Market Commentary Monday, November 11, 2019

Download PDF

November 11, 2019

EXECUTIVE SUMMARY

TPS Portfolio Purchase – Bought 96 AVGO on Nov. 6
Rally Continues – Value Leading the Pack Since Aug. 31
Econ News – Solid Statistics; Still No Recession on the Horizon
Interest Rates – Fed Still Likely to Lower the Fed Funds Rate Target
Bonds – Volatile Asset Class
Sentiment – Investors Still Loving Fixed Income
Valuations – Stocks Still Cheap…Relative to Treasuries
Stock Updates – DIS, QCOM, SIEGY, PRU, COHU, AZSEY, CVS, NEM, KR, TPS, MOS, NLOK & HMC

Market Review

A little housekeeping before beginning this week's Market Commentary. As indicated in the November edition of *The Prudent Speculator*, we bought 96 shares of **Broadcom** (AVGO – $313.41) at $309.7616 for TPS Portfolio on Wednesday, November 6.

It was another terrific week for the U.S. equity markets, with the S&P 500 seeing a total return of 0.93% and the Russell 3000 gaining 0.89%. Even better, Value topped Growth, as the Russell 3000 Value index climbed 1.16%, compared to an advance of 0.63% for the Russell 3000 Growth index, expanding on the handsome outperformance for inexpensively priced stocks since the end of August.

AFAM
a KOVITZ division

THE PRUDENT SPECULATOR
Favorable Returns Growth AND Value

While many think the extraordinarily low interest rate environment and the trend toward passive investing have been the main catalysts for Growth stocks to perform very well over the last decade, we note that the returns on the more inexpensive areas of the equity market have not exactly been chopped liver…and Value has come to life of late!

Total Returns Matrix

Since 8.31.19	Year to Date	1-Year	3-Year	5-Year	7-Year	10-Year	15-Year	20-Year	Symbol	Name
-1.75	5.53	7.90	6.71	10.35	8.31	24.28	63.38	133.09	LEGATRUU Index	Global Aggregate Bond Index
-1.25	7.74	10.60	9.22	15.98	19.33	42.98	83.70	161.71	LBUSTRUU Index	U.S. Aggregate Bond Index
5.22	21.15	8.29	62.05	77.92	156.26	255.13	289.68	316.40	INDU Index	Dow Jones Industrial Average
4.31	21.27	3.64	47.90	53.19	138.21	244.64	262.21	242.14	RUO Index	Russell 2000 Growth Index
10.34	18.39	1.72	30.60	38.19	105.15	186.15	185.31	493.25	**RUJ Index**	**Russell 2000 Value Index**
7.25	19.93	2.77	39.25	45.95	121.74	215.43	224.19	367.14	RUT Index	Russell 2000 Index
4.37	28.17	14.05	67.97	86.77	187.78	305.57	334.30	197.44	RAG Index	Russell 3000 Growth Index
7.67	22.00	9.32	36.68	45.66	124.49	205.78	204.28	287.33	**RAV Index**	**Russell 3000 Value Index**
5.97	25.06	11.69	51.87	65.40	155.07	253.49	266.82	254.64	RAY Index	Russell 3000 Index
3.01	24.34	11.43	61.82	81.42	181.52	292.75	320.14	209.95	SGX Index	S&P 500 Growth Index
9.69	26.90	13.73	43.83	54.15	135.09	217.48	205.61	237.40	**SVX Index**	**S&P 500 Value Index**
6.07	25.52	12.47	53.47	68.64	159.48	256.00	262.63	230.70	SPX Index	S&P 500 Index
2.33	22.48	9.02	50.42	60.56	175.46	313.01	361.65	334.44	SPXPG Index	S&P 500 Pure Growth Index
11.58	22.77	3.67	39.76	41.89	152.47	282.89	297.15	487.31	SPXPV Index	S&P 500 Pure Value Index
8.80	8.39	-0.50	49.75	54.10	161.66	223.08	294.91	429.96	BRK/B Equity	Berkshire Hathaway Inc

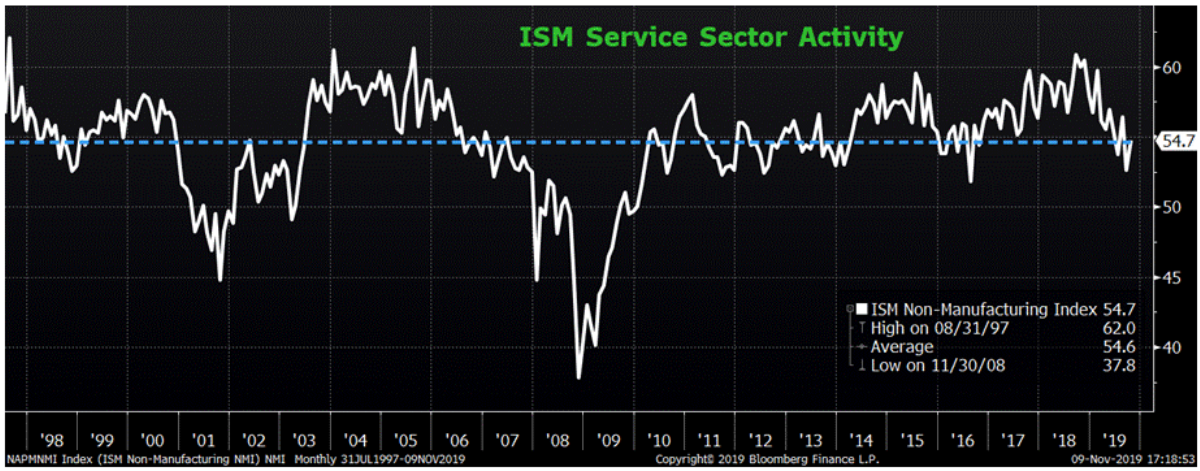
As of 11.08.19. Source Kovitz Investment Group using data from Bloomberg

No doubt, the positivity was supported by upbeat news on the trade front, even as there is still no definitive "phase one" agreement on the table, much less the comprehensive deal President Trump has been advocating. And, the latest economic numbers were generally decent, book-ended by an early-week better-than-expected reading on the health of the service sector…

AFAM
a KOVITZ division

THE PRUDENT SPECULATOR
ISM Non-Manufacturing Rises

The October reading on the health of the service sector (NMI) came in much-better-than-expected at 54.7, near the historical norm and a signal of growth in the non-manufacturing economy, with the Institute for Supply Management stating, "The past relationship between the NMI and the overall economy…corresponds to a 2.1% increase in real gross domestic product (GDP) on an annualized basis."

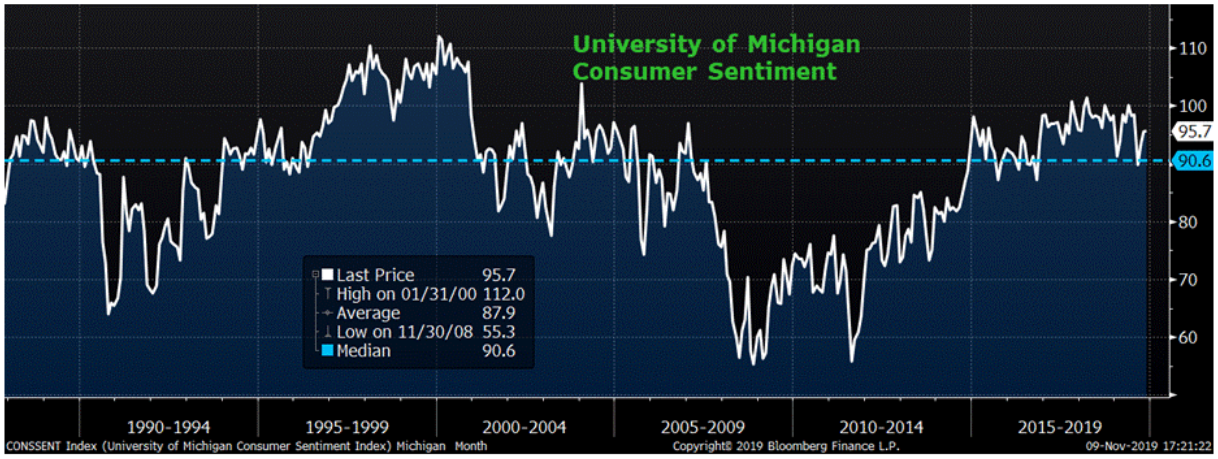


…and a late-in-the-week in-line report on consumer sentiment.

AFAM
a KOVITZ division

THE PRUDENT SPECULATOR
Healthy Reading on Consumer Sentiment

The University of Michigan's latest read on the confidence of the consumer inched up to a solid preliminary November tally of 95.7, slightly better than the 95.5 tally in October. Of course, both of those numbers are well above the long-term average of 87.9, and the most recent figure included favorable data in regard to employment and the stock market that bolstered optimistic expectations.



Interestingly, the prognostications for the economic outlook remain mixed, with the Atlanta Federal Reserve now looking for near-term GDP growth of just 1.0%…

AFAM
a KOVITZ division

THE PRUDENT SPECULATOR
Recession Not Presently the Prediction

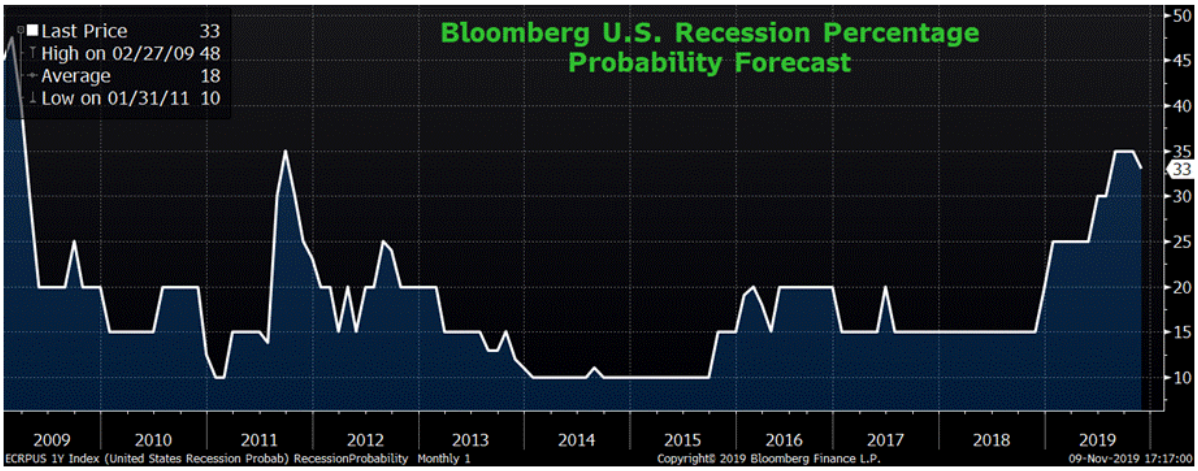
As the saying goes, economists have predicted nine of the last five recessions, and 2019 vividly illustrates why we like the Niels Bohr quotation, "Prediction is very difficult, especially if it is about the future." Indeed, eight months ago, forecasts for U.S. GDP growth were near zero, only to quickly rebound to a 2.8% annualized growth estimate, but then fall and rise and fall again to a 1.0% Q4 guess today.

…though Bloomberg just lowered its odds of recession to 33%, down from 35%.

AFAM
a KOVITZ division

THE PRUDENT SPECULATOR
Recession Probability: Now at 33%

While it is clear that domestic and global economic growth is not as robust as most would like, and recent domestic data points have not exactly been robust, the probability of recession has just dipped a couple of points to 33%. To be sure, this is near highs last seen in the fall of 2011…but that proved to be a fantastic time to buy equities, as the S&P 500 returned 30.2% over the ensuing 12 months.



To be sure, nothing we saw last week altered our view that the economy will continue to muddle along with modest GDP growth that will allow the Federal Reserve to remain highly accommodative in its approach to monetary policy, which should keep interest rates near historically low levels.

AFAM
a KOVITZ division

THE PRUDENT SPECULATOR
Low Interest Rates Headed Lower Still

99) Export — World Interest Rate Probability

United States — Instrument: Futures: Fed Funds - Effective — Fed Effective Rate 1.55

1) Overview | 2) Future Implied Probability

Current Implied Probabilities — 3) Add/Remove Rates

Dates: Meeting / Calculation — Calculated 11/08/2019 — 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%	5.8%	0.0%	0.0%	0.0%	5.8%	94.2%	1.55
01/29/2020	0.0%	17.8%	0.0%	0.0%	0.7%	17.0%	82.2%	1.52
03/18/2020	0.0%	29.7%	0.0%	0.1%	3.1%	26.5%	70.3%	1.49
04/29/2020	0.0%	35.0%	0.0%	0.3%	4.9%	29.8%	65.0%	1.47
06/10/2020	0.0%	39.2%	0.0%	0.6%	6.5%	32.1%	60.8%	1.45
07/29/2020	0.0%	43.7%	0.1%	1.1%	8.4%	34.2%	56.3%	1.43
09/16/2020	0.0%	48.9%	0.2%	1.7%	10.8%	36.2%	51.1%	1.41
11/05/2020	0.0%	52.0%	0.3%	2.3%	12.3%	37.1%	48.0%	1.39
12/16/2020	0.0%	56.6%	0.5%	3.2%	14.7%	38.2%	43.4%	1.36

Even as the amount of negative-yielding debt globally has dipped below $12 trillion, down from $17 trillion several months ago, the futures are signaling a 0% chance of a boost in the current 1.5% to 1.75% target for the Federal Funds rate. In fact, the odds are 38.2% for one more cut and 18.4% for two or more cuts by the end of 2020.

Of course, interest rates around the world jumped last week with the yield on the German Bund ending Friday at -0.26%, up significantly from the -0.39% level a week ago and adding to sizable losses for those who piled in more recently to negative yielding government debt.

Reward-Free Risk – German 10-Year

It must be new math European fixed income investors use when they rationalize buying negative yielding debt. After all, while the Bund has proven lucrative in recent years, the price of the German government bond (which if held to maturity would provide a loss of 0.70% per year for those who bought at the end of August), declined by 4.33% over the last ten weeks. Maybe they think they sextupled their expected annual return as the two negatives cancel (-4.33% divided by -0.70%)!

And, it was not just European bonds that have produced sizable short-term losses for those hiding out in supposedly safe debt instruments, as the yield on Uncle Sam's benchmark 10-year Treasury soared some 23 basis points over the past five trading sessions to 1.94%, the highest level since July 31.

AFAM
a KOVITZ division

THE PRUDENT SPECULATOR
Stocks Not the Only Volatile Asset Class

Though U.S. Treasuries are far less volatile than equities, action in the government bond market last week illustrated that supposedly safe fixed income investments can suffer sizable short-term setbacks. Indeed, the yield on the benchmark 10-Year Treasury jumped from 1.71% to 1.94%, with the resulting price drop equaling a hefty 2.09%.

While we do not think bond yields will skyrocket from current levels, and we believe that the low interest rate environment is incredibly supportive of equities, we suspect that many folks are not going to be happy to see red ink on their statements for their fixed income asset class investments. This is especially true, given all the money that has been poured into bond funds at the expense of U.S. stock ETFs and mutual funds.

AFAM
a KOVITZ division

THE PRUDENT SPECULATOR
Bonds Remain Stunningly Popular

With the S&P 500 at an all-time high, many think folks are infatuated with U.S. equities, but data from the ICI show that a massive net sum of money has flowed out of domestic stock mutual funds/ETFs over the last 4-plus years. Bonds have been the major beneficiary of the exodus.

Investment Company Institute

Long-Term Mutual Fund and Exchange-Traded Fund (ETF) Flows

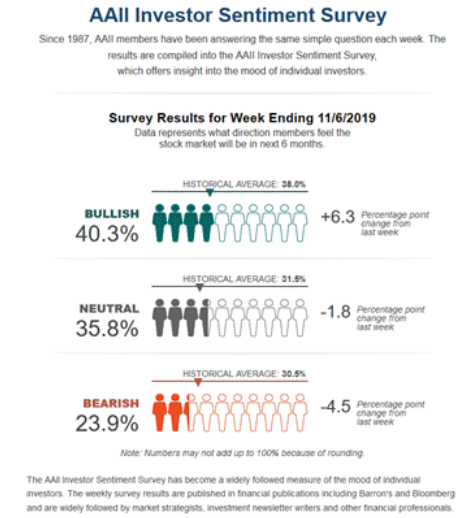
Millions, U.S. dollars

Month	Stocks Domestic	Bonds Total	Month	Stocks Domestic	Bonds Total	Month	Stocks Domestic	Bonds Total	Month	Stocks Domestic	Bonds Total
Jan-15	-14,465	17,535	Apr-16	-12,610	22,114	Jul-17	-12,518	29,139	Oct-18	-9,657	-27,700
Feb-15	5,547	30,321	May-16	-14,252	16,925	Aug-17	-22,771	25,078	Nov-18	2,783	-7,459
Mar-15	-1,494	4,905	Jun-16	-15,530	16,623	Sep-17	-9,775	33,440	Dec-18	-28,953	-49,512
Apr-15	-34,681	11,027	Jul-16	292	33,575	Oct-17	3,166	36,110	Jan-19	-21,190	29,308
May-15	-17,287	5,010	Aug-16	-9,956	30,859	Nov-17	-4,417	19,788	Feb-19	3,632	45,138
Jun-15	-7,023	6,324	Sep-16	-5,713	24,669	Dec-17	-9,054	19,491	Mar-19	-3,647	38,412
Jul-15	-14,864	-1,255	Oct-16	-23,109	13,855	Jan-18	10,778	46,287	Apr-19	-5,313	40,565
Aug-15	-18,569	-18,122	Nov-16	22,993	-13,289	Feb-18	-41,444	2,706	May-19	-24,668	21,287
Sep-15	-4,725	-10,849	Dec-16	18,859	-4,142	Mar-18	-22,152	14,148	Jun-19	-12,011	39,770
Oct-15	-807	15,397	Jan-17	5,097	31,037	Apr-18	-7,403	24,176	Jul-19	-7,886	44,816
Nov-15	654	-5,573	Feb-17	17,613	33,991	May-18	10,068	11,749	Aug-19	-29,804	22,298
Dec-15	476	-25,043	Mar-17	9,411	36,562	Jun-18	-21,004	16,995	Sep-19	-4,648	38,518
Jan-16	-27,222	7,686	Apr-17	-8,266	22,064	Jul-18	1,007	22,495	**Totals:**	**-442,352**	**978,647**
Feb-16	-9,108	11,915	May-17	-10,725	33,070	Aug-18	-6,660	17,219			
Mar-16	7,711	29,296	Jun-17	-7,944	29,372	Sep-18	886	18,526			

One wonders where stocks might be if there was not such significant disinterest, though the contrarian in us would prefer that the masses do not become overly bullish,…

AFAM
a KOVITZ division

THE PRUDENT SPECULATOR
Sentiment: Bullish AAII & Bearish ICI



November 7, 2019 - Individual investor optimism about the short-term direction of the stock market is above average for the first time since July according to the latest AAII Sentiment Survey. Additionally, pessimism fell to a six-month low. Bullish sentiment, expectations that stock prices will rise over the next six months, jumped 6.3 percentage points to 40.3%. Optimism was last higher on May 8, 2019 (43.1%). Bullish sentiment is above its historical average of 38.0% for just the ninth time this year. Bearish sentiment, expectations that stock prices will fall over the next six months, fell 4.5 percentage points to 23.9%. Pessimism was last lower on May 8, 2019 (23.2%).

The latest AAII Sentiment Survey showed a bump in optimism and a dip in pessimism, with the 40.3% Bullish reading now modestly above the 38.0% historical norm. Meanwhile, the most recent ICI calculation of exchange traded and mutual fund flows showed a continuation of the exodus out of U.S. stocks.

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

Week Ended	10/30/2019	10/23/2019	10/16/2019	10/9/2019	10/2/2019
Total Equity	-6,787	-5,659	755	-10,609	-13,429
Domestic	-4,100	-4,693	2,698	-9,964	-11,746
World	-2,687	-967	-1,943	-644	-1,682
Hybrid	-767	-168	-391	-688	-1,163
Total Bond	11,300	10,419	10,473	5,810	8,427
Taxable	9,635	8,275	8,786	3,856	6,810
Municipal	1,665	2,144	1,687	1,954	1,617
Commodities	-319	222	-151	425	489
Total	3,427	4,814	10,686	-5,061	-5,676

Source: Investment Company Institute

…even as we note that *The Wall Street Journal* reported last week, "Nervous investors have socked $3.4 trillion away in cash. But stocks are rising and their nerves are calming, leading bulls to view the huge cash pile as a sign that markets have room to go higher. Assets in money-market funds have grown by $1 trillion over the last three years to their highest level in around a decade, according to Lipper data."

Continuing with the contrarian thought process and illustrating yet again why we always like to say that the only problem with market timing is getting the timing right. *The Wall Street Journal* went on to say, "A UBS Global Wealth Management survey of 4,600 wealthy entrepreneurs and investors showed that more than a third raised their cash allocations in the past quarter in response to flaring trade worries. In total, cash holdings rose a percentage point to 27% of survey respondents' portfolios at the end of the third quarter from the previous quarter, even as a growing number said they were increasingly optimistic on the global economy and stock performance. The cash allocation is much higher than the percentage recommended by the firm."

The Wall Street Journal concluded with: "Analysts at Bank of America Merrill Lynch, meanwhile, see the cash pile as an indication that markets have plenty of room for more gains. The bank's proprietary Cash Rule Indicator, which gives a buy signal on stocks when investors' cash balances are above their long-term averages, has been in bullish territory for the last 20

months. Fund managers polled in the bank's latest survey said they are holding an average of 5% of their portfolios in cash. That compares with a 10-year average of 4.6%."

Certainly, it is not reasonable to expect stocks to head only in the northerly direction, and the equity futures were suggesting that we might see a pullback when trading resumes this morning, while we continue to have a little dry powder waiting to take advantage of the inevitable downturns. Still, we retain our long-term enthusiasm for the prospects of our broadly diversified portfolios of what we believe to be undervalued stocks. After all, stocks remain very attractively priced in our view on both an earnings yield and dividend yield basis, relative to the "risk-free" benchmark government bond.

AFAM a KOVITZ division

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 4.87%.

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/.

Movies, entertainment and theme park company **Walt Disney** (DIS – $137.96) earned $1.07 per share in fiscal Q4 2019 (vs. $0.95 est.). DIS had revenue of $19.1 billion, versus the $19.0 billion estimate. High investment costs related to the company's buildout of its online library weighed on profits, while the company's film studio saw revenue rise more than 50% versus the same quarter last year to $3.3 billion. Shares moved up 3.9% following the announcement.

CEO Bob Iger commented, "We spent the last couple of years completely transforming the Walt Disney Company making strategic acquisitions and organizational changes to focus the resources and immense creativity across the entire company on delivering an extraordinary DTC experience unlike anything else in the market. With the launch of Disney+, we're making a huge statement about the future of media and entertainment and our continued ability to thrive in this new era. I'd like to take this opportunity to publicly acknowledge and sincerely thank the technical and creative teams, along with countless others across our company, who invested their tremendous talent and a lot of time and effort in creating an exceptional DTC experience that is worthy of the Disney name. I talk a lot about the inevitability of change, our ability to both drive it and adapt to it. It's part of Disney's DNA, and it helps keep us relevant to each new generation while also creating new opportunities for growth. It's exciting and exhilarating and on the eve of launching one of our most ambitious initiatives to date, I'm more confident than ever in our strategy and in our ability to execute effectively to deliver compelling value to our consumers and shareholders."

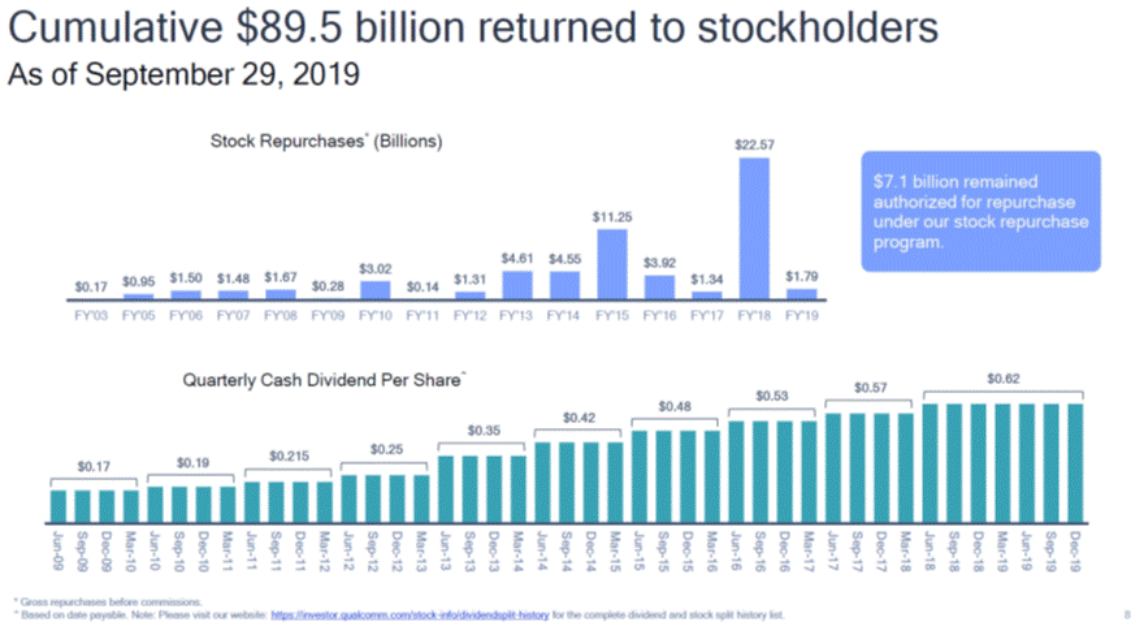
Disney's Parks, Experiences and Products operating income was up 17% in the quarter, an encouraging improvement after last quarter's crowds at the new *Star Wars: Galaxy's Edge* area at Disney's Anaheim, California theme park weighed on overall attendance. In December, the *Rise of the Resistance*, also a *Star Wars*-themed area, is slated to open at Walt Disney World in Florida. We are looking forward to the launch of Disney+, to which both of your TPS contributors have subscribed, and we believe that the offering will be complementary to other streaming packages out there. DIS shares yield 1.3%. Our Target Price for DIS has been hiked to $162.

Semiconductor firm **Qualcomm** (QCOM – $94.03) posted earnings per share of $0.78, versus the $0.71 estimate, in Q4 2019. QCOM had sales of $4.8 billion (vs. $4.7 billion est.). Shares have gained 10.4% since Wednesday, pushing the YTD total return to nearly 70%.

CEO Steve Mollenkopf said, "Over the last several years, we have invested to establish Qualcomm as a leader in 5G. As a reminder, 5G brings a significant increase in complexity over 4G, such as new and dense network architectures, high performance-based bands, advanced RF front end designs, increased processing requirements, in addition to driving the leading-edge process node. We are actively focused on helping to define and standardize releases 16 and 17 features to support the expansion of 5G into new, large, adjacent markets such as enterprise, industrial IoT and automotive. The complexity and expansion of cellular technologies beyond the smartphone into nearly every industry play directly to Qualcomm's strengths and are why we believe 5G will represent the single biggest opportunity in Qualcomm's history. We are pleased with the progress we have made over the course of 2019 and believe the business is very well positioned for sustained long-term growth as we benefit from the decisions and investments

made over the last several years, including 5G, the return of Apple licensing and product revenues, growth in RF front end and growth in adjacent businesses."

Interim CFO Akash Palkhiwala said, "We expect Q1 2020 revenues to be in the range of $4.4 billion to $5.2 billion and non-GAAP earnings per share of $0.80 to $0.90. We estimate fiscal first quarter QTL revenues to be in the range of $1.3 billion to $1.5 billion and EBITDA margin of 70% to 74%. We expect QTL revenues to be up 21% sequentially at the midpoint in our fiscal first quarter due to normal holiday seasonality, driven by timing of flagship phone launches. Our fiscal first quarter forecast does not include any royalty revenues from Huawei while we continue to pursue a negotiated resolution of the licensing dispute. With the completion of the global patent license agreement with Apple earlier this year, QTL revenues will begin to reflect a seasonally high fiscal first quarter. Following this seasonal uplift, we expect QTL revenues to return to a range of $1 billion to $1.2 billion in our fiscal second quarter."



We believe that Qualcomm management made some significant missteps over the past few years that often made us revisit our willingness to hold our shares. However, Mr. Mollenkopf and his team worked out a good deal with Apple and the company is now rapidly expanding its products around the 5G wireless standard. With the benefit of hindsight, we certainly are glad that no merger with Broadcom occurred and that we opted to stick with the undervalued stock. While some shareholders could certainly argue for taking the gains this year and running, we think that

the present business picture offers room for greater optimism. QCOM shares also have a yield of 2.8%, though we respect that the forward P/E ratio of 23 is elevated. Still, the consensus analyst EPS estimate for fiscal '21 is $6.05, resulting in a much more reasonable two-year-out P/E below 16. Our Target Price for QCOM has been increased to $101.

German industrial conglomerate **Siemens AG** (SIEGY – $62.74) posted earnings per share of $0.89, versus the $0.73 estimate, in fiscal Q4 2019. SIEGY had sales of $27.3 billion, versus the $25.6 billion estimate. While shares added 5% on the news, resulting in a 32% gain from this year's low on August 15. Siemens reported order growth around 2%, driven by the Gas and Power and Gamesa segments. The company's book-to-bill ratio was 1.01x, while the backlog stands at 146 billion euros.

CEO Josef Kaeser commented, "With the Vision 2020+, our businesses have now got the entrepreneurial freedom, responsibility and accountability to lead in their respective markets. Our transformation is making good progress, and we will create 3 Siemens company. That is what we call the Industrial Siemens to Siemens AG New, so to speak, Siemens Healthineers and then Siemens Energy. They're carrying strong Siemens spreads. And we will work together where there is mutual interest and value. Each company will strive to be among the best or set the standard for the industry with ambitious targets for profitable growth, and obviously, last, but not least, cash generation."

CFO Ralf Thomas added, "Free cash flow, all in, of EUR 5.8 billion matched the high level of fiscal '18. We continue to drive dedicated investments in CapEx to further strengthen our global footprint. Our senior management levels will continue to be incentivized based on a cash conversion and our target of 1 minus revenue growth remains in place for fiscal 2020, of course. All in all, fiscal '19 was a very successful year for Siemens again. We achieved our targets and our shareholders will benefit. And we decided to raise the dividend for the sixth year in a row and proposed a dividend of EUR 3.90. This equals a payout ratio of 61% and is slightly above the target range of 40% to 60%. With the dividend yield of 4%, as of September 30, we offer a very attractive and sustainable and reliable return. Second pillar of shareholder return is the ongoing execution of our current EUR 3 billion share buyback program running until November '21. We are fully on track and bought almost 11 million shares back for the — around EUR 1 billion equal."

In fiscal 2020, Siemens expects to see adjusted EPS between $6.98 and $7.75 ($3.49 to $3.87 per ADR) with a tax rate between 35% and 39%. Shares still trade below 16 times the current fiscal 2020 (ended Sept. 2020) consensus earnings estimate and yield 2.6% after foreign taxes. Although it was not a straight-line gain, SIEGY shares have risen 16% this year and we believe that an improving global macro environment would reduce some of the headwinds the company has faced recently. Infrastructure project spending can be lumpy, but we think the exposure has a valuable spot in our portfolios. Our Target Price for SIEGY is now $87.

Prudential Financial (PRU – $92.89) reported earnings ($3.22 versus $3.06) that beat analyst estimates, while the insurance giant also grew adjusted book value per share by nearly 5% year-over-year. Operating results were mixed across business segments amidst an adverse capital

market environment. A highlight of the quarter was the $800 million of inflows pushing PGIM assets under management to $1.28 trillion.

PRU CEO Charles Lowrey commented, “During the third quarter, we continued to advance our strategy of delivering financial opportunity to a wider demographic, and the recent acquisition of Assurance IQ expands our distribution capabilities with a direct-to-consumer platform. At the same time, we are making progress in driving greater efficiency and speed within our operations, and we are on track to achieve $50 million in run-rate margin expansion by the end of 2019 and $500 million by the end of 2022. Looking ahead, we are focused on meeting the evolving needs of our customers, while continuing to take a disciplined approach to pricing in consideration of the effects on profitability from the low interest rate environment.”

AFAM a KOVITZ division

THE PRUDENT SPECULATOR
PRU – Shareholder Friendly

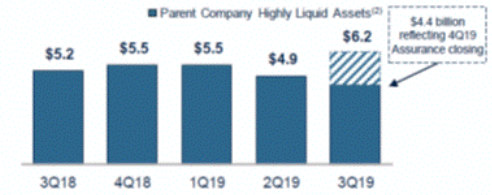
Robust Capital Position Supports Strong Distributions to Shareholders

Capital Position

Capital Deployment	• Capital returned: $1.4 billion (Share repurchases of $1 billion and dividends of $412 million) – $1.00 dividend per share, a 4% yield on adjusted book value
Capital Level	• Continue to hold capital above our AA financial strength levels
Leverage[1]	• Financial leverage ratio less than 25%

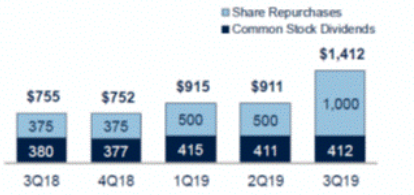
Liquidity Position

($ billions)



Shareholder Distributions

($ millions)



(1) Financial leverage ratio represents capital debt divided by sum of capital debt and equity. Junior subordinated debt treated as 25% equity, 75% capital debt for purposes of calculation. Equity excludes non-controlling interest, AOCI (except for pension and postretirement unrecognized costs), and the impact of foreign currency exchange rate remeasurement.
(2) Highly liquid assets predominantly include cash, short-term investments, U.S. Treasury securities, obligations of other U.S. government authorities and agencies, and/or foreign government bonds.

Advice | Retirement | Investments | Insurance 8

With interest rates down significantly on the year through quarter end, we are impressed by the company’s ability to return 13% on its equity. PRU shares now trade at just over 7 times NTM adjusted EPS expectations and 57% of book value, while offering investors a 4.3% dividend yield. We applaud management’s efforts to ramp up share repurchases at the current discount to book value. Our Target Price for PRU is presently $132.

Semiconductor equipment firm **Cohu** (COHU – $19.71) earned $0.12 per share in fiscal Q3 2019 (vs. $0.00 est.). COHU had sales of $143.5 million (vs. $143.0 million est.). Shares have gained 13% since the announcement, which surprisingly came out on Saturday, Nov. 2.

CEO Luis Mueller was again upbeat, "Third quarter orders were 44% system and 56% recurring, validating our strategy to build a solid foundation of recurring business that helps offset capital equipment cyclicality. We also captured a key design win at a leading U.S. mobile semiconductor manufacturer, adding an approximately $10 million a year customer and broadening our leadership in RF test. Third quarter orders continue to strengthen in mobility, cloud, data center and AI, where we have greater ATE exposure in growing contactor sales to RF and foreign management IC test, and a large thermal handler installed base for microprocessors. These segments are expected to gain momentum in 2020 with 5G power amplifiers and tena tuners, switches and filters tested on our equipment, supporting the initial ramp of next-generation smartphones coming to market next year. We believe that we're seeing the beginning of a new growth cycle, driven by 5G communications, enabling higher data rates and capacity with enhanced mobile broadband, massive machine-type communications on our narrowband Internet of Things and mission-critical applications on ultra-reliable, low-latency communications."

Mr. Mueller continued, "We're also optimistic about the prospects of selling complete solutions consisting of testers and handlers, combined with contactors for semiconductor test across different applications. We recently ramped a complete solution, supporting a global satellite communication project that is forecasted to grow next year. Adding to that, our opportunities in the approximately $200 million flat panel display driver IC test segment, where we continue to make inroads in Taiwan, China and now also Korea. It's too early to speak with certainty about next year but we expect 5G to enter the next phase of expansion with initial volume smartphone production and a return to some level of normality in the automotive market, leading to semi test growth year-on-year… Lastly, it's been 1 year since the acquisition of Xcerra. And I'm happy to report being on track for $40 million annual run rate cost synergies by the end of this quarter. The main synergy objectives are being achieved ahead of schedule."

COHU expects revenue between $134 million and $144 million next quarter, with adjusted EBTIDA growth around 8% and a gross margin between 41% and 43%. While those numbers aren't all improvements over Q3, we think that COHU has generally fared well given the ongoing trade tensions with China and geopolitical challenges in Europe. We were pleased to see growth in the Chinese market in Q3 and think the company's diversified end markets should help smooth out the ride in the future. COHU shares, which have gained more than 20% this year, trade for about 19 times 2020 EPS estimates. Shares yield 1.2%. Our Target Price has been boosted to $22.

Insurer and financial services firm **Allianz SE** (AZSEY – $24.18) earned $0.52 per share in fiscal Q3 2019 (vs. $0.49 est.). AZSEY had revenue of $37.2 billion (vs. $36.2 billion est.). Shares dipped 1% last week after the company reported that inflation weighed on results, despite seeing operating profit growth around 4% year-over-year thanks to the Life/Health and Asset Management businesses.

CFO Giulio Terzariol said, “For the 9 months, I will say we have very good results, very strong results. On the Property-Casualty side, we have a combined ratio, 94.1%, which is a good combined ratio. We have a lot of companies performing very nicely. We have a company where we have some work to do. But again, when you look at the segments, the performance is pretty strong. On the Life/Health side, we see a strong operating profit and also a nice resilience of the value of new business and the new business margin. In Asset Management, we have record-high assets under management. So that’s also something that should be positive as we move into the future. And then when we put all this together, we are revising upwards our outlook for the year.”

AFAM
a KOVITZ division

THE PRUDENT SPECULATOR
AZSEY – 2019 a Nice Year Thus Far

Group financial results 3Q 2019

Group: 9M with good profitable growth

Comments

- **Internal growth strong at 6.0%**
  Strong internal growth in L/H +8.1% and P/C +4.4%. -1.8% internal growth in AM driven by lower performance fees. Favorable impact from consolidation (+0.8%) and F/X (+1.1%) leads to total growth of +7.8%.
- **Operating profit at 79% of FY outlook mid-point**
  Operating profit growth driven by L/H, AM and CO.
- **Outlook 2019: OP in the upper half of target range**
  For the full year, Allianz now expects to arrive in the upper half of its operating profit target range of EUR 11.5bn, plus or minus EUR 500mn, barring unforeseen events, crises or natural catastrophes.
- **S/h net income at 81% of FY 2018**
  Support from operating profit growth (+4.2%) and lower tax rate (-1.5%-p).
- **EUR 1.5bn share buy-back**
  7.3mn shares acquired representing 1.7% of share capital.
- **EPS grow 7.6%**
  Good net income growth and execution of share buy-back support EPS growth. Number of shares outstanding at 416mn.
- **RoE (annualized) improves to 14.1%**
- **P/C – on track**
  Operating profit at 73% of FY outlook mid-point. CR flat as underlying improvements are offset by lower run-off. OP slightly down as a higher underwriting result is offset by lower investment result.
- **L/H – strong performance**
  OP at 81% of FY outlook mid-point. OP in line with business growth. NBM of 3.4%. VNB up 13.2%.
- **AM – very good result**
  OP up by 3% and at 78% of FY outlook mid-point. Strong 3rd party net inflows of EUR 56bn.
- **CO – continuous improvement**
  Operating loss at 49% of FY outlook mid-point. Better result from Allianz Technology.

4

AZSEY expects operating profit to be in the “upper half” of the $12.15 billion to $13.25 billion range for fiscal 2019. We continue to believe that a strong balance sheet and cash generation ability give AZSEY the opportunity to make acquisitions and investments (such as the 4% stake Allianz is taking in the Chinese insurer Taikang Life Insurance for 800 million euros), buy back shares and hike the dividend from the current $0.74 net per share. In addition, the company has a diversified global income stream (including bond manager PIMCO) and diligent management team, while we think that the high-quality shares are very inexpensive, trading for just under 11 times estimated earnings and yielding 3.1%. Our Target Price is $31.

Shares of **CVS Health** (CVS – $72.47) rose more than 7% last week on the back of another strong quarter since completing its acquisition of Aetna last year. For Q3, CVS turned in adjusted EPS of $1.84, versus consensus analyst estimates of $1.77. Revenue for the period of $64.8 billion was better than forecasts of $63.0 billion.

The integrated pharmacy health care provider's legacy Aetna operations generated $17 billion in sales and adjusted operating income of $1.4 billion. The pharmacy benefits management (PBM) business delivered 9% growth in claims processed to 510 million, but price compression squeezed operating income. The retail/long-term care business grew 3% year-over-year to $21.5 billion in sales, but adjusted operating income fell to $1.5 billion as reimbursement pressures impacted performance.

CVS CEO Larry Merlo stated, "Our third quarter results build on the positive momentum we have seen across the company since the beginning of the year. All of our core businesses performed in line with or above expectations, reflecting strong operational execution. As a result, we delivered strong growth and generated robust operating cash flow, which enabled us to continue to deliver while returning capital to our shareholders."

Mr. Merlo continued, "Based on strong year-to-date performance, we are raising and narrowing our full-year 2019 Adjusted EPS guidance range to $6.97 to $7.05. As we approach the first anniversary of the Aetna acquisition, we are increasingly confident in the strength of our broad and differentiated assets as a combined company and our ability to deliver compelling value to our customers and the communities we serve. Looking ahead, we remain focused on successful execution of our strategic priorities and integration plans to unleash the full potential of our consumer-centric health care model and create value for all stakeholders."

Despite a seemingly bright future and the recent momentum, CVS shares have had a disappointing 12 months, with the stock off 6%. Not surprisingly, given the way Wall Street generally works, the stock has hardly been a favorite of analysts, though that seems to be shifting a bit. True, the competitive landscape is challenging, the regulatory environment presents questions and the opioid litigation threat remains front and center, but we continue to believe that CVS is a free-cash-flow generating behemoth with strong potential to evolve its business to a broader health care delivery model. Shares remain highly discounted, trading at just 10.4 times NTM earnings and with a 2.8% yield. Our Target Price for CVS has been lifted to $106.

Shares of **Newmont Goldcorp** (NEM – $36.61) slumped over 7% last week after the price of gold retreated by 3.5% and the giant precious metals miner posted adjusted Q3 EPS of $0.36, a penny light of analyst expectations. CEO Tom Palmer commented, "Newmont Goldcorp generated $1,079 million in adjusted EBITDA and $365 million in free cash flow for the third quarter, building momentum for an even stronger fourth quarter. We expect to deliver $240 million in annual run-rate improvements by the end of 2019 and exceed our initial synergy targets from the Goldcorp acquisition. We also continued to strengthen our portfolio and advance profitable growth by bringing on Borden, the Ahafo Mill Expansion and Quecher Main on time and within budget."

Commenting on progress since the merger, Mr. Palmer stated, “We delivered solid performance and have made excellent progress in delivering on the value we promised to establish Newmont Goldcorp as the world’s leading gold business. Recent highlights include completing three profitable projects on schedule and within budget; exceeding our commitments of value delivery from the Goldcorp acquisition through an acceleration of synergies and Full Potential improvements; closing the Nevada Gold Mine’s joint venture and contributing our Newmont Nevada assets in good order and continuing to improve our safety of performance and advancing our reputation for sustainability. I’m pleased to report that we are exceeding our synergy targets from the Goldcorp acquisition, with run rate improvements expected to reach $240 million by the end of this year, including $60 million in quick wins from Peñasquito and Cerro Negro alone.”

Despite the executive suite optimism, management also lowered its full-year production forecast from 6.5 million ounces to 6.3 million ounces as the company works out a few snags at properties acquired in the Goldcorp merger. On the other hand, as a testament to the Newmont’s solid financial position, the company also refinanced its note due in October by issuing the lowest 10-year metal and mining coupon ever at a 2.8% rate. All things considered, we have fine-tuned our Target Price for NEM to $45. We like the hedge provided by our modest exposure to gold, especially given volatile geopolitical and economic conditions around the globe. That said, we do acknowledge the complexities and obstacles inherent in the mining industry, so we

continue to monitor Newmont's efforts to streamline operations and control costs as it integrates Goldcorp.

Shares of **Kroger** (KR – $27.02) jumped more than 8% last week after management highlighted at its annual investor meeting that returning momentum in its "stable and growing core grocery business" was allowing the grocery store operator to offer next fiscal year's forecasts (including adjusted EPS of $2.30 to $2.40) which showed numerous metrics above consensus expectations. Additionally, the company has approved a $1 billion share repurchase program, replacing the existing authorization that had approximately $546 million remaining.

"Restock Kroger sets Kroger up for a stronger future," said CEO Rodney McMullen. "Momentum is returning to our core grocery business as a result of our customer obsession and renewed intensity around operational excellence, plus the asset-light, margin rich alternative profit streams that enrich our core supermarket business. We look forward to sharing how these come together at Kroger to create a path to consistently strong and attractive total shareholder return."

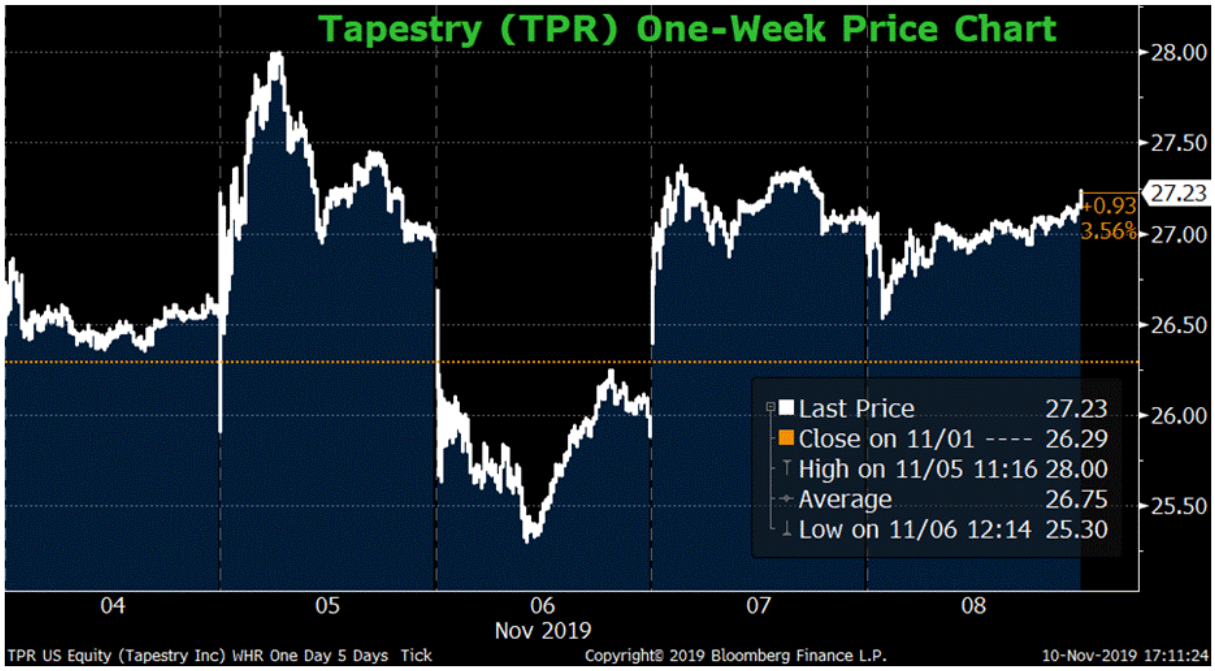
"As promised on our second quarter earnings call, Kroger is using our Investor Conference to provide an update on our future expectations to create value for shareholders, including early detailed guidance for 2020," added CFO Gary Millerchip. "Kroger's value creation model is strong and durable. We are pleased to see identical store sales momentum is building and we expect this trend to continue into 2020 and beyond. We are also delivering adjusted earnings per diluted share growth for our shareholders through the Restock Kroger timeframe, supported by a disciplined approach to returning cash to investors."

Mr. McMullen concluded, "We are confident that Restock Kroger is the right strategic framework for business growth in 2019 and 2020, and to position Kroger for long-term growth in the future. We believe that the food industry is special and big enough for different models to coexist – and Kroger's model will be one of them because, at Kroger, we are uniquely good at food. Kroger is food first and we believe that no matter who you are, where you're from, how you shop or what you like to eat, everyone deserves to have fresh, affordable and easy-to-enjoy food that tastes amazing. Kroger's ability to be America's food partner is our competitive advantage."

While competition remains stiff in the grocery space, we like that Kroger continues to remake itself and has moved more in the direction of being offensive versus defensive/reactive. Competitive headwinds won't die down anytime soon, but we are pleased to see the continued progress being made, and we believe there is more upside to be offered in KR shares. The stock trades a bit above 12 times NTM adjusted EPS projections and carries a dividend yield of 2.4%. We have made a slight adjustment up to our Target Price, which now resides at $34.

Shares of upscale retailer **Tapestry** (TPR – $27.23) gained and lost and gained again last week, ending a roller-coaster five days of trading up better than 3% as investors generally reacted positively to news concerning the U.S. and China trade battle and digested the company's fiscal Q1 2020 financial results. While TPR's revenue of $1.36 billion fell a bit short of the consensus

analyst estimate of $1.37 billion, adjusted EPS of $0.40 was almost 10% greater than what investors were expecting.



We continue to be very impressed with the Coach brand's consistency. Coach saw comparable sales increase 1% internationally, enduring lost sales in Hong Kong due to the protests, but seeing a boost in Japan prior to a new consumption tax going into effect on November 1. On the other hand, the Kate Spade brand continues to struggle, especially in the U.S., which is its primary market, as management continues to try hard to find a way to differentiate from other hand-bag brands. Additionally, the Stuart Weitzman brand, best known for its boots and sandals, is struggling with its wholesale partners as its styles seemingly don't mesh with the current casual athletic fashion trend. While Tapestry plans to expand SW's line of sneakers, it won't be easy dealing with the likes of Nike and Adidas. All that said, we like that management is focused on turning around both the Kate Spade and Stuart Weitzman brands, while keeping a keen eye on expenses, and riding the continued steady resurgence of the Coach brand.

CEO Jide Zeitlin commented on Q1, "Fiscal first quarter revenue was consistent with our expectations. Our business internationally was stronger than in North America where we managed continued industry headwinds. Further, adjusted operating income and earnings per diluted share were better than forecast, including favorable expense timing. We repurchased

$300 million of common stock during the quarter, underscoring our commitment to returning capital to shareholders."

Mr. Zeitlin continued, "Coach delivered its eighth consecutive quarter of positive comparable store sales growth led by digital and international channels. Comps in Europe, Japan and Mainland China were strong, offsetting weakness in Hong Kong, while North America was even with prior year…Kate Spade's comparable store sales declined in line with expectations, reflecting the product and merchandising challenges we've previously identified, while Stuart Weitzman sales were negatively impacted by softer wholesale demand and continued operational challenges."

While there will continue to be some near-term ups and downs, we think Tapestry is putting in the focus and energy necessary to get all the brands rowing the boat in the right direction. As Tapestry evolves, we can't help but be excited by the fact that the stock trades for just 10.5 NTM earnings expectations, and current respective EPS forecasts for fiscal '21 and '22 stand at $2.73 and $2.86, putting the longer-term forward P/E ratios in the single-digits. Shares currently yield a very generous 5.0%, and we continue to like the free-cash-flow generation and willingness of the company to buy back stock at these inexpensive prices. Our Target Price now stands at $41.

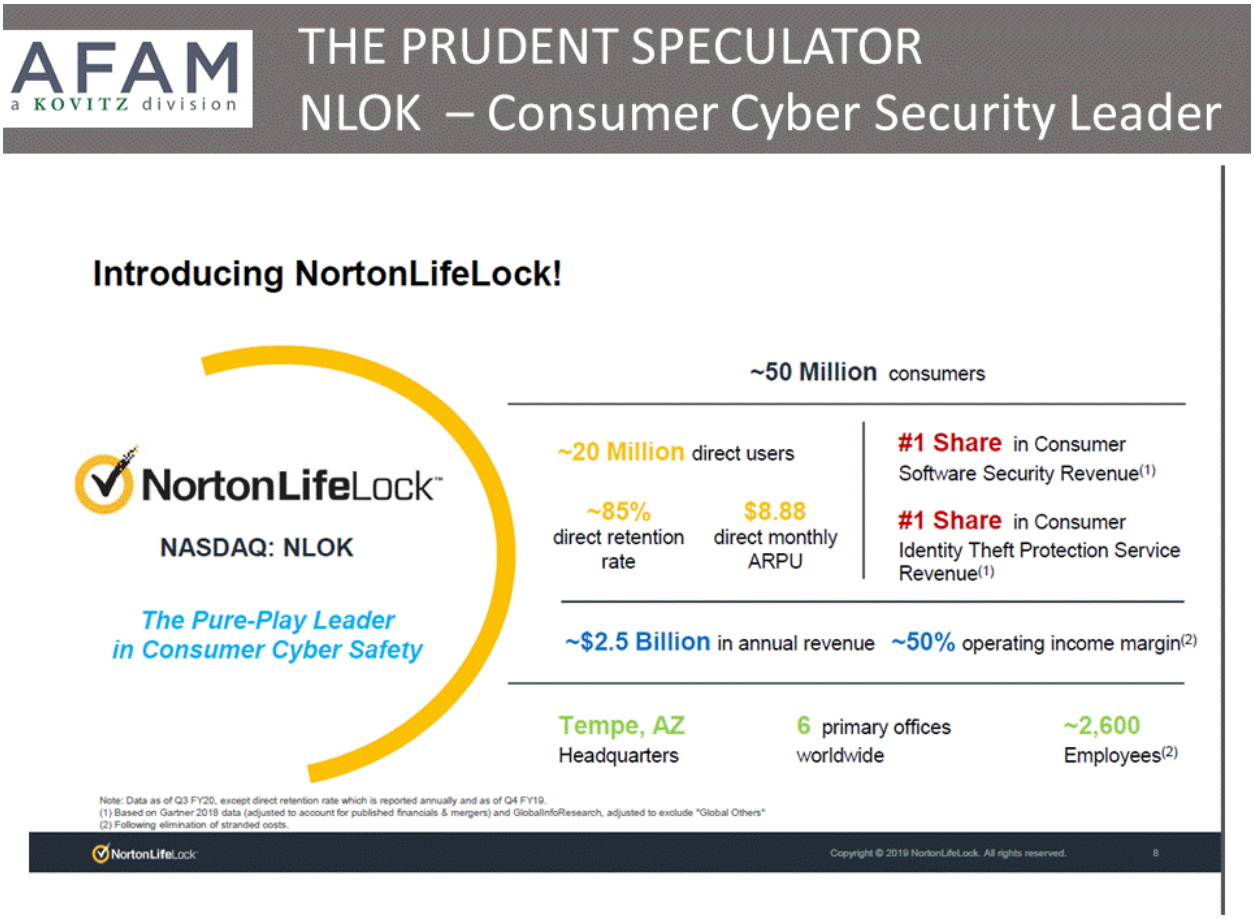
Shares of **Mosaic** (MOS $20.81) dropped nearly 4% since the fertilizer and agricultural chemical firm released Q3 earnings this past Tuesday. The numbers overwhelmingly missed analyst projections (EPS of $0.08 versus $0.22) and sales for the quarter ($2.8 billion) were down 5% on a year-over-year basis. Soft demand within the Phosphates segment contributed toward weak gross margins, while Potash and Mosaic Fertilizantes performance was strong as expected. Management has announced a series of actions to temporarily lower production going into 2020 in both phosphates and potash to better match demand.

CEO Joc O'Rourke commented, "Throughout 2019, Mosaic has continued to focus on strengthening the business, creating additional leverage to market improvement and financial returns. We've managed cash and capital prudently and have maintained our strong financial position. We have lowered sustaining CapEx for the year and have reaffirmed our commitment to shareholder returns by repurchasing $150 million in Mosaic shares year-to-date. We have demonstrated our long-held commitment to market discipline curtailing both phosphate and potash production during periods of market weakness. We have retained our ability to resume production quickly as markets strengthen. In Brazil, our Mosaic Fertilizantes business has completed all the actions required to reach its $275 million synergy target in 2019, a year ahead of schedule, and we believe we can achieve up to $50 million more in excess of what the target was this year. We have also kicked off a new program to generate an additional $200 million of EBITDA contribution after 2019 through a mixture of operational improvements, further cost reductions and additional revenue."

While we know fertilizer prices will remain volatile, we continue to believe that there is plenty of long-term potential, though we realize it takes a lot of patience to stay invested in the space. Higher crop yields become increasingly important as the global population expands, less farmable land is available and more folks in emerging economies move up the socioeconomic ladder, adding more protein to their diets (which requires more grains to feed the cattle, pigs,

etc.). MOS trades for 14.8 times NTM adjusted EPS projections and for just 78% of book value. All things considered, we have trimmed our Target Price to $38, though we like that the company has repurchased $150 million of its shares year-to-date.

Norton LifeLock (NLOK –$24.83), formerly known as Symantec (SYMC), reported fiscal Q2 non-GAAP earnings per share of $0.46 versus the $0.42 estimate. But, perhaps even more notable was the closing of a deal that the company announced a quarter ago to sell its Enterprise Security assets to Broadcom for $10.7 billion. Post transaction, the company will focus solely on its consumer-oriented Norton 360 and Lifelock business, hence the new name.



There is also turnover in the executive suite. Interim CEO Richard Hill, who took the helm back in March of this year amidst the abrupt resignation of former CEO Greg Clark, will cede the top role to current CFO Vincent Pilette. Samir Kapuria is the newly appointed president. Mr. Hill declared, “These two seasoned leaders, coupled with our industry renowned CTO, Dr. Hugh Thompson, give Norton LifeLock a world-class leadership team who are well-respected and provide continuity in the Norton LifeLock business. Vincent brings a history of deep operational discipline, financial fluency and natural leadership skills. Samir provides in-depth understanding of the operational capabilities and needs of the consumer business, while Dr. Hugh Thompson brings the vision and understanding of today’s consumer customer threats as well as a vision of what threats the consumer doesn’t even know about yet.”

We believe that Norton's prospects in data security remain bright. However, we continue to evaluate the newly aligned business while dust from the Broadcom deal settles, as well as the classification of a pending $12 per share special dividend to be declared and distributed in the fourth quarter of fiscal 2020 (ends 3/20). Meanwhile, we are intrigued by the company's commitment to executing the remaining $1.6 billion of its share repurchase authorization and its announcement to raise the current quarterly dividend by 67% to $0.125. This pushes the dividend yield on the stock to 2.0% as of Friday's close. Our Target Price for NLOK is $29, no change from our previous SYMC fair valuation assessment.

Honda Motor (HMC – $28.91) turned in modestly better than expected fiscal second quarter earnings of $1.04 per share on revenue of $34.5 billion. The stock gained more than 3% on the news, even as management cited foreign exchange as a headwind due to a strong Japanese yen, while weak personal consumption in India brought volumes down 20% from the first half of the fiscal year.

Looking ahead, management lowered guidance across all of the company's segments as it expects yen strength to continue with no signs pointing to a turnaround in the Indian economy. In the U.S., lower oil and gas prices have consumers shifting toward pickup trucks and large SUVs. While Honda's Civic and CRV models are at the top of their class, the company is at risk of losing share to competitors, given its slimmer vehicle lineup. Instead of competing in every category, Honda remains focused on controlling costs through fewer trim offerings and common-size vehicle platforms.

Despite what arguably could be considered a less-than-stellar quarterly report, we think investors were relieved that the numbers were not worse. After all, HMC sports a forward P/E ratio around 8.4, while the stock trades at 66% of book value and the net dividend yield stands around 3.2%, so there wasn't a lot of good news baked into the share price. That is fine by us, as we continue to like the geographically diverse revenue stream, exposure to emerging markets (China and India) and prudent financial position. Our Target Price has been bumped up to $35.