Market Commentary Monday, November 4, 2019

November 4, 2019

EXECUTIVE SUMMARY

TPS 637 – November Edition of *The Prudent Speculator* Coming Very Soon
Record Highs – Ups & Downs, But Handsome Rewards for Keeping the Faith
Sentiment – Still Little in the Way of Bullishness
Econ News – Still No Recession on the Horizon
Value Buy Signal – ISM Manufacturing Index
FOMC Meeting – Economic Activity Rising at Moderate Rate; Fed Cuts the Fed Funds Rate
Buffett on Interest Rates – Lower Rates Support Higher Valuations
Stock Updates – AAPL, HSBC, NYCB, AXS, MCK, RDS/A, ADM, HFC, MRK, NOV, T, AVX & RCL

Market Review

We will be emailing out shortly the November edition of *The Prudent Speculator*. This month, *TPS 637* offers one first-time recommendation, while our *Graphic Detail* section takes a look at Seasonal Favoritism and the Presidential Cycle, both of which provide additional support for equities in general and Value Stocks in particular.

Of course, with the S&P 500 and Russell 3000 indexes closing at all-time highs on November 1, and the Dow Jones Industrial Average ending less than 12 points below its record close set on July 15, 2019, one might argue that investors don't need a lot of help in keeping the faith that they will be rewarded for putting up with the inevitable ups and downs,…

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THE PRUDENT SPECULATOR
Volatility is Normal: Value/Divs Win Race

Selloffs, downturns, pullbacks, corrections and even Bear Markets are events that equity investors always have had to endure on their way to the best long-term performance of any of the financial asset classes.

Advancing Markets

Minimum Rise %	Average Gain	Average # Days	Count	Frequency (in Years)	Last Start	Last End
20.0%	108.7%	932	26	3.5	3/9/2009	11/1/2019
17.5%	66.6%	578	38	2.4	12/24/2018	11/1/2019
15.0%	66.4%	561	44	2.1	12/24/2018	11/1/2019
12.5%	43.9%	334	71	1.3	12/24/2018	11/1/2019
10.0%	34.5%	243	97	0.9	12/24/2018	11/1/2019
7.5%	23.4%	148	154	0.6	12/24/2018	11/1/2019
5.0%	14.7%	73	300	0.3	8/14/2019	11/1/2019

Declining Markets

Minimum Decline %	Average Loss	Average # Days	Count	Frequency (in Years)	Last Start	Last End
-20.0%	-34.3%	371	25	3.6	1/6/2009	3/9/2009
-17.5%	-30.3%	222	37	2.4	9/20/2018	12/24/2018
-15.0%	-28.3%	192	43	2.1	9/20/2018	12/24/2018
-12.5%	-22.6%	140	70	1.3	9/20/2018	12/24/2018
-10.0%	-19.5%	103	96	0.9	9/20/2018	12/24/2018
-7.5%	-15.4%	65	153	0.6	9/20/2018	12/24/2018
-5.0%	-10.9%	37	299	0.4	7/26/2019	8/14/2019

From 02.20.28 through 11.01.19. Price return series. We defined a Declining Market as an instance when stocks dropped the specified percentage or more without a recovery of equal magnitude, and an Advancing Market as in instance when stocks appreciated the specified percentage or more without a decline of equal magnitude. SOURCE: Kovitz Investment Group using data from Bloomberg, Morningstar and Ibbotson Associates

LONG-TERM RETURNS

	Annualized Return	Standard Deviation
Value Stocks	13.1%	25.9%
Growth Stocks	9.4%	21.4%
Dividend Paying Stocks	10.5%	18.0%
Non-Dividend Paying Stocks	8.7%	29.4%
Long-Term Corporate Bonds	6.1%	7.6%
Long-Term Gov't Bonds	5.5%	8.5%
Intermediate Gov't Bonds	5.1%	4.4%
Treasury Bills	3.3%	0.9%
Inflation	2.9%	1.8%

From 06.30.27 through 09.30.19. Growth stocks = 50% Fama-French small growth and 50% Fama-French large growth returns rebalanced monthly. Value stocks = 50% Fama-French small value and 50% Fama-French large value returns rebalanced monthly. The portfolios are formed on Book Equity/Market Equity at the end of each June using NYSE breakpoints via Eugene F. Fama and Kenneth R. French. Dividend payers = 30% top of Fama-French dividend payers, 40% of middle Fama-French dividend payers, and 30% bottom of Fama-French dividend payers rebalanced monthly. Non-dividend payers = Fama-French stocks that do not pay a dividend. Long term corporate bonds represented by the Ibbotson Associates SBBI US LT Corp Total Return index. Long term government bonds represented by the Ibbotson Associates SBBI US LT Govt Total Return index. Intermediate term government bonds represented by the Ibbotson Associates SBBI US IT Govt Total Return index. Treasury bills represented by the Ibbotson Associates SBBI US 30 Day TBill Total Return index. Inflation represented by the Ibbotson Associates SBBI US Inflation index. SOURCE: Kovitz Investment Group using data from Professors Eugene F. Fama and Kenneth R. French and Ibbotson Associates

…but there surprisingly is still not a whole lot of optimism toward stocks.

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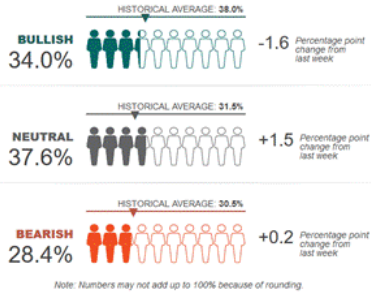
THE PRUDENT SPECULATOR
Sentiment: Mixed AAII & Pessimistic ICI

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 10/30/2019

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.

October 31, 2019 - Bullish sentiment, expectations that stock prices will rise over the next six months, pulled back by 1.6 percentage points to 34.0%. Optimism is below its historical average of 38.0% for the 36th time this year and the 24th time in 25 weeks.

Bearish sentiment, expectations that stock prices will fall over the next six months, edged up 0.2 percentage points to 28.4%. Pessimism is below its historical average of 30.5% on consecutive weeks for the first time since July 10, 2019, and July 17, 2019.

The latest AAII Sentiment Survey showed a modest dip in optimism and a slight rise in pessimism, with the Bullish reading still below the historical norm. Meanwhile, the most recent ICI calculation of exchange traded and mutual fund flows showed a resumption in the exodus out of U.S. stocks.

Combined Estimated Long-Term Fund Flows and ETF Net Issuance

Millions of dollars

Week Ended	10/23/2019	10/16/2019	10/9/2019	10/2/2019	9/25/2019
Total Equity	-5,656	754	-11,514	-13,431	-15,772
Domestic	-4,689	2,698	-10,868	-11,748	-13,957
World	-967	-1,944	-646	-1,682	-1,815
Hybrid	-168	-391	-688	-1,147	-1,918
Total Bond	10,469	10,473	5,810	8,418	6,864
Taxable	8,275	8,786	3,856	6,803	4,587
Municipal	2,194	1,687	1,954	1,615	2,278
Commodities	222	-151	425	489	2,356
Total	4,868	10,685	-5,967	-5,670	-8,470

Source: Investment Company Institute

While we suspect that lack of grand enthusiasm is due to the constant drama emanating from the White House and Capitol Hill, not to mention the long-playing trade battle with China and lackluster growth around the world, we note that the U.S. economy continues to muddle long. Indeed, domestic GDP expanded in the third quarter at a 1.9% level that has been about the norm over the last 20 years,…

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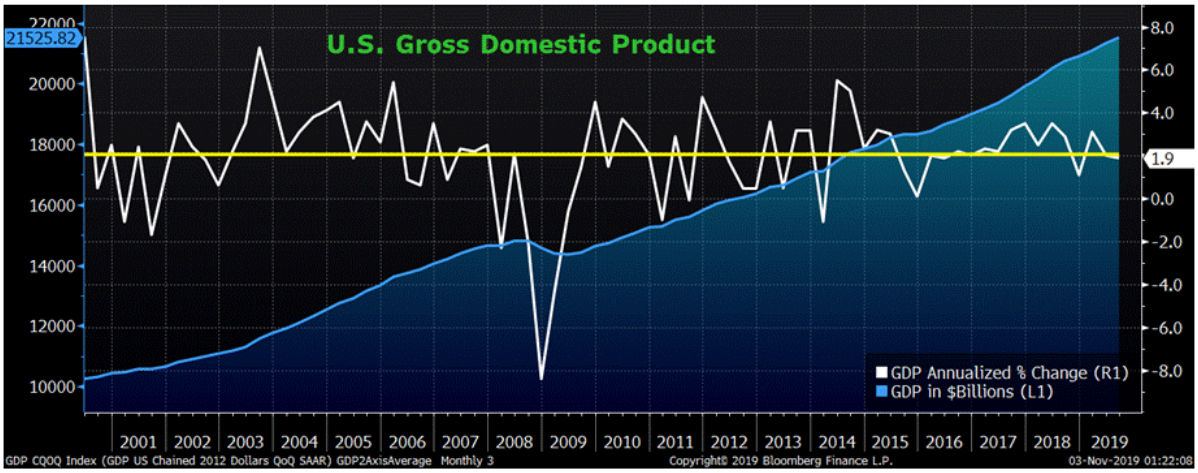
THE PRUDENT SPECULATOR
U.S. Economic Growth OK in Q3

Uncle Sam calculated Q3 '19 GDP growth at a revised and moderately healthy 1.9% annualized real (inflation-adjusted) rate, dipping from the 2.0% rate turned in for Q2 '19. True, 1.9% growth is hardly robust (it is about average since 2000) and many still think a recession is imminent, due in large part to the escalating trade tensions, but even a modest downturn would still see the economy expand on a nominal basis.



…and the employment picture looks very good,…

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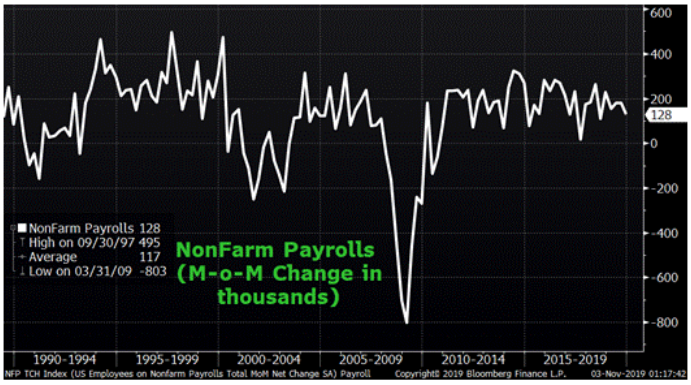
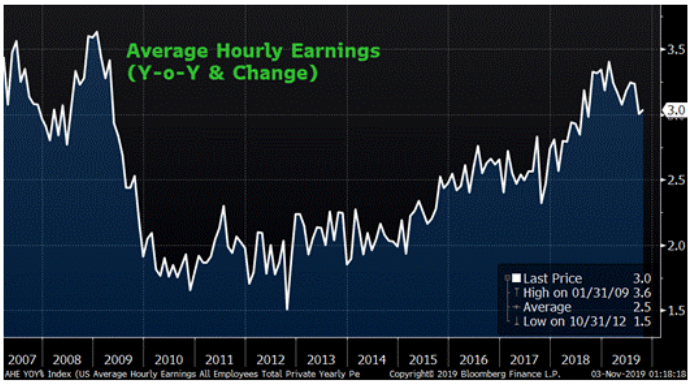
THE PRUDENT SPECULATOR
Solid Employment Report





Uncle Sam said that the number of new jobs created during October came in at 128,000, nicely above the GM-strike-impacted consensus forecast of 90,000. September's payroll number was also revised sharply-higher by 44,000 jobs. And, the gain in average hourly earnings was as projected at 3.0% on a year-over-year basis, continuing to suggest that inflation in the labor market remains contained.

…especially when several recent data points are residing right near the best levels in half a century.

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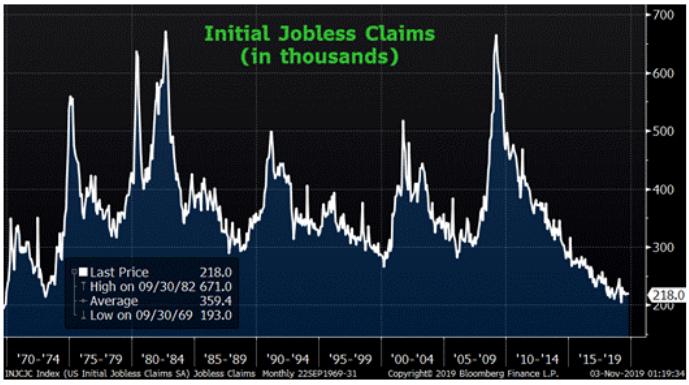
THE PRUDENT SPECULATOR
Near Historic Lows in Jobless Numbers



The jobs number in October came in above forecasts, but the unemployment rate ticked up to 3.6%, still right near a 50-year low, with a modest increase in the labor participation rate to 63.3%. And, the latest figures on initial claims for unemployment benefits saw 218,000 new filings, still near lows last seen back in December 1969, when the workforce was significantly smaller than it is today.

True, the health of the factory sector is presently leaving a lot to be desired, with a contraction signified by the latest ISM Manufacturing number, but the Institute for Supply Management this month made a special point to remind folks that a 48.3 PMI reading corresponds to 1.6% overall growth in real GDP.

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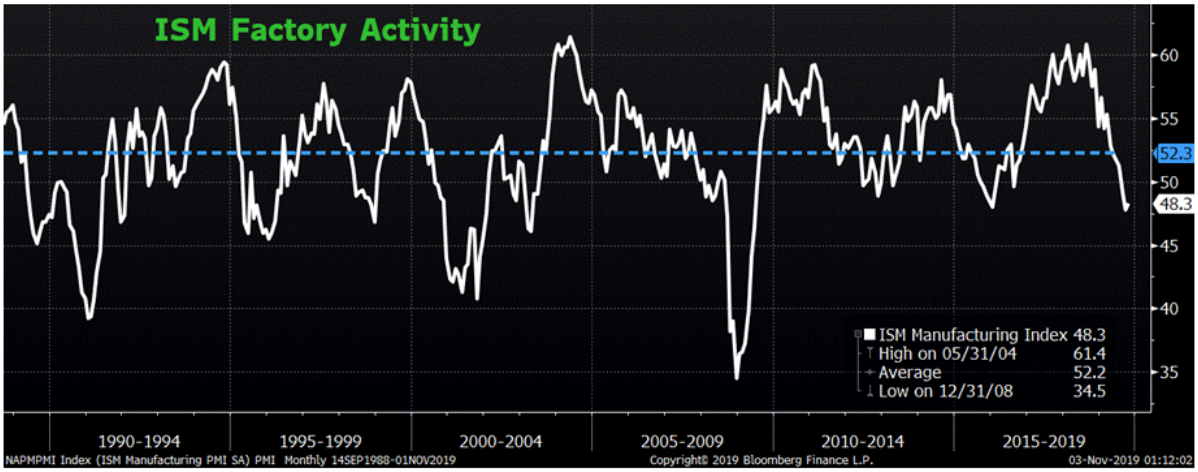
THE PRUDENT SPECULATOR
ISM Manufacturing = 1.6% GDP Growth

The latest read on the health of the manufacturing sector dipped to 48.3 in October. While the measure indicated contraction in the factory sector, manufacturing accounts for around 11% of the U.S. economy, and the Institute for Supply Management stated, "The past relationship between the PMI and the overall economy…corresponds to a 1.6% increase in real gross domestic product (GDP) on an annualized basis."



Last month, with the PMI dropping below 50 for the first time in more than three years, many in the media mistakenly warned that a recession was being signaled, even as those who actually bothered to read the full news release knew better, so the ISM felt compelled this month to set the record straight. Of course, we have no complaints about the current PMI tally, given what has transpired in the equity markets the prior 189 times we have had a 48.3 or lower figure.

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THE PRUDENT SPECULATOR
Major Value Buy Signal: ISM PMI

Returns Following ISM PMI Readings of <= 48.3

Statistic	Fama French Value	Fama French Growth	S&P 500
One-Year			
Average	26.0%	22.5%	19.9%
Median	26.3%	23.3%	21.0%
Max	84.6%	83.8%	61.0%
Min	-24.5%	-28.0%	-23.6%
# Positive	162	164	164
# Negative	27	25	25
Three-Year Annualized			
Average	20.2%	13.8%	15.3%
Median	21.3%	15.1%	15.5%
Max	38.9%	28.4%	32.7%
Min	-6.6%	-7.2%	-4.6%
# Positive	188	177	178
# Negative	1	12	11
Five-Year Annualized			
Average	18.6%	12.9%	14.6%
Median	18.7%	13.2%	15.1%
Max	32.5%	25.7%	29.7%
Min	3.2%	-6.3%	-0.6%
# Positive	188	182	186
# Negative	0	6	2

From March 1948 - July 2019. Source: Kovitz Investment Group using data from Bloomberg, Professors Eugene F. Fama & Kenneth R. French and the Institute for Supply Management.

The financial press wanted to run with negative headlines on Nov. 1 when the Manufacturing Index (aka PMI) for October from the Institute for Supply Management fell below expectations, but an equity market rally spoiled their fun. With a reading of 48.3, up from 47.8 in September, the PMI continued to signify contraction in the factory sector, which would seemingly be a negative for the U.S. economy and, in turn, stocks…yet the historical evidence convincingly argues otherwise. In fact, looking at what actually has occurred with equities following the 189 times that the PMI has tallied 48.3 or lower shows that, on average, one-, three- and five-year returns have been fantastic, with Value leading the way by a wide margin.

To be sure, the U.S. economy is not exactly booming, which is why the Federal Reserve saw fit last week to cut the Fed Funds rate to a range of 1.50% to 1.75%, with the accompanying FOMC Statement including the following:

Information received since the Federal Open Market Committee met in September 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 remain weak. 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 1-1/2 to 1-3/4 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. The Committee will continue to monitor the implications of incoming

information for the economic outlook as it assesses the appropriate path of the target range for the federal funds rate.

Though Fed Chair Jerome H. Powell was quick to say, "If developments emerge that cause a material reassessment of our outlook, we would respond accordingly. Policy is not on a preset course," investors are presently of the mind that there is zero chance of an interest rate hike before the end of 2020. Instead, the betting is overwhelmingly in favor of at least one more cut in the Fed Funds rate,…

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THE PRUDENT SPECULATOR
Already Low Interest Rates May Go Lower

99) Export — World Interest Rate Probability

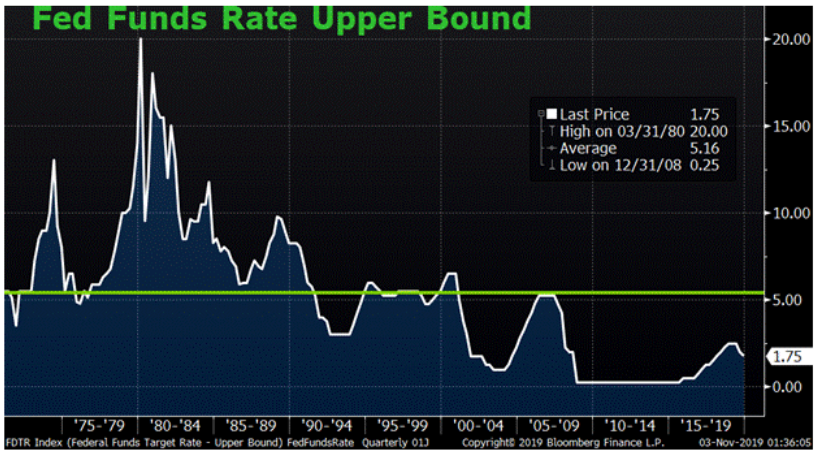
United States — Instrument: Futures: Fed Funds - Effective — Fed Effective Rate 1.58

1) Overview | 2) Future Implied Probability

Current Implied Probabilities — 3) Add/Remove Rates

Dates: Meeting / Calculation — Calculated 11/01/2019 — Based on rate 1.50-1.75

Meeting	Hike Prob	Cut Prob	0.5-0.75	0.75-1	1-1.25	1.25-1.5	1.5-1.75	Fwd Rate
12/11/2019	0.0%	16.5%	0.0%	0.0%	0.0%	16.5%	83.5%	1.54
01/29/2020	0.0%	41.6%	0.0%	0.0%	4.9%	36.6%	58.4%	1.47
03/18/2020	0.0%	53.7%	0.0%	1.0%	11.5%	41.2%	46.3%	1.42
04/29/2020	0.0%	60.7%	0.2%	2.6%	16.0%	41.9%	39.3%	1.38
06/10/2020	0.0%	65.9%	0.5%	4.4%	19.4%	41.6%	34.1%	1.34
07/29/2020	0.0%	70.3%	1.0%	6.3%	22.3%	40.6%	29.7%	1.31
09/16/2020	0.0%	73.2%	1.5%	7.9%	24.1%	39.6%	26.8%	1.29
11/05/2020	0.0%	76.4%	2.3%	9.8%	25.9%	38.0%	23.6%	1.25
12/16/2020	0.0%	78.6%	3.0%	11.3%	27.0%	36.7%	21.4%	1.23



It is fascinating that investors, at least as evidenced by the Fed Funds Futures market, now believe that there is no chance whatsoever that the Federal Reserve will hike interest rates by the end of 2020 after fretting back in December that Jerome Powell & Co. were on a pre-set course to hike rates throughout 2019.

…which would seem to make sense, given that inflation remains below the Fed's preferred level.

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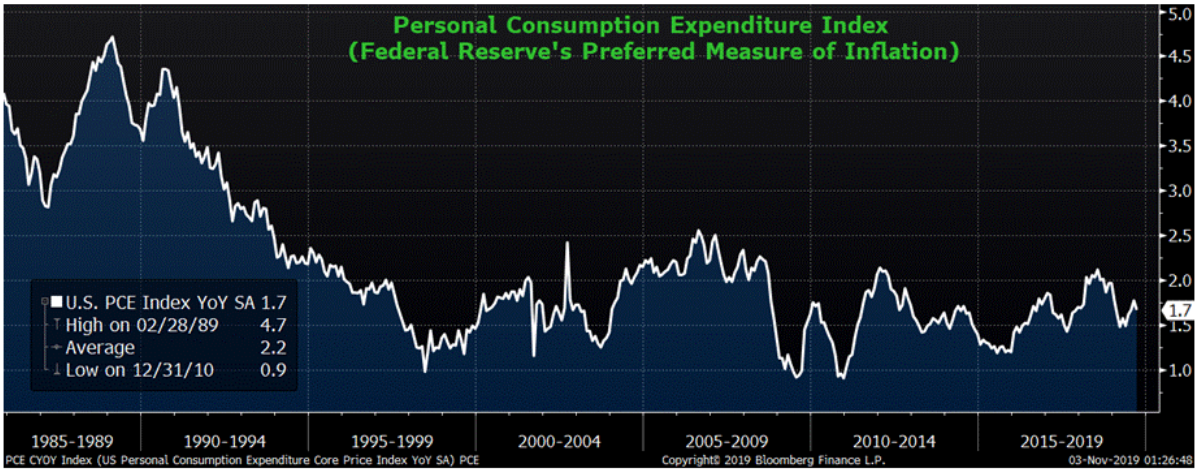
THE PRUDENT SPECULATOR
Inflation Continues to Run Unusually Low

The Consumer Price Index for September came in at a tame 1.7% year-over-year gain, matching the latest reading on the "core" Personal Consumption Expenditure (PCE), the latter the Federal Reserve's preferred measure of inflation, with both gauges remaining below the desired 2.0% level, meaning that there is little reason for Jerome H. Powell & Co. to consider raising the Federal Funds rate target.



And, we continue to argue that low interest rates are very much a positive for stock prices. After all, as Warren Buffett stated back in April 2016, "Interest rates act on asset values like gravity works on physical matter. If you had zero interest rates and you knew you were going to have them forever, stocks should sell at, you know, 100 times earnings or 200 times earnings." Though the Oracle of Omaha was not necessarily referring to the Fed-Model in his comments, he was very much arguing that equity valuations can be much higher than normal when interest rates are lower than usual. Interestingly, the earnings yield and 10-year U.S. Treasury have sported not-so-different average levels since the launch of *The Prudent Speculator* more than 42 years ago, yet today the latter is well below the former.

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THE PRUDENT SPECULATOR
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 4.94%.

Certainly, we are not making a prediction that stocks will move massively higher in the near-term, but, assuming that S&P 500 profit levels were maintained, if the current 4.94% earnings yield shrank to match today's 1.71% yield on the 10-year U.S. Treasury, the S&P 500 would trade at 8860, just a smidge higher than today's 3067 level!

As such, we think that equities remain attractively priced and we concur with the additional wisdom from Mr. Buffett, "When interest rates were 15 percent with [Paul] Volcker, you know, it was an enormous gravitational pull on all assets, not just stocks. If you can get 15 percent, it makes the choices way different than if you get zero."

Interest rates, at least here in the U.S., are not at zero, but we think folks should look at stocks in a favorable light today. After all, at past record market highs in 2000 and 2007, the "risk-free" rate was significantly higher,…

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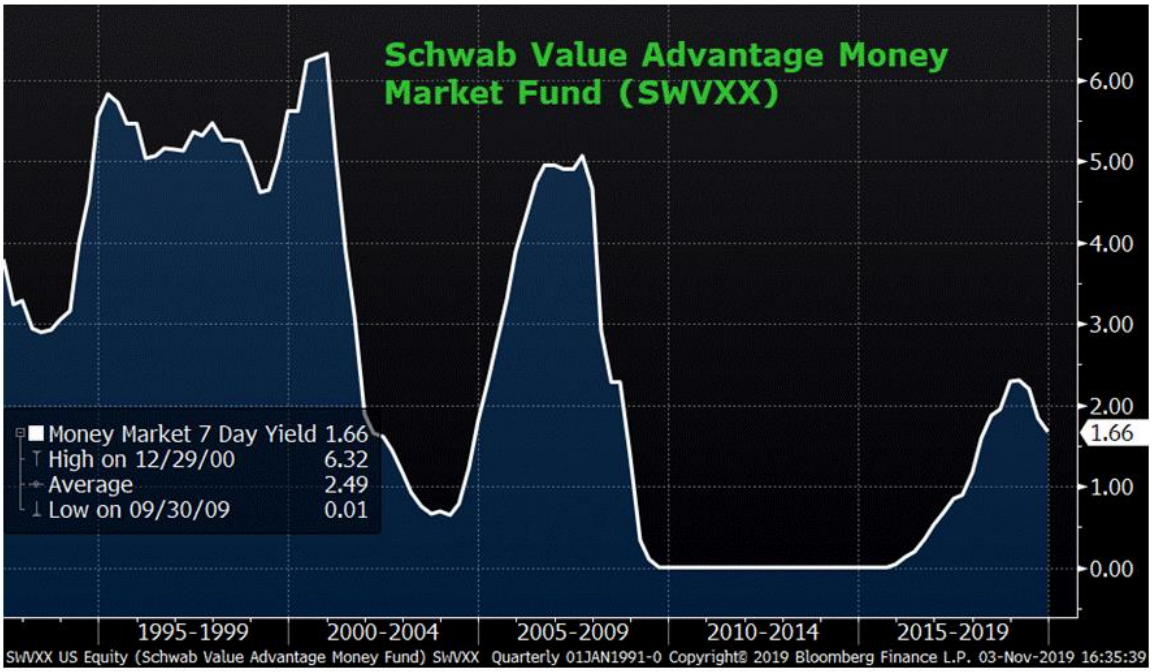
THE PRUDENT SPECULATOR
Money Market Fund Yields Over Time

The yield on the Schwab Value Advantage Fund is no longer near zero, but there is a long way to go to approach the 2000 or 2007 levels.



…while today a broadly diversified portfolio of what we believe to be undervalued stocks boasts a generous dividend yield of 3%, well above what is available in a money market fund.

CURRENT PORTFOLIO AND INDEX VALUATIONS

Name	Price to Earnings Ratio	Price to Fwd. Earnings Ratio	Price to Sales Ratio	Price to Book Ratio	Dividend Yield
TPS Portfolio	13.6	12.2	1.1	2.1	3.0
Select Value	14.2	12.5	1.2	2.1	2.6
Select Dividend	14.3	12.7	1.0	2.1	3.3
Select Focused Dividend	13.4	12.3	1.0	2.4	3.3
Select Focused Value	14.3	13.1	1.4	2.4	2.7
Select SMID Dividend	12.9	11.7	0.6	1.6	3.2
Russell 3000	21.4	19.3	2.0	3.2	1.8
Russell 3000 Growth	27.9	24.6	3.0	8.2	1.2
Russell 3000 Value	17.3	15.8	1.5	2.0	2.5
Russell 1000	20.7	18.9	2.2	3.3	1.9
Russell 1000 Growth	26.8	23.7	3.4	8.2	1.2
Russell 1000 Value	16.7	15.6	1.6	2.1	2.6
S&P 500 Index	20.0	18.5	2.2	3.4	1.9
S&P 500 Growth Index	25.3	22.6	3.7	5.6	1.5
S&P 500 Value Index	16.2	15.3	1.5	2.4	2.4
S&P 500 Pure Value Index	12.1	11.1	0.6	1.3	2.8

As of 11.01.19. Weights based on model portfolios. Harmonic mean used to calculate the portfolio price metrics. Companies with negative earnings are excluded from the P/E and Estimated P/E calculations. SOURCE: Kovitz Investment Group using data from Bloomberg Finance L.P.

Stock Updates

Jason Clark and Chris Quigley offer updates on 13 of our companies that were out with Q3 numbers this past week, the news of sufficient importance to trigger a review of their Target Price. Keep 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/.

Technology hardware designer and manufacturer **Apple** (AAPL – $255.82) earned $3.03 per share in Q4 2019 (vs. $2.84 est.). AAPL had revenue of $64.0 billion, versus the $63.0 billion estimate. Shares advanced more than 3%, pushing the YTD gains to 64%. The company reported strong iPhone demand worldwide and a resurgence in demand for Apple's wares in the Chinese market (mainland China, Hong Kong and Taiwan).

Regarding the quarterly numbers, CEO Tim Cook explained, "In iPhone, where customers have only begun to get their hands on the strongly popular and unmatched iPhone 11 and iPhone 11 Pro models, our year-over-year performance continued to improve. More on that in a moment. Outside of iPhone, our September quarter revenue was up 17%. We reached a new all-time high for Services with growth accelerating to 18%. We generated well over 50% revenue growth from Wearables, and I'm thrilled to say that we set Q4 records for Wearables in each and every market

we track. We continue to invent and improve on cutting-edge renewable materials, including the 100% recycled aluminum alloy found in many of our products. And we've added rare earth elements to our list of recycled materials with the introduction of iPhone 11. We're disassembling, recycling or refurbishing millions of devices every year with the help of Daisy, our recycling robot, and we're pushing the entire global supply chain toward recycled or renewable materials. We're driving access to critical coding skills development to educators and students through programs such as our teaching coding academies and our free Everyone Can Code curriculum. We continue to put user privacy at the center of everything that we do. And we know that Apple is strongest when our commitment to diversity and inclusion brings all voices to the table."

CFO Luca Maestri added, "We returned over $21 billion to shareholders during the September quarter, including almost $18 billion through open market repurchases of 86 million Apple shares and $3.5 billion in dividends and equivalents. We also retired an additional 7 million shares in the final settlement of our 14th ASR. As we move ahead into the December quarter, I'd like to review our outlook, which includes the type of forward-looking information that Nancy referred to at the beginning of the call. We expect revenue to be between $85.5 billion and $89.5 billion. This range includes a negative impact from foreign exchange of over $1 billion. We expect gross margin to be between 37.5% and 38.5%. We expect OpEx to be between $9.6 billion and $9.8 billion. We expect OI&E to be about $200 million, and we expect the tax rate to be about 16.5%."

While the quarter was one "without blemishes," as one analyst called it, there remain areas on which we are keeping a watchful eye. The Trump Administration could expand tariffs on Chinese goods this December, while the popularity of Apple TV+ remains to be seen. And there are always currency and exchange rate movements. Of course, we don't want to rain on the parade – Apple's quarter was indeed solid and we remain fans of the company. Even though Apple is again setting all-time highs, we think that the valuation remains reasonable, especially given that there is over $100 billion of cash on the balance sheet, with metrics like a forward price to earnings ratio of 19.8, a free cash flow yield of 5% and a dividend yield of 1.2%. The company is also buying back mountains of stock. We have ratcheted our Target Price for AAPL up to $267.

Globally diversified bank **HSBC Holdings PLC** (HSBC – $38.07) continued to frustrate us, posting Q3 financial results that trailed consensus analyst estimates on both the top- and bottom-lines. For the period, adjusted EPS came in at $0.17, which trailed forecasts by 12%. Revenue for the period of $13.27 billion fell short of the $13.8 billion investors were expecting.

Group CEO Noel Quinn said, "Parts of our business, especially Asia, held up well in a challenging environment in the third quarter. However, in some parts, performance was not acceptable, principally business activities within continental Europe, the non-ring-fenced bank in the UK, and the U.S. Our previous plans are no longer sufficient to improve performance for these businesses, given the softer outlook for revenue growth. We are therefore accelerating plans to remodel them, and move capital into higher growth and return opportunities."

Shares of HSBC have struggled this year, and now management has proclaimed that the bank is going to need to once again remodel the path forward. No doubt, our patience is wearing thin after what seems like a history of one step forward and two steps back. In the end, its an execution thing. On the positive side, however, we like the bank's global footprint, which gives it the unparalleled ability to offer services around the world and we believe HSBC's exposure to higher economic growth markets, as well as continued cost-cutting initiatives and efforts to improve operational efficiencies, could eventually boost the bottom line. Of course, we do like that the shares currently yield 6.7%, which includes the four regular quarterly dividends and an extra one that the company has paid out each April. For now, our Target Price has been trimmed to $48.

Shares of **New York Community Bancorp** (NYCB – $11.69) fell more than 13% last week despite the bank posting Q3 financial results that were a tad better than consensus analyst expectations. Adjusted EPS came in at $0.20, versus forecasts of $0.19, while revenue of $260 million was slightly higher than expectations. CEO Joseph R. Ficalora commented, "Overall, we are pleased with the company's performance this quarter. With the FOMC having lowered short term interest rates twice so far during the third quarter, we are beginning to see a positive impact on our funding costs, marking an inflection point in the net interest margin and net interest income. The net interest margin during the third quarter stabilized at 1.99%, down only one basis point from the previous quarter, while net interest income was relatively unchanged. We anticipate further improvements in our funding costs, and hence our net interest margin going forward due to our liability sensitive balance sheet."

Overview: Who we are

- We are a leading producer of multi-family loans in New York City. Our niche focuses on non-luxury apartment buildings that are rent-regulated featuring below-market rents.
- Our expertise in this particular lending niche arises from:
  - A consistent presence in this market for 50 years over all business cycles
  - Long standing relationships with our borrowers, who come to us for our service and execution capabilities
  - Decades long relationships with the top commercial mortgage brokers in the NYC market
- In addition, we originate commercial real estate loans, and to a much lesser extent, acquisition, development, and construction loans. We also originate commercial and industrial loans, including specialty finance loans.
- We operate over 230 branches in five states with leading market share in many of the markets we operate in.
- We are a conservative lender across all of our loan portfolios.
- We maintain an efficient operation.
- We complement our organic growth with accretive acquisitions.

All might have seemed well, but what spooked investors was that the bank saw slower lending in the multifamily sector and pointed to tougher competition from smaller rivals and the government. In the wake of new rent rules in New York state, it has become increasingly difficult to raise rents following property renovation which hurts NYCB's refinancing business. Mr. Ficalora added, "On the lending front, our loan portfolio continued to grow compared to the level at year-end 2018, led by our multi-family and specialty finance loan portfolios, but our end of period loan portfolio was down modestly compared to the prior quarter. However, on an average basis, average total loan balances increased 5% annualized compared to the prior quarter to $40.8 billion. During the quarter, we experienced a number of loans refinancing away from us, as the dollars offered by alternative lenders did not meet our stringent underwriting standards."

He continued, "Our overall deposit growth slowed this quarter as we strategically chose to allow higher cost deposits to roll off. This had a modest favorable impact on deposit costs during the third quarter. We expect it to have a greater benefit going forward. As we adjust to a lower interest rate environment, we are aggressively managing our deposit costs lower and proactively reducing higher cost deposit balances. Our operating expenses, excluding certain items related to severance costs, declined compared to the previous quarter and the efficiency ratio improved to 47.37%. Finally, our asset quality metrics continue to be solid. More importantly, we are not seeing any negative credit trends in the rent-regulated portion of our multi-family portfolio post the passage of new rent control laws in June."

While there are definitely operating headwinds for NYCB with the interest rate environment as well as local changes to rent rules that can impact future business, we think the selloff in the stock last week was overdone, even as the shares are still up some 24% in price this year. We like that NYCB has a solid balance sheet and continues to focus on cost controls. Long-term, we believe there will be ample opportunity for NYCB to grow its balance sheet, redeploy excess cash into higher yielding assets and continue to tighten expense controls to drive EPS growth. NYCB shares yield 5.8%. All considered, we have trimmed our Target Price to $13.

Axis Capital (AXS – $59.33) saw its shares drop almost 4% last week after the insurance and reinsurance company reported bottom-line results that fell well short of analyst expectations. For Q3, AXS said its adjusted EPS was -$0.34, versus consensus expectations of +$0.13. While catastrophe losses were pre-announced by Axis, elevated aviation and credit losses, which are normally volatile, hurt results.

CEO Albert Benchimol commented, "These losses obscure positive underlying trends that reflect our progress in building an organization that will consistently deliver strong results. Specifically, even with higher mid-size loss experience, within our Insurance segment, the current year ex-cat loss ratio is down more than a point this quarter versus the prior year. In our Reinsurance segment, while the ex-cat loss ratio is higher this quarter, this same ratio is down over a point year-to-date, reflecting the continued execution of our strategy to improve risk adjusted returns…We remain focused on continuing our progress and are confident that these positive underlying trends can be sustained. "

We continue to like that Axis' leadership team is experienced and focused on controlling costs and bringing specialist underwriting to new target markets, as well as creating more business balance and decreasing volatility. As Mr. Benchimol stated, "AXIS has leading positions in the markets that are experiencing the most significant pricing improvements which, combined with our underwriting actions and investments in digital capabilities, put us on a strong pathway toward long-term profitable growth." It is worth noting that the industry has seen consolidation, and we wouldn't be surprised that a mid-cap name like AXS could become a take-out candidate. AXS shares currently yield 2.7% and trade near book value per share, not to mention 12.5 times NTM expected adjusted EPS. Our Target Price has been pared to $67.

Shares of **McKesson** (MCK – $137.11) fell more than 6% last week, even as the drug distribution titan reported better-than-expected fiscal Q2 2020 top- and bottom-lines. A cloud continues to hang over the company as MCK deals with the seemingly constant negative headlines concerning subjects like cutting prescription drug costs and the opioid crisis.

Opioid-Related Costs

Results ($ in millions)	Q2 FY 2020	Q2 FY 2019	YTD Q2 FY 2020	Full Year FY 2019
Opioid-Related Costs				
Litigation Reserves Adjustment	$82	-	$82	$37
Legal Fees and Other	$36	$34	$72	$114
Total Expense	**$118**	**$34**	**$154**	**$151**

Litigation Reserves Adjustment
- McKesson recorded a pre-tax charge of $82 million in Q2 FY20 in connection with an agreement reached in principle to settle all claims filed by Cuyahoga and Summit counties of Ohio
- GAAP-only operating expense

Legal Fees and Other
- Opioid-related costs, primarily litigation expenses, included in adjusted operating expense

5 MCKESSON

Nevertheless, for the recently completed quarter, MCK turned in adjusted EPS of $3.60 (vs. the $3.58 forecast) on revenue of $57.6 billion (vs. consensus estimate of $55.1 billion). The company also reaffirmed its fiscal 2020 adjusted EPS guidance range of $14.00 to $14.60. "McKesson's second-quarter results reflect continued momentum across the business as well as further progress against our cost savings initiatives," said CEO Brian Tyler. "As we look forward to the second half of our fiscal year, we remain confident in the strength of our broad set of solutions and capabilities, delivering execution against our strategic imperatives as we become a more focused and efficient organization."

While there continues to be no shortage of stiff headwinds for MCK and its operations, we think the post-earnings-release selloff was overdone as the company has continued to show signs of stability across its businesses and even with all going on is still on pace to generate $3 billion of free cash flow this year. Certainly, the many hurdles and challenges in front of MCK could cause a near-term squeeze, 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 $14.37, $15.54 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 9.3 times NTM earnings expectations and our Target Price stands at $186.

Despite turning in a solid quarter, integrated oil and gas giant **Royal Dutch Shell** (RDS/A – $58.64) saw its shares fall almost 2% last week. This was the case even as Shell posted net income of $4.8 billion, well ahead of consensus estimates of $3.9 billion. Both its Upstream and Downstream businesses beat expectations.

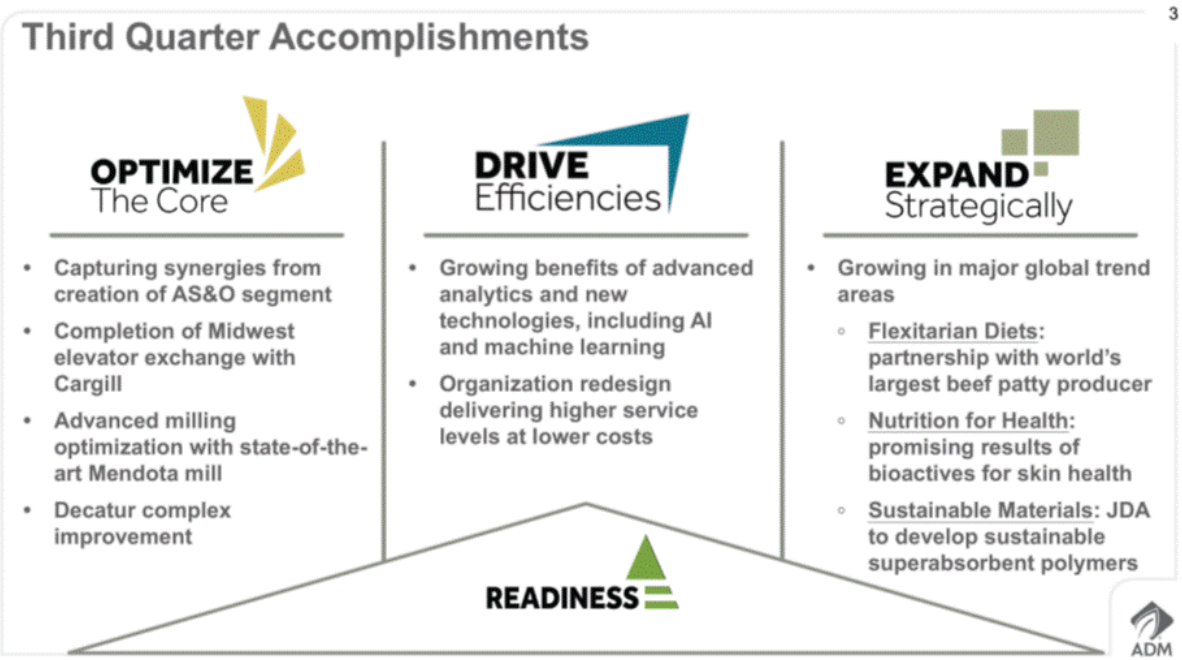
CEO Ben van Beurden commented, "This quarter we continued to deliver strong cash flow and earnings, despite sustained lower oil and gas prices, and chemicals margins. Our earnings reflect the resilience of our market-facing businesses and their ability to capitalize on market conditions, including very strong trading and optimization results this quarter. Our intention to buy back $25 billion in shares and reduce net debt remains unchanged. The prevailing weak macroeconomic conditions and challenging outlook inevitably create uncertainty about the pace of reducing gearing to 25% and completing the share buyback program within the 2020 timeframe."

And therein lied the problem as investors seemed to brush off management's continued commitment to returning almost all of the FCF to shareholders and its commitment to completing the $25 billion share buyback program, instead lamenting leadership's position that the timing of the completion of said program might not be by the end of 2020, but would depend on macro-economic conditions.

On the contrary, we like that Royal Dutch is focused on transforming itself from a "Big Oil" to a "Big Energy" company. Shares trade for less than 11 times forward earnings expectations and offer a hefty dividend yield of 5.5%. We continue to believe that global energy demand will increase over the long term, as usage in emerging economies should rise. We note that exposure to integrated energy names like Royal Dutch offers the opportunity to partake in numerous aspects of the energy stream, and the potential of a growing alternative segment. Our Target Price is now $92.

Archer-Daniels-Midland (ADM – $42.43) saw its shares rise more than 3% last week after the agricultural products company reported better-than-expected Q3 financial results. ADM earned $0.77, versus the consensus analyst estimate of $0.69. On the top-line, ADM reported revenue of $16.7 billion, versus the $16.1 billion estimate. While Q3 was an improvement over Q2, trade tensions continue to weigh on results. ADM's South American business benefited from strong exports to China. Its Nutrition segment benefited from the growing plant-based meat industry, however weak soy crush margins and headwinds in ethanol continued to negatively impact overall results.

"We delivered solid third quarter results, consistent with the perspectives we provided last quarter, despite a difficult external environment," said CEO Juan Luciano. "We maintained our focus on serving our customers and advancing our strategic goals, and continued to realize the benefits of the actions that we took earlier this year."



Looking ahead, Mr. Luciana added, "We are excited about our strategic growth activities, and particularly our participation and leadership in major global trends such as flexitarian diets, nutrition for health, and sustainable materials. We have invested in assets, platforms and technological capabilities to serve and grow with our customers, who are embracing these market-changing trends…While external conditions for certain businesses may remain fluid and potentially challenging in the near term, our growing leadership position in major global trends, and our strength in innovation, efficiency, and customer service, position us well for stronger results in 2020 and beyond."

Near-term operational challenges remain, but we think ADM has probably experienced the worst of the U.S.-China trade battle. We believe things will improve in 2020, and if "phase one" of a trade deal includes China purchasing U.S. agricultural products, especially ethanol, ADM should meaningfully benefit as China has indicated it intends to continue towards its E10 fuel mandate (mixing 10% ethanol with 90% gasoline). We continue to like the longer-term global secular growth trends in agriculture, and we think that ADM's scale gives it advantages over regional competitors. We also note that the company continues to work to strengthen its balance sheet, reshape its portfolio and return cash to shareholders. ADM currently yields 3.3% and trades for 13.3 times NTM EPS forecasts. Our Target Price has been bumped up to $56.

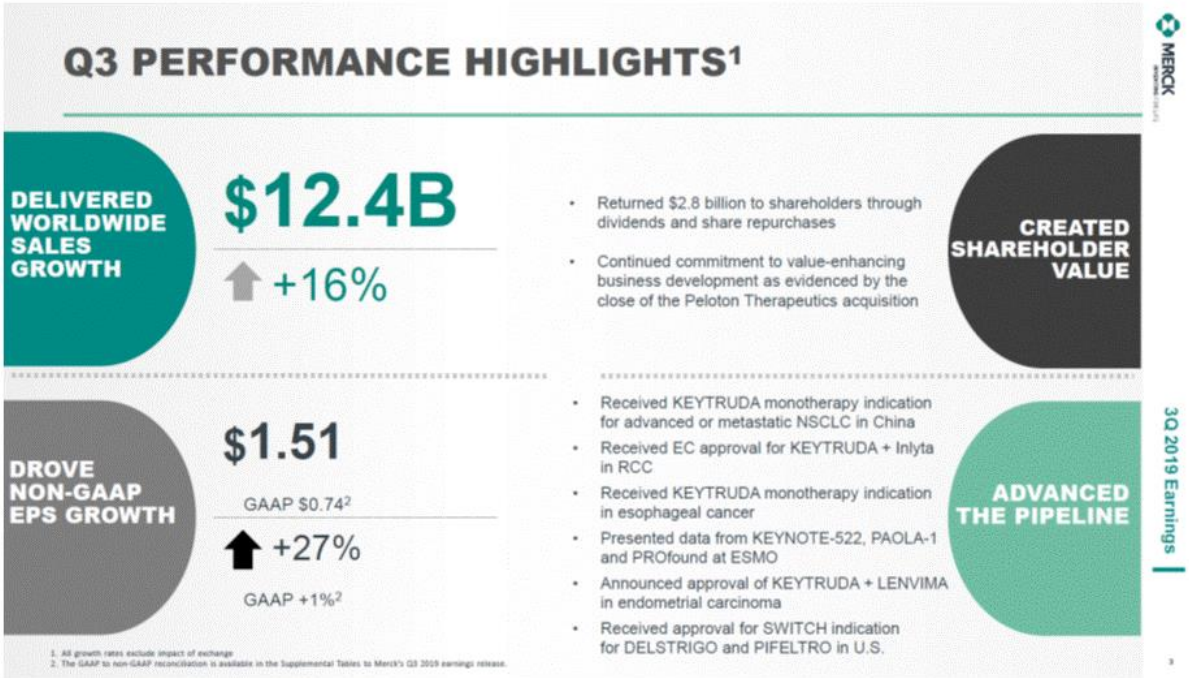
Despite reporting Q3 results that outpaced analyst expectations on both the top- and bottom-line, shares of oil and gas refiner **HollyFrontier** (HFC – $54.34) fell more than 5% last week. HFC reported adjusted EPS of $1.68, more than 18% better than expectations. Revenue for the period was $4.42 billion, versus the $4.11 billion estimate

CEO, George Damiris, commented, "HollyFrontier's solid third quarter results were driven by record throughput volumes and healthy gasoline and diesel margins across our refining system. We returned over $259 million to shareholders through dividends and share repurchases, signaling our strong commitment to return free cash flow to our shareholders. We are currently undergoing turnarounds at our El Dorado and Cheyenne refineries and plan to return to normal operations later in the fourth quarter."

We continue to like having our exposure to HFC especially as the stock trades for 10.7 times NTM adjusted earnings expectations and offers a dividend yield of 2.4%. Despite the $259 million returned to shareholders during the quarter, Holly still has the lowest payout ratio of the independent refiners, so there is the potential that we will see greater dividends in the future. We also like that Holly's refinery capabilities give the firm flexibility to tailor output more towards higher margin products as opportunities allow. Our Target Price for HFC has been inched down to $73.

Shares of **Merck & Co.** (MRK – $86.66) rose 3% last week as the pharmaceutical giant posted strong Q3 financial results and boosted its guidance for full-year 2019 adjusted EPS. Merck turned in adjusted EPS of $1.51, versus consensus expectations of $1.24. Revenue for the quarter was $12.4 billion, compared to forecasts calling for $11.6 billion. MRK's key growth driver, oncology drug Keytruda, experienced sales growth of 62% to $3.1 billion versus Q3 2018. Merck also enjoyed strong trends in human vaccines, with sales growing 17% YoY.

"We achieved another quarter of strong revenue and earnings growth as we continue to realize the benefits of our sustained investment in research and development and our focus on commercial execution," said CEO Kenneth C. Frazier. "We are confident that the investments we are making now will allow us to convert cutting-edge science into medicines and vaccines of great benefit to patients and value to shareholders."



Merck narrowed and raised its 2019 full-year revenue range to between $46.5 billion and $47.0 billion. The company also narrowed and raised its 2019 full-year adjusted EPS range to between $5.12 and $5.17.

We expect new cancer drug combinations will further propel Merck's overall drug sales. We see additional upside in MRK shares as we still believe the market doesn't fully appreciate its potential upside in immunooncology. 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 2.5%. We have boosted our Target Price to $94.

Shares of **National Oilwell Varco** (NOV – $23.15) spiked 11% last week following the oil service company's Q3 earnings release and conference call. While revenue of $2.13 billion was generally inline with consensus estimates, adjusted EPS of $0.04 was well short of the $0.13 expectation. However, NOV saw adjusted operating margins surge to 7.5% from 1.9% in the prior quarter and realized improvements in cash-flow generation.

“In the third quarter, adjusted EBITDA improved significantly relative to second quarter results due to accelerating cost reductions, a favorable revenue shift towards higher-margin offshore and aftermarket businesses, and positive project close-out variances,” commented CEO Clay Williams. “While third quarter revenue was essentially flat with the prior quarter, margins improved as sales growth in international and offshore markets helped offset sequential declines from North American operations where our customers are reducing their spending.”

Mr. Williams continued, “We were also pleased to see NOV post its strongest cash flow quarter in more than three years, as our concerted efforts to more efficiently manage working capital are making an impact. Overall, NOV’s unique strategic position within oil and gas, including its broad geographic and product diversity, its market leadership, and its large installed base, contributed to its improving results in the third quarter. As our industry battles deep cyclicality and divergent market conditions, the company remains committed to improving its financial returns while also helping our customers improve the efficiency, environmental performance and safety of their operations.”

Like others in the space, NOV saw solid results in its international segment while its North American line continued to face brisk headwinds. Though we have little doubt that operating pressures will persist, we still believe in long-term energy demand growth with the global population expected to expand from 7.6 billion to 9 billion and worldwide economic output more than doubling by 2040, and we think that NOV and its relatively solid balance sheet will survive the current energy difficulties and thrive during the next leg up. With the recent cost control initiatives taking hold, as well as other improvements, we have edged up our Target Price to $35.

Integrated telecom services firm **AT&T** (T – $38.95) posted adjusted earnings per share of $0.94, versus the $0.93 estimate, in fiscal Q3 2019. T had sales of $44.6 billion (vs. $45.0 billion est.). Shares gained 5.5% for the week, after the company reached a truce with activist investor Elliott Management in which T committed to regular share buybacks, added two new directors to its board and indicated that it would not make any major new acquisitions. The company later in the week also announced the launch of its $15 per month HBO Max streaming service featuring shows like South Park, Game of Thrones and 31 originals in the first year.

CEO Randall Stephenson explained, “Since 2012, we’ve made a series of strategic investments, and those investments have been aligned around 2 overarching trends: First, consumers will continue to spend more time viewing premium content; and second, businesses and consumers will continue to demand more connectivity, more bandwidth and more mobility. When we began pursuing this strategy, we saw an emerging world in which consumption of video and other premium content was no longer bound to your living room. And everything we expected has arrived, and it has arrived sooner than we or anyone else anticipated. And now the foundational elements of our investment thesis are clearer than ever. It all starts with advanced high-capacity networks. From our iPhone experience, we knew the mobile Internet revolution in a world of streaming video would require much more capacity than people were anticipating, so we began investing for future demand.”

Mr. Stephenson continued, “Over the last 18 months, we’ve been putting all this capacity into service, and the performance results have been dramatic. AT&T now has the fastest and most

reliable wireless network in the U.S. We've invested to extend these same capabilities south into Mexico. In 4 years, we built a high-speed nationwide network and have doubled the customer base. We've also been undertaking the most aggressive fiber deployment program in the U.S. since 2015 with over 20 million locations passed. Over the next 3 years, our strong spectrum position will allow for lower capital intensity, and that bodes well for growing operating margins. We're committed to an objective, diligent and disciplined process. We'll analyze the merits of each of our businesses individually and as a part of the whole. But let me be clear, we have no sacred cows. We're always open to making portfolio moves, and DIRECTV has been the source of a lot of public speculation in that regard. As we've said, it will be an important piece of our strategy over the next 3 years. But no portion of our business is ever exempt from a continuous assessment for fit and performance."

CFO John Stephens added, "Our path to [growing 3-year EPS to] $4.50 to $4.80 a share is clear and achievable. A large part of that expected growth is a result of share retirements. That alone should get us about $0.40 a share. Our enterprise-wide cost-reduction plans and Mexico profitability growth should net us another $0.25. Our remaining WarnerMedia synergies adds another $0.20. We also include about $0.10 of HBO Max investment in 2022. That business should turn profitable after that. The growth plans provide real earnings opportunities. When you combine our dividend yield along with share retirements of more than 3% a year for the next 3 years, that provides a yield of about 8.5% per year. And when you factor in EPS growth, you get a solid double-digit return."

Financial Outlook & Capital Allocation Plan: 2020 - 2022

Revenue Growth
- Revenue growth every year driven by Mobility, Fiber & WarnerMedia
- 1-2% three-year CAGR

Adjusted EBITDA Margin Growth
- Stable in 2020, even with HBO Max investment
- Ongoing cost evaluation and operational review
  - *Overseen by Corporate Development and Finance Committee*
- 200bps above 2019 by 2022, targeting 35% Margin
  - *~$6B of EBITDA growth by 2022; includes HBO Max investment*
  - *WM merger synergies; incremental cost savings; continued Mobility improvement; Mexico EBITDA growth*

Free Cash Flow
- Stable at $28B range in 2020
  - *Growing by more than $1B per year in 2021 & 2022*
- 2022 Free Cash Flow of $30B - $32B

Dividend growth & payout ratio
- Continued modest annual dividend increases
- Dividends as % of FCF — less than 50% in 2022

Post-dividend free cash flow
- 50-70% for retiring majority of shares issued for TWX

Net Debt to Adjusted EBITDA
- 2.0 to 2.25x by 2022

Portfolio Management and M&A
- Continued portfolio review and monetization of non-core assets
  - *Analyzing merits of each business; all assets under review*
  - *Overseen by Board's Corporate Development & Finance Committee*
  - *Continued regular updates to shareholders*
- No major acquisitions

Adjusted EPS Growth
- Adj. EPS of $3.60 - $3.70 in 2020
- Adj. EPS of $4.50 - $4.80 in 2022

Includes HBO Max investment of 15-20¢ per share in 2020, decreasing to ~10¢ per share in both 2021 & 2022

10

We are surprised that HBO Max's monthly fee is $15 per month but considering that the current HBO offering is similar in price, perhaps customers that haven't yet subscribed will find more value in the service dollar-for-dollar. We have noticed that a healthy portion of streaming subscribers subscribe to multiple services, so we expect that HBO Max will slot nicely into offerings from Netflix, Prime Video and the like, rather than competing for their subscription dollars. Of course, we also like the, as Elliott Management stated, "steps toward a faster-growing, more profitable, focused and shareholder-friendly company." To us, AT&T is a better-than-utility-like exposure with a 5.2% yield and a very reasonable sub-11 times P/E ratio. Our Target Price is now $43.

Electronic components designer and manufacturer **AVX Corp.** (AVX – $15.60) posted earnings per share of $0.20, versus the $0.24 estimate, in fiscal Q2 2020. AVX had sales of $377 million (vs. $385 million est.). Shares dropped 4% on the news, a result of the disappointing Q2 results and a rise in inventories.

CFO Michael Hufnagel explained, "Overall, orders to continue to decline in comparison to the previous quarter. Inventory levels remain high in the sales channel and the global economy continues to show weakness. The global economic environment remains uncertain as international relations and trade relations continue to put pressure on the global economy. POS at our distribution customers continues to be slower than expected and is negatively impacting the

order rate. Currently, we do not expect orders to improve substantially until later in the fourth quarter of our fiscal year. Product lead times continue to decline on commodity and standard tantalum products but remain extended on certain high-capacitance ceramics. We are continuing to bring on additional capacity for high-capacitance MLCCs and these improved lead times are contributing to the reduced order rate."

Mr. Hufnagel added, "We trust in an overall long-term growth for our electronic components and interconnect sensing and control devices based on R&D activities we are involved in with on several new customer applications, which will lead to future volume markets for electronic components like IoT, 5G, smart home grids, smart cities and agricultural, robots, drones, wearables, 3D printing, health care and further electrification of cars compared to new auto applications in safety and health."

Despite the rising prices, we expect smartphone sales to continue to grow over the longer term. While headwinds seem likely to weigh on AVX in the near term, especially on margins, we think that the company has wiggle room when it comes to cost controls and other margin improvement projects. We like AVX's balance sheet (net cash of more than $4.40 per share, though the company continues to make acquisitions) and 2.9% yield. Our Target Price has been reduced to $20.

Cruise line operator **Royal Caribbean Cruises** (RCL – $111.18) reported its strongest-ever Q3 earnings ever and updated full-year guidance last week. Despite the record earnings, RCL's $4.27 in EPS came in below the consensus analyst estimate of $4.32. Revenue during Q3 was $3.19 billion versus expectations of $3.17 billion. "Our business continues to thrive and exceed our expectations," CEO Richard D. Fain. "While Hurricane Dorian had a negative impact, stronger demand for our brands and our key itineraries exceeded our expectations. Excluding the hurricane impact, we are not only able to maintain our yield and earnings guidance, but to raise both slightly as a result of particularly strong performance in the U.S. and China."

The company now expects full year adjusted EPS to be in the range of $9.50 to $9.55. This range includes the negative impact of approximately $0.15 from Hurricane Dorian. The company's booking strength has completely offset the negative yield impact related to Dorian.

"2019 is shaping up to be another year of solid yield growth and record earnings despite some unusual headwinds," said CFO Jason T. Liberty. "As we enter 2020, we are particularly enthusiastic about the new ship deliveries, the development of new destinations, our fleet modernization and technology initiatives. These investments will help us deliver even greater vacations while generating higher yields and better returns."

We remain enthused about the overall prospects of the cruise industry, especially given favorable demographic and cruise-pricing trends, not to mention strong experience-oriented travel demand and the long-term potential in emerging markets. Shares trade inexpensively, changing hands at less than 11 times NTM projected adjusted EPS, and offer investors a 2.8% dividend yield. Our Target Price sails in at $156.