles the Nixon Impeachment proceedings in 1974. Of course, that period included an oil shock, runaway inflation and a nasty recession,…



…but it is interesting to note that the S&P 500 closed at 93.26 the day that impeachment process was formally initiated on February 6, 1974. The S&P plunged to as low as 62.28 on October 3, 1974, though by February 6, 1976, the index was at 99.46. That may sound like a not-so-great two years, but dividends were generous in those days, so the total return for the S&P was 16.42%, or 7.90% on an annualized basis.

A more reasonable comparison, in our view, given that the U.S. economy is in decent shape today, while inflation is very much contained,…

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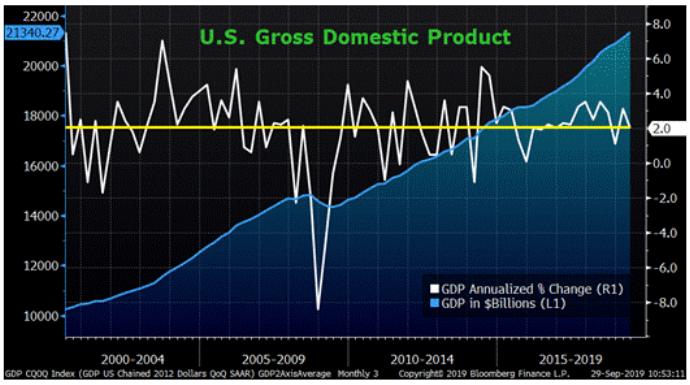
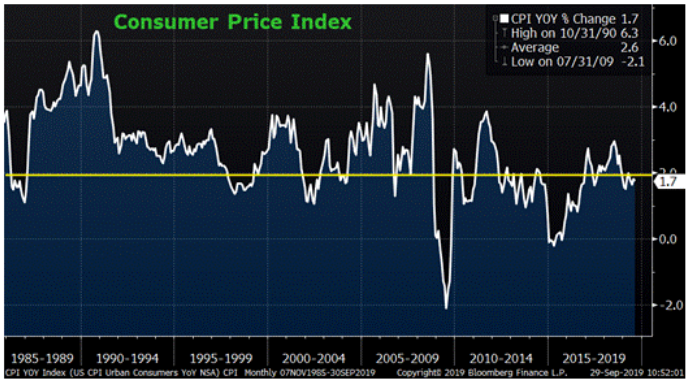
THE PRUDENT SPECULATOR
Trump Impeachment Econ Numbers





While U.S. GDP growth in Q2 ’19 came in at a 2.0% annualized real (inflation-adjusted) rate, dipping from the 3.1% rate turned in for Q1 ’19, it is about average since 2000. True, many think a recession is imminent, due in large part to escalating trade tensions, but even a modest downturn would still see the economy expand on a nominal basis and the Federal Reserve today is actually worried about inflation being too low!

…would be to the Clinton Impeachment in 1998. To be sure, there were plenty of other market moving events leading up to that time span, including the Asian currency crisis and the blow-up of Long-Term Capital Management, which had led to a big market downturn prior to October 8, 1998, when impeachment proceedings commenced, but the economy was then growing and inflation was below 2%.

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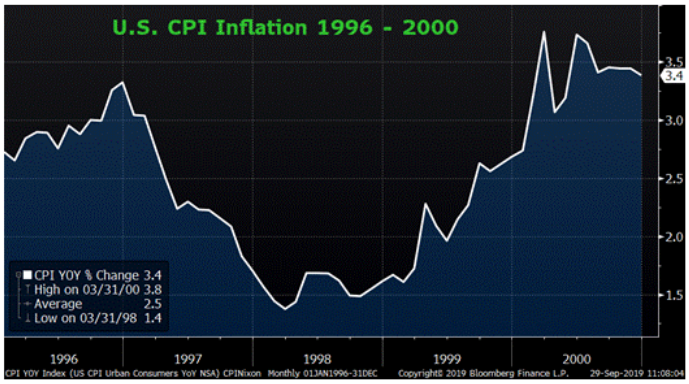
THE PRUDENT SPECULATOR
Clinton Impeachment Econ Numbers



While U.S. stocks endured a big selloff in 1998, due in large part to the Asian economic crises and the Russian financial crisis, not to mention the collapse of the Long Term Capital Management hedge fund, domestic GDP growth generally remained healthy, staying above 3% on a real basis throughout that turbulent year, and inflation also was below the Federal Reserve's preferred 2% level.

And, perhaps of more importance to students of stock market history, equities enjoyed a spectacular rally in the 12 months that followed, while President Clinton was acquitted of the charges against him on February 12, 1999.

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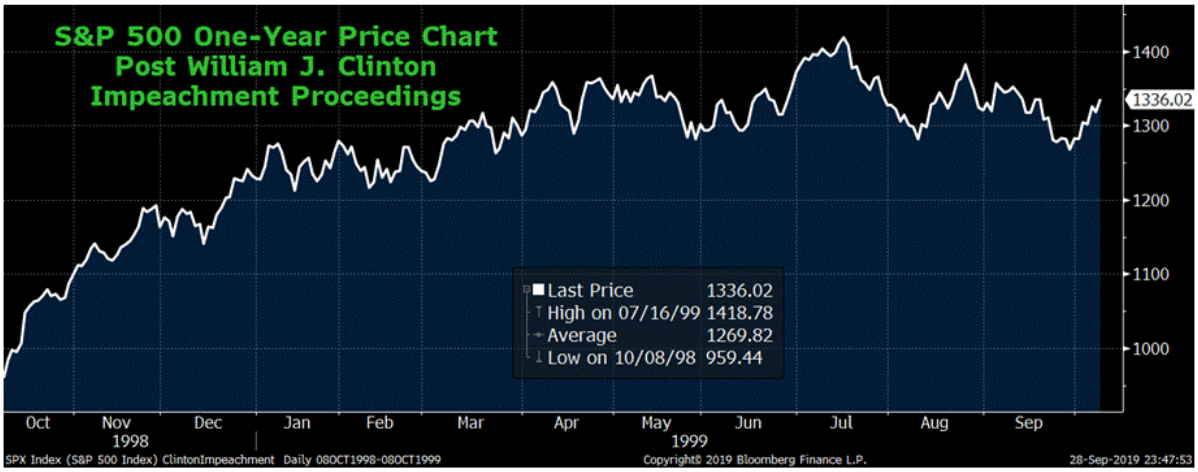
THE PRUDENT SPECULATOR
Clinton Impeachment Equity Rally

No doubt, it was easier for stocks to rebound, given that a lot of bad news was priced in after equities had endured a Bear Market in the months leading up to the commencement of Impeachment Proceedings against President Clinton on October 8, 1998, but the S&P 500 soared from 959.44 that day to 1336.02 one year later, a whopping gain of 39%, not counting dividends or the impact of their reinvestment.



Certainly, we understand that every period is unique and we are not expecting a massive market advance following the initiation of the Trump Impeachment proceedings, but we continue to believe that the health of the U.S. economy matters more than drama in the House of Representatives…and we think the economy will at least muddle along as housing statistics out last week were very good,…

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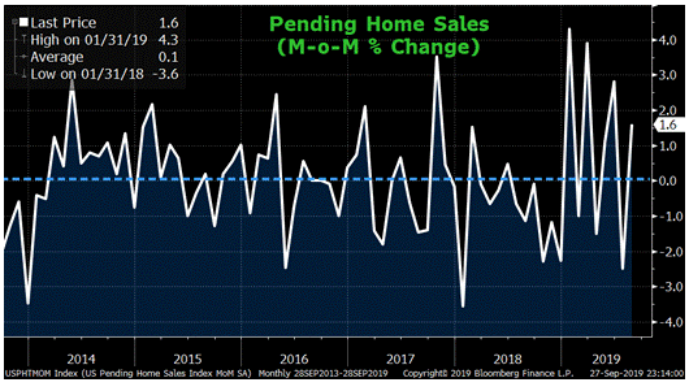
Terrific Housing Numbers



Sales of new homes soared in August to a 713,000 annual rate, blowing away the consensus forecast of 662,000, and climbing sharply from July's revised reading of 666,000. No doubt, low mortgage rates and a strong U.S. labor market deserve the credit, with the strong housing market further illustrated by a better-than-expected 1.6% rise in pending home sales last month, compared to projections of a 0.6% advance.

…and consumers remain generally optimistic,…

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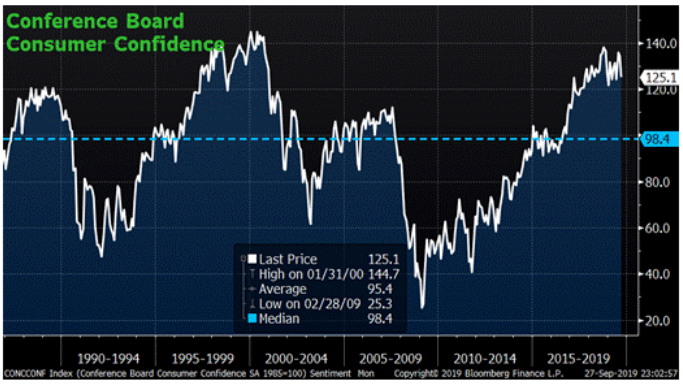
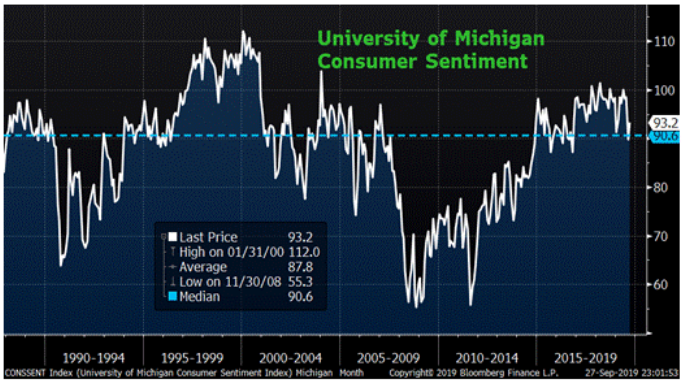
Consumers Remain Fairly Upbeat





The Conference Board's read of Consumer Confidence for September came in weaker-than-expected at 125.1, down from the revised 134.2 in August, though the tally was still much higher than the median over the last 30 years. It was a slightly different story, though, with the Univ. of Michigan's gauge of Consumer Sentiment, as the measure for September rebounded to 93.2, up from 89.8 in August and above the long-term median.

…even as they did not do as much shopping last month as some would have preferred.

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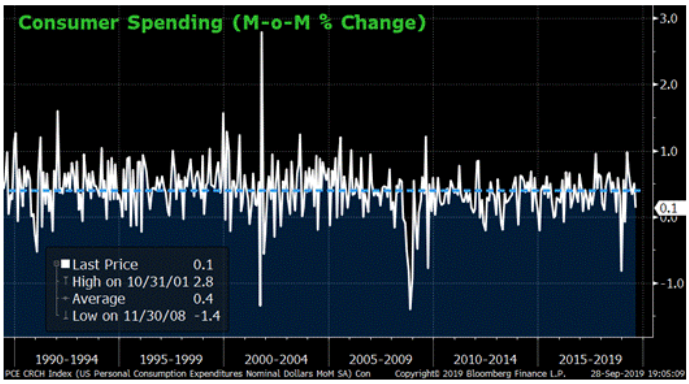
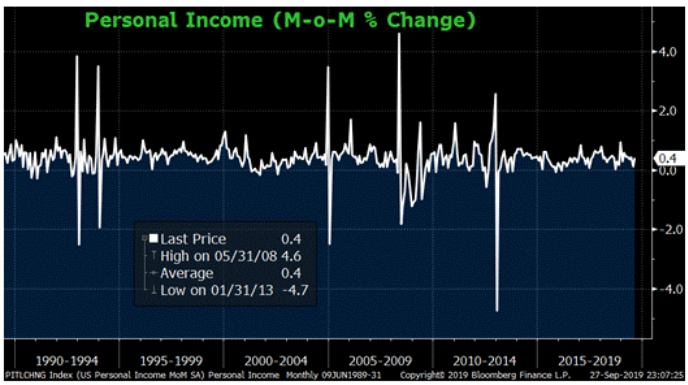
Consumer Pocketbooks Close a Bit

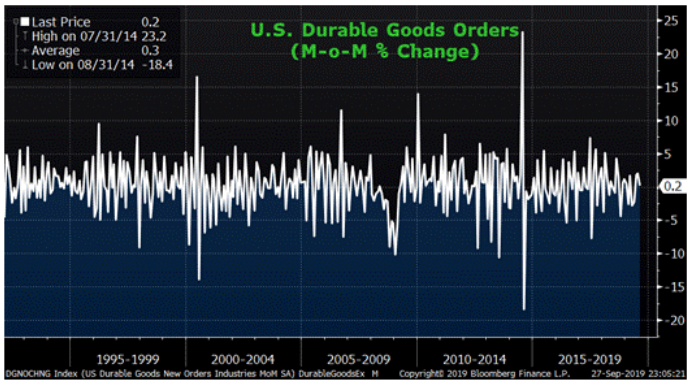


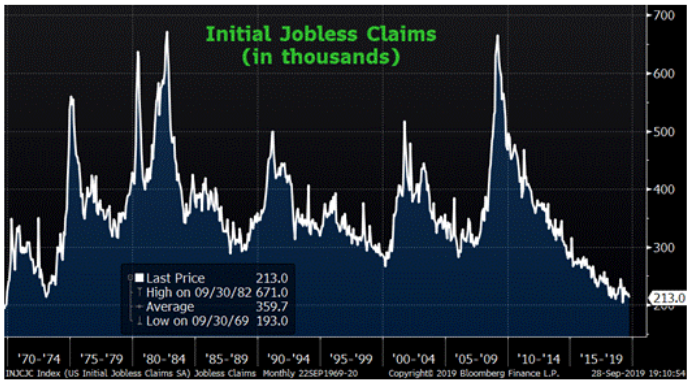


With the numbers reflecting the escalation of the tariff skirmish, the Commerce Department reported that consumer spending gained a weaker-than-expected 0.1% in August, due in large part to a slowdown in outlays for services. On the other hand, Commerce also said that personal incomes rose a better-than-forecast 0.4% during the month, thanks to a sizable jump in wages and salaries.

While we respect that folks are concerned about the strength of the manufacturing sector, with the trade battle not helping, the jobs picture still remains very healthy,…

Solid Econ Data





The headline number for durable goods orders in August came in much better than expected, rising 0.2%, compared to estimates of a 1.2% contraction, but the figure was below the 2.0% advance in July and core capital goods orders declined by 0.2%. And, first-time filings for unemployment benefits continue to bounce along near five-decade lows, with the latest week's tally inching up to 213,000.

…suggesting to us that there is no reason to alter our enthusiasm for the long-term prospects of our broadly diversified portfolios of what we believe to be undervalued stocks. The near term always remains a question mark, and October historically has been a volatile month, but we think a decent economic backdrop, extraordinarily low interest rates, generally healthy corporate income statements and balance sheets, and reasonable valuations are supportive of higher stock prices. And, we were pleased from a contrarian standpoint to see the number of Bulls drop 6.0 percentage points to 29.4% and the number of Bears rise 5.4 percentage points to 33.3% in the latest Sentiment Survey from the American Association of Individual Investors.

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/.

Along with the volatility that has been felt in the oil patch, driven by the supply and demand debate as well as geopolitical tensions in the Middle East, **Total SA** (TOT – $51.86) shares were hit last week after the integrated oil giant hosted its Investor Day that focused on its 2025

outlook. The presentation and comments seemed to be mostly good news for investors as company management said it will keep its focus on cost control initiatives, reasonable but restrained capital investment and volume and cash flow growth, all while reiterating long-term emissions targets.

That said, investors were seemingly less pleased that management left unanswered questions about whether it would extend its share repurchase program once it is over at the end of 2020 (it is a $5 billion repurchase plan). On a bright note concerning shareholder returns, the company targeted its dividend growth rate at 5% to 6% annually, though some seem to think that if the share repurchases are going to be somewhat minimal, Total should be more aggressive with the dividend.

Additionally, in the presentation, management said Total is adapting to the changing energy markets to ensure a sustainable future, and is focusing on LNG and renewables, which it believes will grow the fastest. Management reminded investors that the company has successfully reduced its organic pre-dividend breakeven to less than $30 per barrel of oil and confirmed its key objective to maintain it below this level to be resilient in any price environment. Discipline on costs will be maintained, including an additional $1 billion cost reduction program until 2023, notably supported by a strong digital ambition. Management also said Total will generate production growth of more than 5% per year through 2021, then after a stable period between 2022-23, growth will resume at more than 3% per year driven mainly by LNG project start-ups. Total targets a ROE of 12%.

All considered, and not knowing exactly where energy prices or global demand will be in three to five years, and despite the lack of guidance and given the tough and volatile recent environment for energy companies, we think Total management retains the ability to repurchase shares as free cash flow should exceed the dividend payout in the coming years.

We continue to like that Total's production costs are meaningfully lower than most of its large integrated peers and that those costs should continue to drop over the next few years. We also like that Total has a high quality portfolio of assets and a well-funded balance sheet. Respective consensus adjusted EPS estimates (in U.S. dollars) for 2020 and 2021 currently reside at $5.56 and $5.84. TOT shares currently carry a net dividend yield above 4.6% and trade at 10.7 times NTM adjusted EPS consensus estimates. Our Target Price now stands at $89.

While we don't like to use the word sink in reference to a cruise line company, that is exactly what happened to shares of **Carnival Corp** (CCL – $43.58) last week after the company reported Q3 financial results and cut forward guidance. On the plus side, Carnival posted adjusted earnings per share of $2.63 in Q3 2019 (vs. $2.53 est.) and revenue of $6.53 billion, versus the consensus analyst estimate of $6.2 billion.

Carnival CEO Arnold Donald commented, "We achieved additional cost improvements largely driven by leveraging our scale, offsetting the earnings impact due to voyage disruptions from the combined impact of Hurricane Dorian, the tensions in the Arabian Gulf and the delayed delivery of Costa Smeralda. A further reduction in guidance for ticket and onboard revenue worth $0.06 per share in part contributed to by the high level of close-in voyage disruptions was also offset.

However, due to an $0.08 impact from the recent spike in fuel prices caused by geopolitical events, we are reducing our full year guidance for 2019 by $0.05 per share."

Based on current booking trends, Carnival expects full year 2019 constant currency net cruise revenue to be up approximately 4%, with capacity growth of 4.2%. Management still expects its North American and Australian segment yields to be up for the full year, but slightly less than previously forecast, while its Europe & Asia segment is still expected to be down for the year, but a bit more than its previous guidance. Full-year net cruise costs excluding fuel are now expected to be up approximately 0.3% versus the prior year, compared to June guidance of up approximately 0.7%.

As such, Carnival expects full-year 2019 adjusted earnings per share to be in the range of $4.23 to $4.27, compared to June guidance of $4.25 to $4.35 and 2018's $4.26. While the stock price was hit hard last week on the reduced outlook, we thought it worth noting that despite the $0.13 of headwinds to EPS that management pointed out, they only reduced the midpoint of guidance by $0.05.

Mr. Donald continued, "As a truly global cruise company, with nearly 50% of our guests sourced outside of the U.S., we are facing a number of current headwinds, including weakening economies affecting our Europe & Asia segment, a strong dollar and of course, the IMO 2020 regulations, and we are working to mitigate them. We have taken actions to bring capacity in Southern Europe more in line with demand, reflecting the current conditions which have been heavily influenced by ongoing economic malaise, the uncertain geopolitical environment and recent trends in consumer confidence. We have also made close-in deployment changes, including those made to address the recent situation in the Arabian Gulf, which has had an impact on recent booking trends and ticket prices. While we are subject to uneven economies in the short run, the global aspect of our business has proven to be a strength over time, producing our industry leading position with over $5 billion in cash from operations, attractive returns on capital and the strongest balance sheet in the industry."

While headwinds in some of Carnival's segments don't seem to be going away in the near-term, we note that cumulative advance bookings for the first half of 2020 are ahead of the prior year at prices that are relatively in line with 2019 metrics. That said, demand has seemingly slowed since June and prices have softened, though the current consensus analyst EPS forecast for all of fiscal 2020 is $4.48.

Not surprisingly, given that the stock now trades for less than 10 times that 2020 estimate, we see recent weakness in CCL as a good entry point to initiate or add to a position. We maintain our long-term optimism on Carnival and the overall cruise industry space, given favorable demographic trends and the fact that there are still meaningful growth opportunities in emerging economies, which are encouraging for global revenue diversification and the ability to rapidly reach a new customer base. CCL shares now sport a 4.6% dividend yield. Our Target Price has been trimmed to $71.

Electronic manufacturing services firm **Jabil Inc.** (JBL – $35.23) earned $0.88 per share in fiscal Q4 2019 (vs. $0.87 est.). Jabil had sales of $6.57 billion (vs. $6.61 billion est.). In Q4, JBL was

helped by "higher targeted end-markets in 5G" and strong revenue in the Cloud, Energy and Health Care segments. Shares gained nearly 15% on the week, after the company's guidance was better than the analyst consensus. JBL expects core EPS between $0.82 and $1.04 (vs. $0.93 analyst midpoint est.) and net revenue between $6.65 billion and $7.35 billion (vs. $6.87 billion analyst midpoint est.).

CEO Mark Mondello commented, "Our team is carrying positive momentum in the fiscal year '20. Our strategy is continuous and remains unchanged. Our path is well understood by our leadership team and our financial outlook is sound. During the past 3 to 4 years, substantial revenue growth drove earnings. While reducing our dependence on any single product or product family. For fiscal '20, we plan to expand margins primarily through operating leverage and network efficiencies, consistent with our strategy and squarely within our control. For me success will be keeping our people safe, assuring remarkable customer care, achieving near-perfect execution, delivering on our financial commitments and giving back to the communities in which we work. If our team can accomplish all the above, it'll be a banner year, a year that will make us proud. [We have] three key areas that have management's attention for fiscal '20. Optimize, execute and deliver."

Mr. Mondello continued, "The company is well positioned to deliver solid financial results over the coming 24 months, whether your vantage point is based on an absolute scale or a relative scale. Today's outlook for fiscal '21, shows core earnings per share in the neighborhood of $4 and a core operating margin of 4%. A 30 basis point increase relative to our outlook for fiscal year '20 and a 50 basis point expansion relative to fiscal year '19."

We were pleased that JBL reported a good fourth quarter and a strong outlook, despite the geopolitical environment. We believe that the improving margins and business segment diversification are significant, while the stock's reasonable valuation metrics include a 10.3 times forward P/E ratio. Our Target Price has been boosted to $50.

Memory maker **Micron Technology** (MU – $43.21) posted earnings per share of $0.56, versus the $0.48 estimate, in fiscal Q4 2019. MU had total revenue of $4.9 billion, versus the $4.6 billion estimate. While shares have still gained 36% year to date, the price slumped 11% after the company's guidance came in below analyst estimates. Micron expects Q1 2020 EPS between $0.39 and $0.53 per share, lower than the analyst consensus midpoint of $0.49. The company expects the upcoming quarter's revenue to come in between $4.8 billion and $5.2 billion, above the consensus midpoint of $4.78 billion. The gross profit margin is expected to be between 25% and 28%.

CEO Sanjay Mehrotra explained on the earnings call, "Fiscal 2019 was another solid year of execution as we continue to transform the New Micron. Despite the challenging industry environment, we achieved the second-best year in our history for revenue, free cash flow and earnings, which underscores the strength of the New Micron. We improved structural profitability by further reducing the technology gap with competitors and by strengthening our product portfolio. We also made progress on our $10 billion share repurchase program by returning $2.7 billion to our shareholders."

Overview

Strong Execution Against Backdrop of Challenging Industry Environment
- **FQ4-19:** Results exceeded guidance ranges
- **FY-19:** 2nd best year in Micron history for revenue, free cash flow, earnings

Continued Excellent Progress on Key Strategic Objectives
- Improved structural profitability
- Reduced technology gap with competitors
- Strengthened product portfolio

Executed $2.7 Billion of Share Repurchases
- 65% of FY-19 free cash flow

Market Environment Broadly Consistent with Expectations
- DRAM demand bounced back as issues impacting first half 2019 dissipated
- NAND elasticity driving robust demand growth
- Demand recovery is encouraging, but we remain mindful of macroeconomic and trade uncertainties

4 September 26, 2019 Micron

Mr. Mehrotra continued, "Before talking about the market outlook, I want to provide an update on our business with Huawei and the ongoing impact of trade uncertainties. As we noted last quarter, we started shipping some products to Huawei that are not subject to Export Administration Regulations and Entity List restrictions. In the fiscal fourth quarter, sales to Huawei declined sequentially and were down meaningfully from the levels we anticipated prior to the addition of Huawei to the Entity List. We have applied for licenses with the Department of Commerce that would allow us to ship additional products, but there have been no decisions on licenses to date. We see ongoing uncertainty surrounding U.S. China trade negotiations. If the Entity List restrictions against Huawei continue and we are unable to get licenses, we could see a worsening decline in our sales to Huawei over the coming quarters."

Mr. Mehrotra offered the outlook, "The DRAM and NAND industry demand growth in the second half of calendar 2019, compared to the first half, is primarily being driven by a normalization of inventories at most customers, and secular growth trends in various end markets. In recent months, we have seen increased demand from customers headquartered in mainland China, some of whom could be making strategic decisions to build higher levels of inventory in the face of increased trade tensions between the U.S. and China, as well as Japan and Korea. While NAND and DRAM market conditions are showing some promising signs, in order to bring our supply in line with the market demand, we are targeting our fiscal 2020 front-end equipment CapEx to be reduced by more than 30%from fiscal 2019. Our CapEx decision is

also influenced by macroeconomic uncertainty and low industry profitability. Our front-end CapEx outlook reflects our strategy for limited ramp of our first RG node. While we are reducing front-end equipment CapEx, we are spending significantly more on shell space to enable future node transition, and also investing in a new SSD packaging facility in Penang, Malaysia."

MU finished the quarter with approximately $3.3 billion in net cash and $13.0 billion of total liquidity. While analysts project the company to earn just $2.76 per share in fiscal 2020, the company is expected to see a solid turnaround with EPS of $5.32 and $7.42 in fiscal 2021 and fiscal 2022, respectively. MU shares have certainly been volatile, gaining in the first part of the year, dropping in Q2, then making all of it back plus some in Q3. We believe long-term catalysts like an improving global macroeconomic backdrop, possible resolution of the U.S.-China trade spat and growing NAND demand are qualitative reasons to have MU in a broadly diversified portfolio. In addition, the company has a strong balance sheet and reasonable valuation metrics. Our Target Price for MU has been pared to $64.