Market Commentary Monday, December 9, 2019

December 9, 2019

EXECUTIVE SUMMARY

Housekeeping – Newsletter Portfolio Sales and Buys
Volatility – Plenty of it on a Daily Basis Last Week, but Not So Much on a Weekly View
ISM Surveys – Both the PMI & NMI Still Suggest Overall GDP Growth
Econ News – Blockbuster Jobs Report
Reasons for Optimism – Valuations, Dividend Yields, Low Interest Rates and Luke Warm Investor Sentiment
Stock Updates – KR, CM & BIIB

Market Review

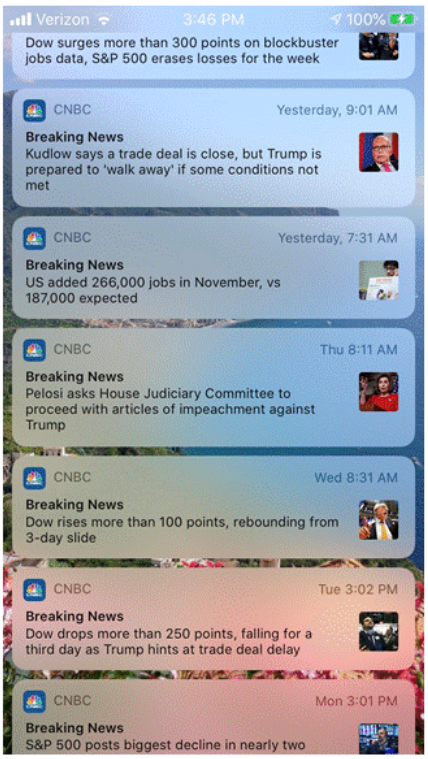
A little housekeeping before this week's Market Review and Stocks Updates…

As mentioned on our recent *Sales Alert*, on Monday, December 2, we sold 423 and 2,185 shares of **AVX Corp.** (AVX – $20.28) at $20.4424 for Buckingham Portfolio and TPS Portfolio, respectively. We will use that price to close out the 1,648 and 769 AVX shares respectively held in our hypothetical PruFolio and Millennium Portfolio.

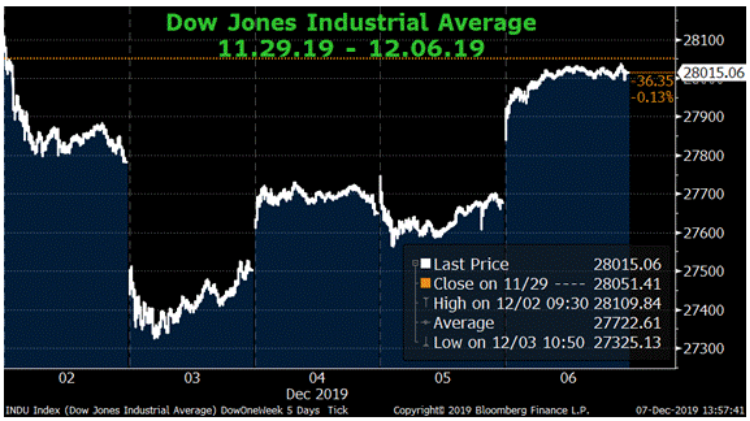
As discussed in the latest edition of *The Prudent Speculator*, on Thursday, December 5, we bought 759 shares of **Foot Locker** (FL – $39.85) at $39.5332 in TPS Portfolio and 31 shares of **Gilead Sciences** (GILD – $67.08) at $65.655 in Buckingham Portfolio. In our hypothetical accounts, we added 169 shares of **Bristol-Myers** (BMY – $59.95) at $58.86 and 94 shares of **JM Smucker** (SJM – $107.30) at $106.35 to Millennium Portfolio, as well as 727 shares of **Kroger** (KR – $27.49) at $27.50, 428 shares of **Micron Tech** (MU – $47.93) at $46.71 and 45 shares of **FedEx** (FDX – $156.61) at $154.84 to PruFolio.

We trust that readers have had a chance to peruse *TPS 638* as the early-December downturn discussed in the *Editor's Note,* as of this moment anyway, appears to have turned out to be short-lived. With the first week of the final month of the year beginning with a pair of 250-plus-point tumbles for the Dow Jones Industrial Average, due to renewed concerns about a trade deal with China and the health of the U.S. economy, we suspect most were surprised by the turnaround over the last three days that brought the Dow back near breakeven and pushed most of the major market averages modestly into the green for the five-day period. Interestingly, when measured with a weekly gauge, and not a daily one, the Dow had a fairly quiet week!

THE PRUDENT SPECULATOR
Not Much Happened Last Week…



No doubt, there was Breaking News galore last week, with the ups and downs of the China trade drama, Impeachment developments, and arguably negative and positive economic releases all battling for investor attention, yet when all was said and done, the Dow ended the week just slightly below where it began.



Of course, as the *CNBC Breaking News* stories contained in the graphic above illustrate, there were plenty of headlines with which investors had to deal, including a disappointing reading on the health of the factory sector from the Institute for Supply Management (ISM), which again had some folks erroneously concluding that a recession might be around the corner,…

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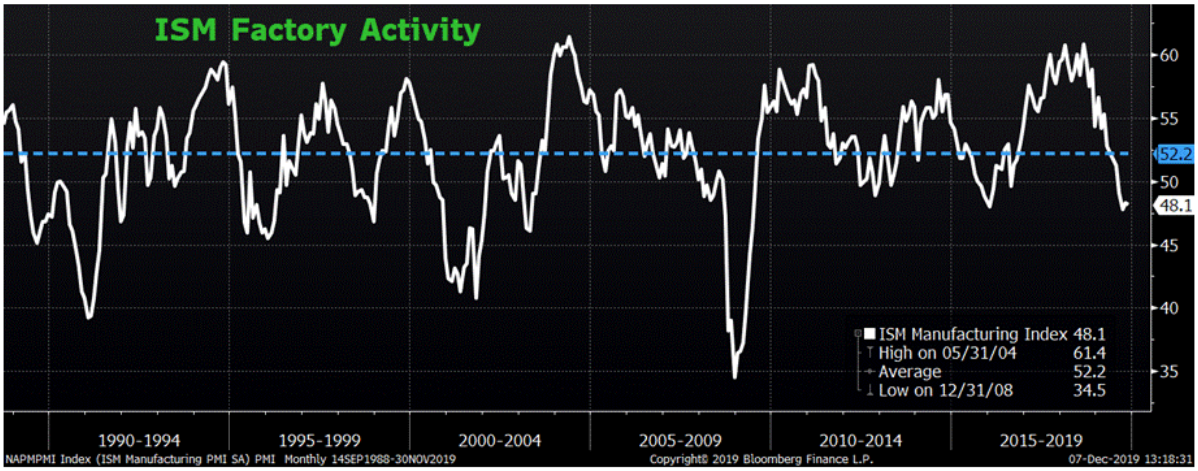
THE PRUDENT SPECULATOR
ISM Manufacturing = 1.5% GDP Growth

The latest read on the health of the manufacturing sector dipped to 48.1 in November. 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 1.5% increase in real gross domestic product (GDP) on an annualized basis."



…even as the November measure of 48.1 corresponds to a 1.5% overall growth rate in U.S. GDP. More importantly, perhaps, low ISM PMI readings have proved to be major buy signals, on average, for equities in general and Value Stocks in particular!

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THE PRUDENT SPECULATOR
Buy Signal: ISM PMI

Returns Following ISM PMI Readings of <= 48.1

Statistic	Fama French Value	Fama French Growth	S&P 500
One-Year			
Average	26.5%	22.8%	20.1%
Median	26.6%	23.6%	21.1%
Max	84.6%	83.8%	61.0%
Min	-24.5%	-28.0%	-23.6%
# Positive	157	159	159
# Negative	26	24	24
Three-Year Annualized			
Average	20.3%	13.9%	15.4%
Median	21.7%	15.4%	15.4%
Max	38.9%	28.4%	32.7%
Min	-6.6%	-7.2%	-4.6%
# Positive	182	171	172
# Negative	1	12	11
Five-Year Annualized			
Average	18.6%	13.0%	14.6%
Median	18.8%	13.2%	15.1%
Max	32.5%	25.7%	29.7%
Min	3.2%	-6.3%	-0.6%
# Positive	182	176	181
# Negative	0	6	1

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 equity markets again sold off following a sub-par Manufacturing Index (aka PMI) tally from the Institute for Supply Management for November. With a reading of 48.1, the PMI signified 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 183 times that the PMI has tallied 48.1 or lower shows that, on average, one-, three- and five-year returns (182 periods) have been fantastic, with Value leading the way.

To be sure, the other ISM release out last week, the Non-Manufacturing index, also came in below expectations, but the 53.9 tally for the measure of activity in the service sector corresponds to a 1.9% overall GDP growth rate based on historical calculations,…

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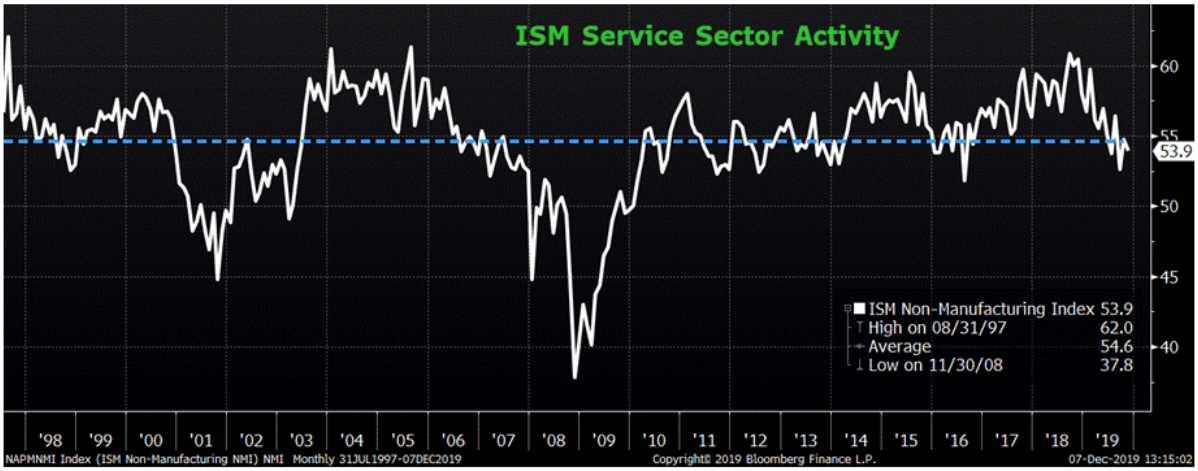
THE PRUDENT SPECULATOR
ISM Non-Manufacturing Falls

The November reading on the health of the service sector (NMI) came in weaker-than-expected at 53.9, below the historical norm, but still 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 1.9% increase in real gross domestic product (GDP) on an annualized basis."



…while other economic data points last week were not bad,…

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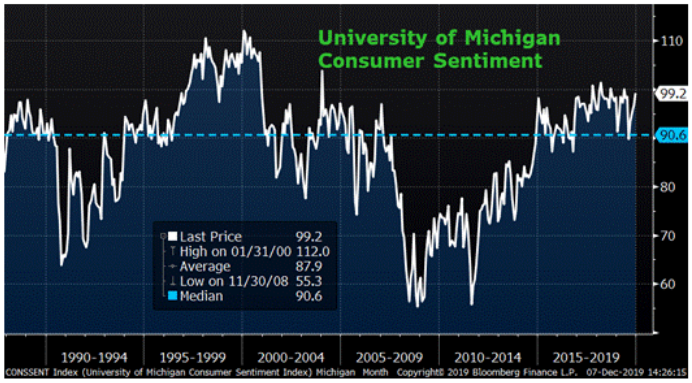
Favorable Econ Numbers



Factory orders rose 0.3% in October, about as expected, following a revised 0.8% drop in September. Gains in transportation equipment, computers & electronics and machinery were the largest contributors. The University of Michigan's preliminary reading on Consumer Sentiment for December came in at 99.2, well above analyst projections and a marked improvement over November's final tally of 96.8.

…capped by a much-better-than-projected November Employment Situation report, with an impressive 266,000 new jobs created,…

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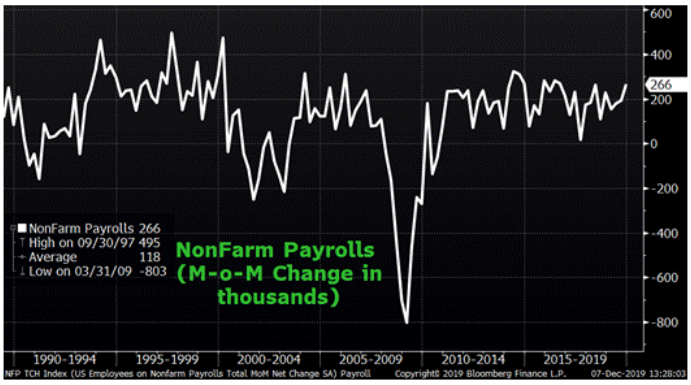
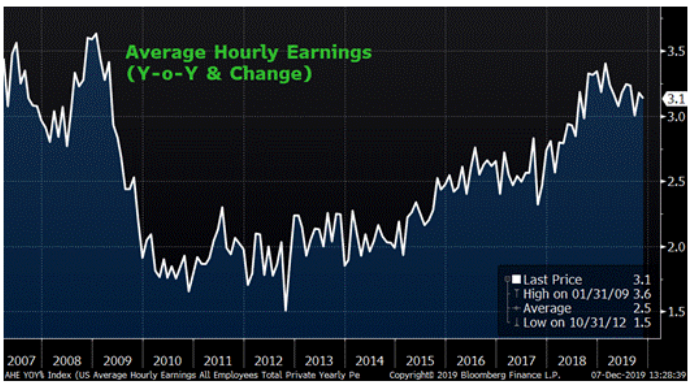
THE PRUDENT SPECULATOR
Blockbuster Employment Report





The number of new jobs created during November soared to 266,000. True, the tally included some 50,000 GM employees returning to work, but the figure blew away the forecast of 180,000. Payrolls for the previous two months were also revised sharply-higher by a combined 41,000 jobs. And, the annual gain in average hourly earnings was 3.1%, continuing to suggest that inflation in the labor market remains in check.

…and a return to the five-decade record low 3.5% jobless rate.

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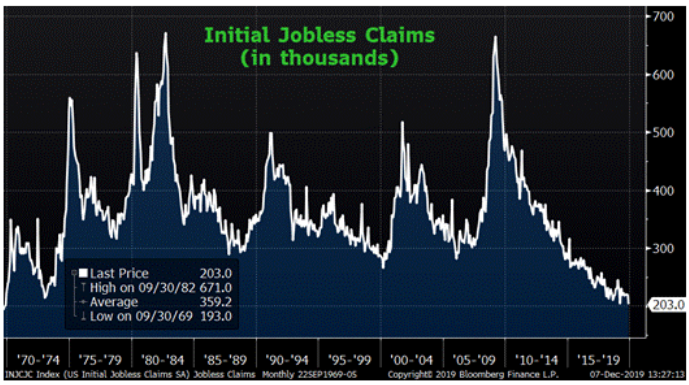
THE PRUDENT SPECULATOR
Historic Lows in Jobless Numbers



The jobs number in November came in well above forecasts, with the unemployment rate ticking down to 3.5%, a 50-year low, with a modest decrease in the labor participation rate to 63.2%. And, the latest figures on initial claims for unemployment benefits saw 203,000 new filings, still near lows last seen back in December 1969, when the workforce was significantly smaller than it is today.

Not surprisingly, given the latest econ stats, the near-term economic outlook has improved,…

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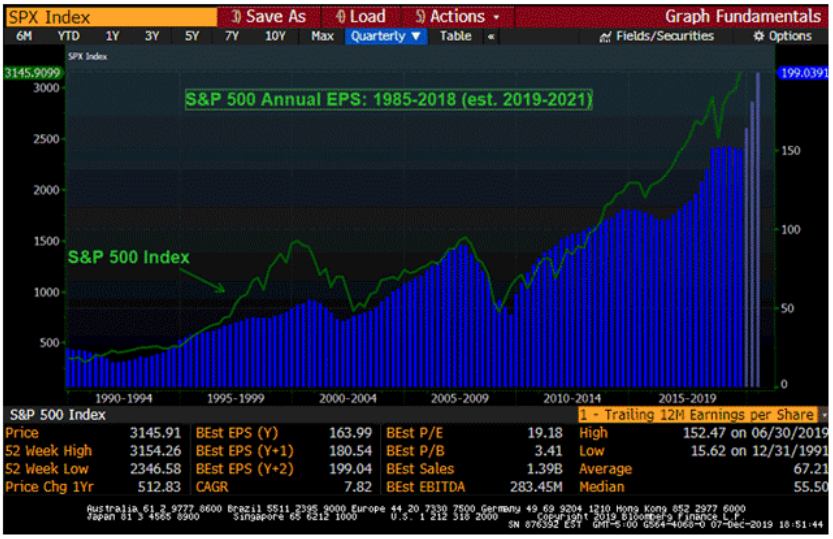
THE PRUDENT SPECULATOR
Recession Not Presently the Prediction

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, nine months ago, forecasts for U.S. GDP growth were near zero, only to quickly rebound to a 2.8% annualized growth guess, but then fall and rise and fall and rise again to a 2.0% estimate today.

…which might suggest that the latest estimates for corporate profits in Q4 and 2020 will prove to be conservative.

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



S&P 500 Earnings Per Share		
Quanter Ended	Bottom Up Operating EPS 3 Month	Bottom Up Operating EPS 12 Month
ESTIMATES		
12/31/2020	$46.31	$176.42
9/30/2020	$45.92	$170.51
6/30/2020	$43.62	$164.55
3/31/2020	$40.57	$161.07
12/31/2019	$40.40	$158.49
9/30/2019	$39.96	$153.12
ACTUAL		
6/30/2019	$40.14	$154.54
3/31/2019	$37.99	$153.05
12/31/2018	$35.03	$151.60
9/30/2018	$41.38	$150.42
6/30/2018	$38.65	$140.37
3/31/2018	$36.54	$132.23
12/31/2017	$33.85	$124.51
9/30/2017	$31.33	$118.56
6/30/2017	$30.51	$115.92
3/31/2017	$28.82	$111.11
12/31/2016	$27.90	$106.26
9/30/2016	$28.69	$101.42
6/30/2016	$25.70	$98.17
3/31/2016	$23.97	$98.61
12/31/2015	$23.06	$100.45

Source: Standard & Poor's. As of 12.05.19

Certainly, we recognize that there continues to be plenty about which to be concerned as there is still not even a "phase one" deal on trade finalized with China, while there are more than a few geopolitical wild cards, so we are always braced for an inevitable market downturn.

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Ups and Downs Aplenty…Just Since '09

S&P 500 Moves (on a Closing Basis) of 5% Without a Comparable Move in the Opposite Direction

2/9/2009	3/9/2009	-22.23%	BEAR	3/9/2009	3/26/2009	23.11%	BULL
3/26/2009	3/30/2009	-5.44%	BEAR	3/30/2009	6/12/2009	20.15%	BULL
6/12/2009	7/10/2009	-7.09%	BEAR	7/10/2009	10/19/2009	24.89%	BULL
10/19/2009	10/30/2009	-5.62%	BEAR	10/30/2009	1/19/2010	11.01%	BULL
1/19/2010	2/8/2010	-8.13%	BEAR	2/8/2010	4/23/2010	15.19%	BULL
4/23/2010	5/7/2010	-8.74%	BEAR	5/7/2010	5/12/2010	5.47%	BULL
5/12/2010	6/7/2010	-10.34%	BEAR	6/7/2010	6/18/2010	6.38%	BULL
6/18/2010	7/2/2010	-8.49%	BEAR	7/2/2010	8/9/2010	10.29%	BULL
8/9/2010	8/26/2010	-7.14%	BEAR	8/26/2010	2/18/2011	28.25%	BULL
2/18/2011	3/16/2011	-6.41%	BEAR	3/16/2011	4/29/2011	8.49%	BULL
4/29/2011	6/15/2011	-7.20%	BEAR	6/15/2011	7/7/2011	6.94%	BULL
7/7/2011	8/8/2011	-17.27%	BEAR	8/8/2011	8/15/2011	7.60%	BULL
8/15/2011	8/19/2011	-6.72%	BEAR	8/19/2011	8/31/2011	8.49%	BULL
8/31/2011	9/9/2011	-5.30%	BEAR	9/9/2011	9/16/2011	5.35%	BULL
9/16/2011	10/3/2011	-9.60%	BEAR	10/3/2011	10/28/2011	16.91%	BULL
10/28/2011	11/25/2011	-9.84%	BEAR	11/25/2011	4/2/2012	22.47%	BULL
4/2/2012	6/1/2012	-9.94%	BEAR	6/1/2012	9/14/2012	14.69%	BULL
9/14/2012	11/15/2012	-7.67%	BEAR	11/15/2012	5/21/2013	23.34%	BULL
5/21/2013	6/24/2013	-5.76%	BEAR	6/24/2013	1/15/2014	17.50%	BULL
1/15/2014	2/3/2014	-5.76%	BEAR	2/3/2014	9/18/2014	15.47%	BULL
9/18/2014	10/15/2014	-7.40%	BEAR	10/15/2014	3/2/2015	13.69%	BULL
5/21/2015	8/25/2015	-12.35%	BEAR	8/25/2015	9/16/2015	6.84%	BULL
9/16/2015	9/28/2015	-5.69%	BEAR	9/28/2015	11/3/2015	12.12%	BULL
11/3/2015	2/11/2016	-13.31%	BEAR	2/11/2016	6/23/2016	5.64%	BULL
6/23/2016	6/27/2016	-5.34%	BEAR	6/27/2016	1/26/2018	43.60%	BULL
1/26/2018	2/8/2018	-10.16%	BEAR	2/8/2018	3/9/2018	7.96%	BULL
3/9/2018	4/2/2018	-7.35%	BEAR	4/2/2018	9/20/2018	13.55%	BULL
9/20/2018	11/23/2018	-10.17%	BEAR	11/23/2018	12/3/2018	5.99%	BULL
12/3/2018	12/24/2018	-15.74%	BEAR	12/24/2018	4/30/2019	25.30%	BULL
4/30/2019	6/3/2019	-6.84%	BEAR	6/3/2019	7/24/2019	10.02%	BULL
7/24/2019	8/14/2019	-6.12%	BEAR	8/14/2019	11/27/2019	11.65%	BULL
	Average Drop	**-8.88%**	**BEAR**		**Average Increase**	**14.46%**	**BULL**

While the S&P 500 skidded 6.8% during an ugly May, and fell 6.1% from late-July to mid-August, we suspect that few realize that these were the 29th and 30th pullbacks of 5% or more without an intervening 5% recovery just since the Financial Crisis market low on March 9, 2009. Happily, the returns in the 30 periods where the S&P has gained more than 5% over the past 10+ years have dwarfed the losses.

However, we continue to be optimistic about the long-term prospects of our broadly diversified portfolios of what we believe to be undervalued stocks.

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Managed Account Ports & Benchmarks

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	14.2	12.5	1.1	2.1	2.9
Select Value	14.8	13.1	1.2	2.1	2.5
Select Dividend	15.0	13.1	1.0	2.1	3.2
Select Focused Dividend	14.1	12.7	1.0	2.3	3.2
Select Focused Value	15.2	13.9	1.5	2.5	2.5
Select SMID Dividend	13.8	12.2	0.6	1.6	3.1
Russell 3000	22.2	20.1	2.1	3.3	1.8
Russell 3000 Growth	28.9	25.7	3.2	7.8	1.1
Russell 3000 Value	17.9	16.4	1.5	2.0	2.5
Russell 1000	21.6	19.6	2.2	3.4	1.8
Russell 1000 Growth	28.0	24.7	3.5	8.2	1.2
Russell 1000 Value	17.5	16.1	1.6	2.1	2.5
S&P 500 Index	20.9	19.2	2.3	3.5	1.9
S&P 500 Growth Index	26.4	23.4	3.8	5.6	1.4
S&P 500 Value Index	17.0	15.9	1.6	2.5	2.3
S&P 500 Pure Value Index	12.7	11.7	0.6	1.3	2.7

As of 12.07.19. 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.

While the yields on our portfolios are even more attractive, we think the income offered by stocks in general compares extraordinarily well with what is available on other investments,…

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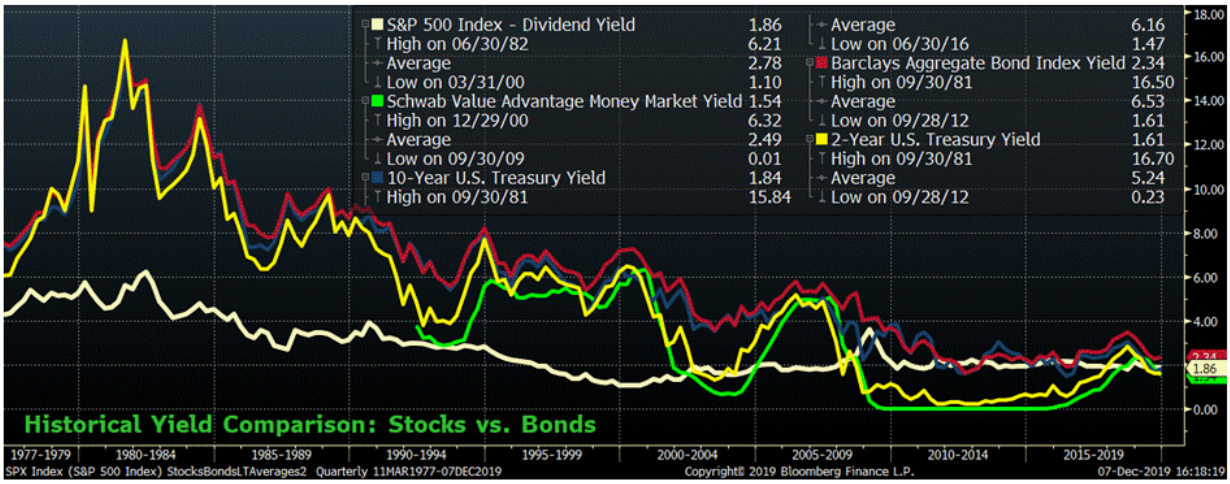
THE PRUDENT SPECULATOR
Equity vs. Fixed Income Yields

Though stocks are not necessarily a substitute for bonds, U.S. Treasuries and money market funds, the current payout on the S&P 500 (1.86%) is still very generous versus the income provided by fixed income. And, the comparison to the average yields for all of the securities below over the past four-plus decades very much favors equities.



…and we also like that investor sentiment is a long way from euphoric, despite the near record highs.

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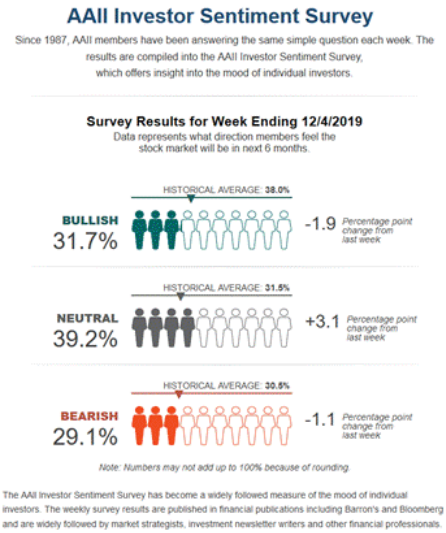
THE PRUDENT SPECULATOR
Sentiment: Not a Lot of Enthusiasm



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.

December 5, 2019 - Bullish sentiment, expectations that stock prices will rise over the next six months, fell 1.9 percentage points to 31.7%. Bullish sentiment is below its historical average of 38.0% for 39th time this year.

Bearish sentiment, expectations that stock prices will fall over the next six months, pulled back by 1.1 percentage points to 29.1%. Pessimism is below its historical average of 30.5% for a seventh consecutive week.

The latest AAII Sentiment Survey showed a dip in optimism to 31.7% with the Bullish reading now well below the 38.0% historical norm. Meanwhile, the most recent five weeks of ICI calculations 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

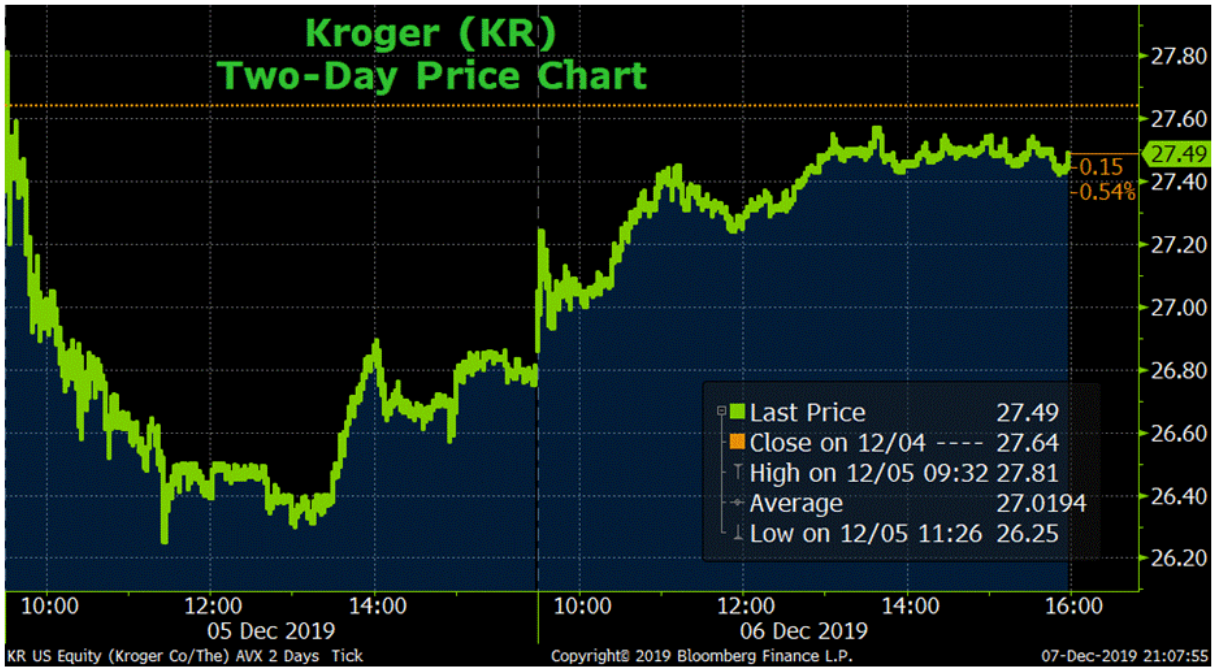
Week Ended	11/26/2019	11/20/2019	11/13/2019	11/6/2019	10/30/2019
Total Equity	-22	-5,632	1,592	-4,491	-6,791
Domestic	609	-7,048	-3,327	-7,732	-4,107
World	-631	1,416	4,919	3,241	-2,684
Hybrid	-748	-345	-268	-626	-767
Total Bond	8,716	13,265	6,682	12,598	11,277
Taxable	6,005	10,527	4,875	10,416	9,612
Municipal	2,711	2,738	1,806	2,182	1,665
Commodities	243	-355	-1,036	127	-319
Total	8,189	6,933	6,970	7,608	3,400

Source: Investment Company Institute

Stock Updates

Jason Clark and Chris Quigley offer updates on 3 of our companies that were out with news this past week of sufficient importance to trigger a review of their Target Prices. 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/.

Shares of **Kroger Co.** (KR – $27.49) fell on Thursday and recovered nearly all of those losses on Friday after the grocery store operator reported fiscal Q3 2020 earnings that missed analyst expectations. KR earned $0.47 per share in the period, versus the expected $0.49, and had revenue of $28.0 billion. The company expects operating income for fiscal 2020 to come in between $2.9 billion and $3.0 billion, an upward revision of $100 million from the guidance issued in September.



"We believe that Restock Kroger is the right framework to re-position our business to create value for all of our stakeholders. It provides us with a clear purpose and our vision to serve America through food inspiration and uplift. It focuses us on redefining the customer experience, identifying the partners who will help us deliver customer value today and in the future and putting the right talent and teams in place to focus on growth in our supermarket business and our alternative profit businesses," said CEO Rodney McMullen. "We are proud of the progress we have made, and we've learned from the challenges we've experienced. We are on track with a stable and growing supermarket business as a result of our customer obsession, renewed intensity around operational excellence and continued investment in seamless."

"Kroger reported identical sales without fuel of 2.5% during the third quarter, marking our strongest quarter since we launched Restock program. Several supermarket departments outperformed the company, including produce, key beverage categories, pharmacy and natural foods. Digital contributed approximately 70 basis points to identical sales, with Kroger pickup and delivery continuing to show strong momentum," added CFO Gary Millerchip.

"A key element of our capital allocation strategy is to use our free cash flow to invest in the business and drive profitable growth while also maintaining our current investment-grade debt rating and returning capital to shareholders. We actively balance the use of cash flow to achieve these goals," Mr. Millerchip concluded.

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 below 12 times NTM adjusted EPS projections and carries a dividend yield of 2.3%. Our Target Price is $34.

Shares of **Canadian Imperial Bank of Commerce** (CM -$82.90) opened nearly 4% lower Thursday morning, after the north-of-the-border financial giant posted fiscal Q4 earnings the previous evening that missed analyst estimates ($2.15 vs. $2.31). The disappointment was driven by sequentially higher provisions for credit losses as the bank experienced slight reversion from a period where provisions had arguably trended below their long-run average. On the positive end, the Common Equity Tier 1 (CET1) Ratio strengthened to 11.6%, up from 11.4% last quarter and above management's target range, while CM experienced a 37% jump in U.S. commercial banking and wealth management net income.

CEO Victor Dodig elaborated on the bank's continued growth in the U.S., "We reported very strong earnings growth of 22%, driven by strong connectivity across teams and borders. We achieved a significant milestone early in the year with the PrivateBank acquisition becoming accretive to earnings well ahead of expectations, further validating the strategic and financial benefits of our investment. We're growing our U.S. business through a combination of deepening existing relationships in verticals we know well and by selectively entering new markets. We now have offices in 27 U.S. cities, and we're building momentum in banking the private economy. We also continue to extend our U.S. Private Wealth Management capabilities with the recent acquisition of Lowenhaupt Global Advisors, a leading family office in St. Louis in New York. With this acquisition and our ongoing client development efforts, we grew assets under administration by more than 12% this year."

While we have trimmed our Target Price to $105 on the results, we appreciate the ever-increasing impact that the U.S. business is having on revenue, enabling the bank to continue growing deposits and fee revenue given continued consumer strength. We also note that the company benefits from high barriers to entry due to the Canadian regulatory structure. We also like the 5.3% yield and the single-digit P/E ratio.

Shares of **Biogen** (BIIB – $300.26) rose and tumbled and soared last week after the biotech concern presented additional phase 3 data for Alzheimer's disease drug candidate aducanumab at the Clinical Trials on Alzheimer's Disease meeting and released positive Phase 2 study results for Cutaneous Lupus Erythematosus (CLE) and Systemic Lupus Erythematosus (SLE).

Considering the potential Lupus treatments, VP of Lupus and MS Portfolio at Biogen, Nathalie Franchimont said, "There is substantial unmet medical need for people with lupus given the limited number of treatment options available to help manage this difficult-to-treat and chronic disease. We are excited by the LILAC study results, and the potential for BIIB059 to be a meaningful new treatment option for patients living with lupus. We also believe these results support Biogen's goal of continuing to build a multi-franchise portfolio by bringing potential new treatment options to people with great unmet medical need."

While there seems to be a divide among investors about the potential for Biogen's Alzheimer drug, the company still plans to file for Food and Drug Administration approval of aducanumab in early 2020 based on full data from its two phase 3 studies, Engage and Emerge. There is little doubt that this medication has blockbuster potential, though some in the Alzheimer arena are calling for a third phase 3 study to further evaluate risks versus potential benefit. While last week's update was encouraging, we're still uncertain about how the FDA will view the weaker Engage trial results in light of the benefit seen in the Emerge study.

Versus the news in March that Biogen was going to discontinue work on aducanumab, the further data release and the upcoming filing are still an overall positive surprise. If approved, this drug could end up being one of the biggest pharmaceuticals ever, though we realize that there is a long way to go before the FDA allows aducanumab to come to market. No doubt, there will be plenty of stock price volatility as news flows out, as evidenced by Thursday's trading!

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BIIB – Stop-Loss Danger: Mid-Day Oops

Independent of the Alzheimer drug potential, we like that Biogen is still generating strong free cash flow which can aid in strengthening a pipeline that we already think has solid long-term potential keying on cancer and neurology disorders. All are important because BIIB still faces looming pressure from generics in the coming years for its MS drug Tecfidera and potential competition from Novartis for its spinal muscular atrophy treatment Spinraza. Even with the positive updates, our Target Price remains $460.