Market Commentary Monday, January 20, 2020

January 20, 2020

EXECUTIVE SUMMARY

Week in Review – Rally Picks Up Steam
Value Returns – Excellent Long-Term Performance
Interest Rates vs. Dividend Yields – Payouts on Stocks Generally Increase Over Time
Bond Infatuation – Investors Love Fixed Income and Dislike Stocks
Econ Update – Favorable Data Last Week
Corporate Profits – EPS Likely to Continue to Show Solid Growth in 2020 and 2021
Target Prices – New Listing Posted to theprudentspeculator.com
Stock News – Updates on JPM, BAC, C, GS, BK, PNC, SLB, DAL & TGT

Market Review

Attention last week turned away from the hostilities in the Middle East to the signing of the "phase-one" trade agreement between the U.S. and China and the Impeachment Proceedings moving to trial in the Senate, but the rally in the equity markets gained steam. Indeed, the S&P 500 and Russell 3000 indexes gained 1.99% and 2.04%, respectively, though the Russell 3000 Value index climbed "only" 1.70%, versus a 2.35% advance for the Russell 3000 Growth index. No doubt, Growth is off to a great start in 2020, building on stellar returns seen for a number of years,…

AFAM
a KOVITZ division

THE PRUDENT SPECULATOR
Excellent Returns Growth AND Value

While returns for the more inexpensive areas of the equity market are again lagging growth, the absolute numbers for Value are still very good.

Total Returns Matrix Annualized (except YTD)

Year to Date	1-Year	3-Year	5-Year	7-Year	10-Year	15-Year	20-Year	Symbol	Name
-0.15	6.37	3.78	2.27	1.41	2.31	3.23	4.49	LEGATRUU Index	Global Aggregate Bond Index
0.51	9.19	3.97	2.87	2.84	3.67	4.18	5.08	LBUSTRUU Index	U.S. Aggregate Bond Index
2.92	23.38	16.69	13.61	14.35	13.52	9.80	7.23	INDU Index	Dow Jones Industrial Average
2.04	21.52	11.15	8.76	9.98	9.67	7.60	6.05	NYA Index	NYSE Composite Index
3.48	21.92	13.47	10.51	12.78	13.20	9.45	5.71	RUO Index	Russell 2000 Growth Index
0.26	12.91	5.30	7.60	9.49	10.32	7.28	9.36	**RUJ Index**	**Russell 2000 Value Index**
1.90	17.49	9.37	9.12	11.18	11.80	8.42	7.64	RUT Index	Russell 2000 Index
4.80	34.39	20.79	15.67	16.80	15.45	10.91	5.44	RAG Index	Russell 3000 Growth Index
1.33	21.21	9.72	8.94	11.54	11.55	7.84	7.26	**RAV Index**	**Russell 3000 Value Index**
3.12	27.76	15.24	12.33	14.21	13.54	9.44	6.54	RAY Index	Russell 3000 Index
4.77	30.77	19.64	14.81	16.47	15.17	10.66	5.90	SGX Index	S&P 500 Growth Index
1.30	26.73	11.80	10.40	12.41	11.99	7.93	6.35	**SVX Index**	**S&P 500 Value Index**
3.14	28.85	15.93	12.80	14.60	13.68	9.38	6.23	SPX Index	S&P 500 Index
4.09	26.09	17.05	12.10	15.47	15.44	11.16	7.15	SPXPG Index	S&P 500 Pure Growth Index
0.45	16.48	8.91	8.63	12.40	13.29	9.56	9.49	SPXPV Index	S&P 500 Pure Value Index
1.63	15.81	12.98	9.06	13.43	13.49	9.72	10.03	BRK/B Equity	Berkshire Hathaway Inc

As of 1.17.20. Source Kovitz Investment Group using data from Bloomberg

…but performance for Value have also been very good,…

AFAM
a KOVITZ division

THE PRUDENT SPECULATOR
Death of Value is Greatly Exaggerated

Hard to argue that Value has performed poorly, considering its returns against global stocks, bonds, commodities and U.S. Treasuries.

Total Returns Matrix Annualized (except YTD)

Index		YTD	1-Year	3-Year	5-Year	7-Year	10-Year	15-Year
	Value Stocks							
RAV Index	**Russell 3000 Value**	**1.5%**	**21.2%**	**9.7%**	**8.9%**	**11.5%**	**11.5%**	**7.8%**
SVX Index	**S&P 500 Value**	**1.5%**	**26.7%**	**11.8%**	**10.4%**	**12.4%**	**12.0%**	**7.9%**
	Global Equities							
MXWDU Index	MSCI ACWI excluding United States	2.2%	19.0%	10.0%	6.8%	5.8%	5.4%	6.1%
MXEA Index	MSCI EAFE (Europe, Australasia, Far East)	1.6%	19.6%	9.7%	6.9%	6.6%	5.9%	5.7%
MXEU Index	MSCI Europe	1.7%	21.7%	10.1%	6.2%	6.1%	5.7%	5.6%
MXEF Index	MSCI Emerging Markets	3.6%	16.8%	11.6%	6.6%	3.8%	4.1%	8.1%
AS51 Index	S&P/ASX 200 - Australia	3.5%	22.3%	10.2%	8.3%	5.5%	6.8%	9.2%
CAC Index	CAC 40 Index - France	1.7%	28.1%	12.6%	9.5%	7.9%	5.4%	5.5%
DAX Index	Deutsche Boerse - Germany	1.8%	20.7%	6.7%	5.0%	5.5%	5.9%	6.8%
HSI Index	Hang Seng - Hong Kong	4.7%	13.6%	12.3%	7.6%	7.0%	6.7%	8.9%
IBOV Index	Ibovespa - Brazil	0.6%	11.5%	12.3%	8.7%	-1.0%	-3.1%	7.9%
SHCOMP Index	Shanghai - China	4.4%	21.5%	1.9%	-1.7%	5.4%	1.8%	10.0%
SENSEXTR Index	Sensex - India	0.7%	16.6%	15.2%	6.6%	8.4%	5.8%	11.5%
NKY Index	Nikkei 225 - Japan	0.5%	19.1%	11.6%	10.9%	11.2%	8.1%	6.3%
UKX Index	FTSE 100 Index - United Kingdom	1.4%	18.0%	8.2%	4.3%	4.3%	5.1%	4.6%
	Other Assets							
SPGSCI Index	S&P GSCI Commoditles	-1.5%	5.1%	2.1%	1.7%	-6.0%	-2.0%	1.7%
LBUSTRUU Index	Bloomberg Barclays U.S. Agg Bond	0.7%	9.2%	4.0%	2.9%	2.8%	3.7%	4.2%
LEGATRUU Index	Bloomberg Barclays Global Agg Bond	0.5%	6.4%	3.8%	2.3%	1.4%	2.3%	3.2%
IDCOT7TR Index	ICE U.S. Treasury 7 - 10 Year	0.8%	9.6%	3.8%	2.4%	2.6%	4.4%	4.8%
IDCOT3TR Index	ICE U.S. Treasury 3 -7 Year	0.6%	6.4%	2.8%	2.1%	1.9%	2.9%	3.7%
IDCOT1TR Index	ICE U.S Treasury 1 - 3 Year	0.3%	3.7%	1.8%	1.3%	1.1%	1.2%	2.2%

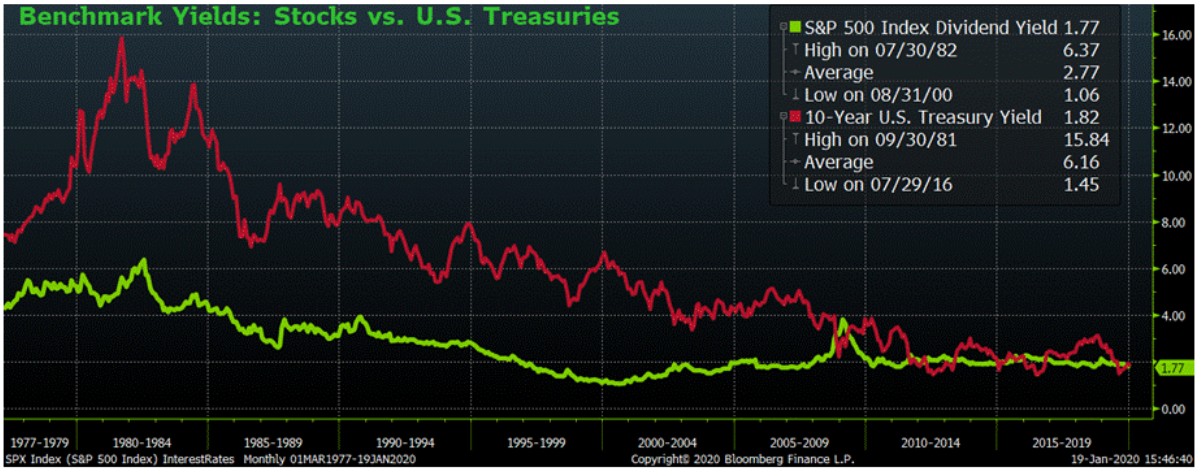
As of 1.17.20. Source Kovitz Investment Group using data from Bloomberg

…especially considering that even modest returns would be satisfactory in the extraordinarily low interest rate environment in which we have been operating for quite some time.

AFAM
a KOVITZ division

THE PRUDENT SPECULATOR
Equity vs. Treasury Yields

Though stocks are not necessarily a substitute for government bonds, the current payout on the S&P 500 (1.77%) is very competitive with the yield on U.S. Treasuries, with Uncle Sam's 10-year bond residing near historic lows. True, over the past four decades, the yield on stocks has been 100 basis points higher at 2.77%, on average, but the current 1.82% yield on the 10-year is just 30% of its 6.16% historical average.



Despite the sensational returns for stocks, and the likelihood that the income generated from equities will continue to grow,…

AFAM
a KOVITZ division

THE PRUDENT SPECULATOR
Dividends Provide Handsome Income

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

COUNT OF S&P 500 DIVIDEND ACTIONS	INCREASES	INITIATIONS	DECREASES	CESSATIONS
2019	355	6	7	0
2018	374	6	3	0
2017	351	5	9	2
2016	344	7	19	2
2015	344	7	16	3
2014	375	8	8	0
2013	366	15	12	0
2012	333	15	11	1
2011	320	22	5	0
2010	243	13	4	1
2009	151	6	68	10
2008	236	5	40	22
2007	287	11	8	4
2006	299	6	7	3

Source: Standard & Poor's.

S&P 500 DIVIDENDS PER SHARE	
2021 (Est.)	$65.73
2020 (Est.)	$62.05
2019	$58.69
2018	$53.86
2017	$50.47
2016	$46.73
2015	$43.49
2014	$39.44
2013	$34.99
2012	$31.25
2011	$26.43
2010	$22.73
2009	$22.41
2008	$28.39
2007	$27.73

Source: Bloomberg. As of 1.17.20

…we remain perplexed (and very happy from a contrarian perspective) by the continued love affair investors have had with fixed income.

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 $500 billion has flowed out of domestic stock mutual funds/ETFs and $1.1 trillion has flowed into bond mutual funds/ETFs over the last five years.

Investment Company Institute

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

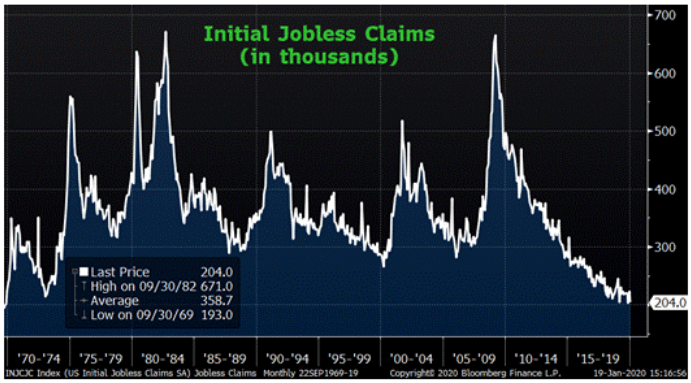
Millions, U.S. dollars

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	-21,195	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	-3,654	38,412
Jul-15	-14,864	-1,255	Oct-16	-23,109	13,855	Jan-18	10,778	46,287	Apr-19	-5,307	40,565
Aug-15	-18,569	-18,122	Nov-16	22,993	-13,289	Feb-18	-41,444	2,706	May-19	-24,652	21,332
Sep-15	-4,725	-10,849	Dec-16	18,859	-4,142	Mar-18	-22,152	14,148	Jun-19	-11,997	39,771
Oct-15	-807	15,397	Jan-17	5,097	31,037	Apr-18	-7,403	24,176	Jul-19	-7,889	44,811
Nov-15	654	-5,573	Feb-17	17,613	33,991	May-18	10,068	11,749	Aug-19	-29,909	22,304
Dec-15	476	-25,043	Mar-17	9,411	36,562	Jun-18	-21,004	16,995	Sep-19	-4,650	38,482
Jan-16	-27,222	7,686	Apr-17	-8,266	22,064	Jul-18	1,007	22,495	Oct-19	-24,556	43,209
Feb-16	-9,108	11,915	May-17	-10,725	33,070	Aug-18	-6,660	17,219	Nov-19	-17,499	41,203
Mar-16	7,711	29,296	Jun-17	-7,944	29,372	Sep-18	886	18,526	Dec-19	-15,951	54,234
									Totals:	-500,444	1,117,304

This is especially true considering that the latest batch of economic statistics ranged from superb,…

AFAM
a KOVITZ division

THE PRUDENT SPECULATOR
Terrific Economic Numbers

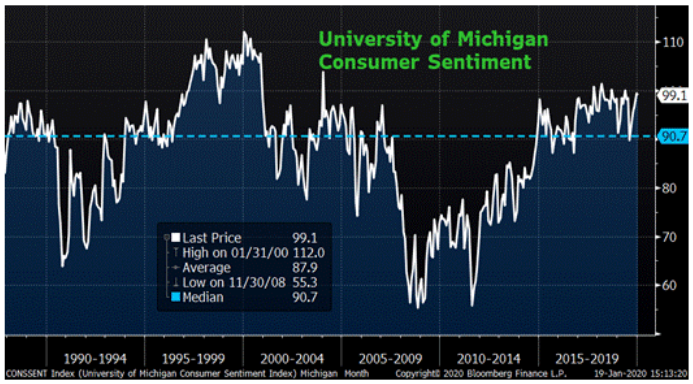


Favorable weather played a role, but builders broke ground on far more homes during December than expected, with housing starts soaring 17% versus November to a 13-year high at an annual rate of 1.608 million. And, the latest figures on first-time claims for jobless benefits saw just 204,000 new filings, still near lows last seen back in December 1969 when the workforce was much smaller than it is today.

…to solid,…

AFAM
a KOVITZ division

THE PRUDENT SPECULATOR
Healthy Business/Consumer Confidence

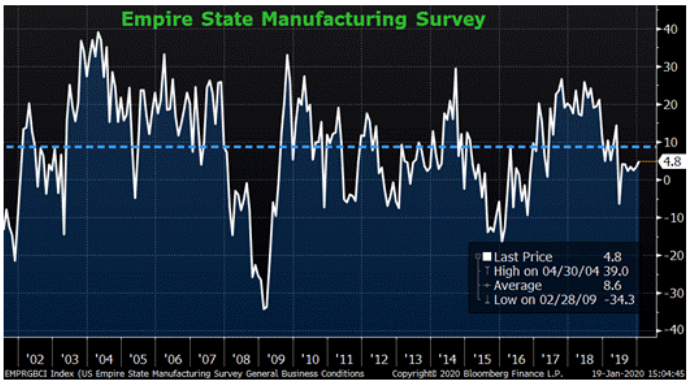


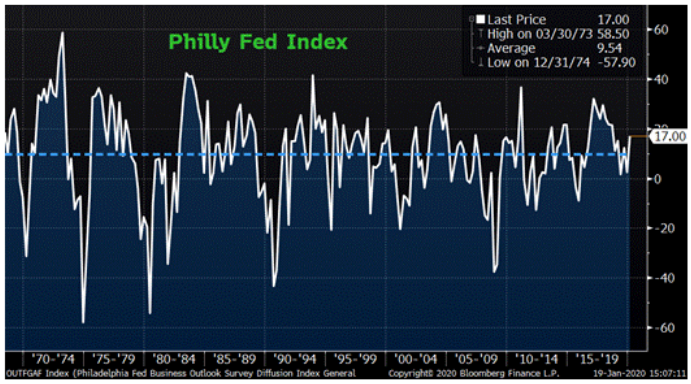
Uncertainty regarding trade and the strength of the global and U.S. economies no doubt playing a part, the NFIB Small Business Optimism Index for December trailed expectations by moving down to 102.7. Looking at consumer optimism, the preliminary University of Michigan gauge of sentiment for January inched down to a modestly weaker-than-expected 99.1. Of course, both tallies were well above the long-term medians.

…to OK, but better than expected.

AFAM
a KOVITZ division

THE PRUDENT SPECULATOR
Improving Manufacturing Data



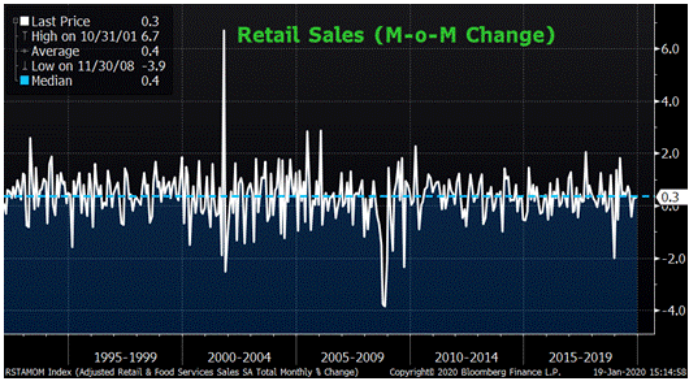


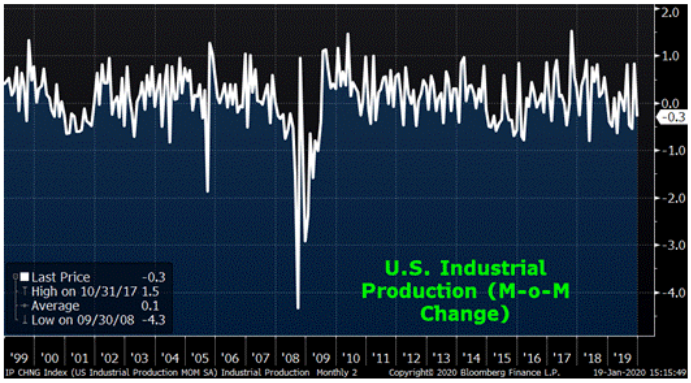
With the numbers still impacted by the U.S.-China trade battle, the Empire State gauge of manufacturing activity in the New York area for January came in above expectations at 4.8, indicating expansion in the factor sector. It was an even better story for the 17.0 reading on the Philadelphia Fed's January measure of manufacturing activity in the mid-Atlantic region, with the figure standing well above average.

True, not all of the numbers have been rosy,…

AFAM
a KOVITZ division

THE PRUDENT SPECULATOR
Good, but not Great, Econ Stats





Uncle Sam said that retail sales for December came in as projected with a gain of 0.3%, while full year 2019 retail sales rose 5.3%, a little better than the historical average. Vehicle sales held back the December number, as retail sales excluding automobiles rose 0.7%. Weaker car sales also hit output at the nation's factories, mines and utilities, as Industrial Production dipped a worse-than-expected 0.3% in December.

…while few are expecting a blockbuster economic expansion this year,…

AFAM
a KOVITZ division

THE PRUDENT SPECULATOR
No Recession & Lower Rates the Outlook

The Fed left its GDP growth projections unchanged, with the longer-run forecast still at 1.9% and the estimate for 2020 at 2.0%. The long-run estimate for the Federal Funds rate remained at a very low 2.5%.

Table 1. Economic projections of Federal Reserve Board members and Federal Reserve Bank presidents, under their individual assumptions of projected appropriate monetary policy, December 2019

Advance release of table 1 of the Summary of Economic Projections to be released with the FOMC minutes

Percent

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

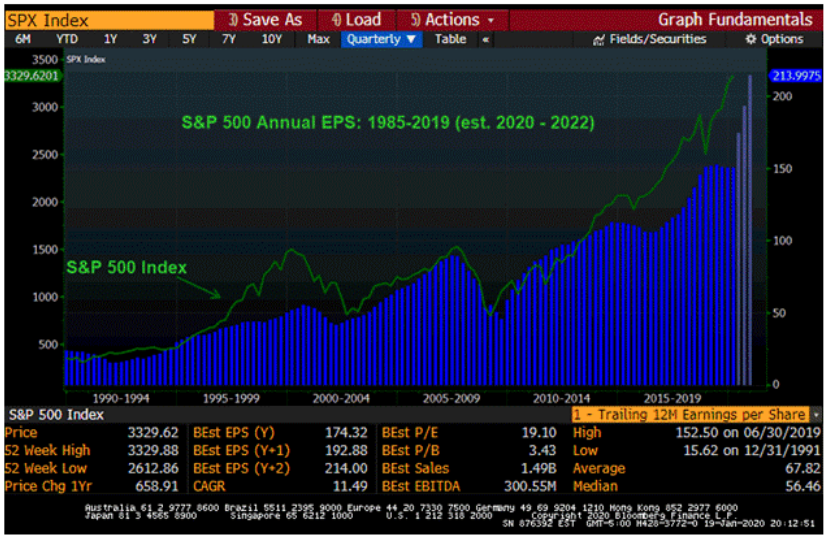
Source: Federal Reserve, December 11, 2019

…but corporate profits are likely to continue to show decent growth over the next few years.

AFAM
a KOVITZ division

THE PRUDENT SPECULATOR
Growing Black Ink for Corporate America

Certainly, we understand that analysts are often overly optimistic in their projections, but solid year-over-year earnings expansion is expected in '20, with further growth likely in '21 and '22.



S&P 500 Earnings Per Share

Quanter Ended	Bottom Up Operating EPS 3 Month	Bottom Up Operating EPS 12 Month
ESTIMATES		
12/31/2021	$50.07	$191.22
9/30/2021	$49.44	$187.06
6/30/2021	$47.43	$183.33
3/31/2021	$44.28	$179.29
12/31/2020	$45.91	$175.16
9/30/2020	$45.71	$169.34
6/30/2020	$43.39	$163.44
3/31/2020	$40.15	$160.19
12/31/2019	$40.09	$158.03
ACTUAL		
9/30/2019	$39.81	$152.97
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

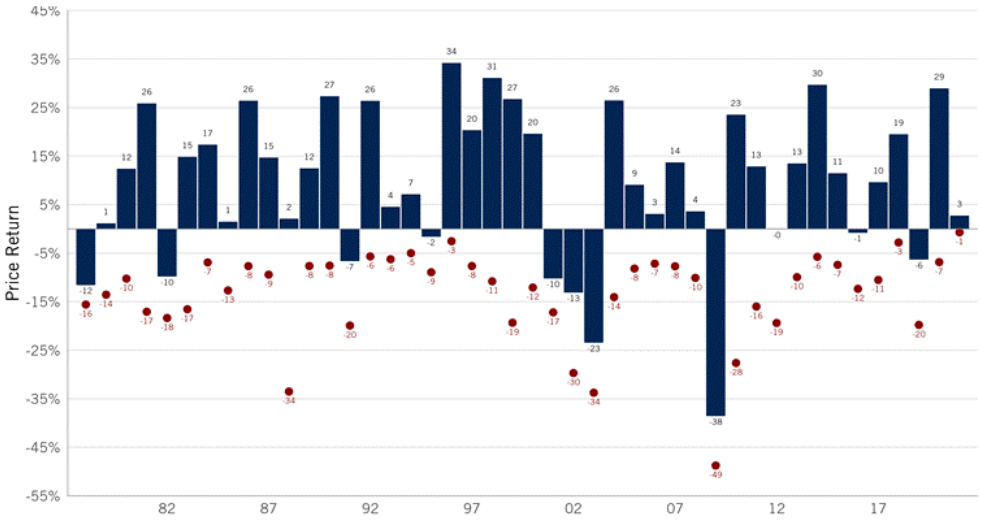
Source: Standard & Poor's. As of 1.16.20

To be sure, we are always braced for a pullback as we are very much aware that downturns, corrections and even Bear Markets are part of the investment equation,…

AFAM
a KOVITZ division

THE PRUDENT SPECULATOR
A Big Selloff Happens Almost Every Year

While the S&P 500 has enjoyed excellent long-term returns and endured a relatively small number of negative full years since the founding of *The Prudent Speculator* in 1977, there have been corrections of 10% or more in 25 of the 43 years, including a 19.8% one (on a closing basis) in 2018.



From 12.31.76 through 01.16.20. Price returns do not include dividends. Intra-year drops refer to the largest drops between high and low close prices during a calendar year. 2019 return is year to date. SOURCE: Kovitz Investment Group using data from Bloomberg Finance L.P.

…but we retain our enthusiasm for the long-term prospects of equities in general, and our broadly diversified portfolios of what we believe to be undervalued stocks in particular.

AFAM a KOVITZ division

THE PRUDENT SPECULATOR
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	14.8	13.0	1.2	2.2	2.8
Select Value	15.4	13.4	1.2	2.2	2.5
Select Dividend	15.5	13.5	1.0	2.2	3.1
Select Focused Dividend	14.7	13.0	1.0	2.4	3.2
Select Focused Value	15.7	14.3	1.6	2.8	2.4
Select SMID Dividend	14.2	12.7	0.6	1.7	2.9
Russell 3000	23.5	19.8	2.2	3.4	1.7
Russell 3000 Growth	31.3	25.3	3.4	8.1	1.1
Russell 3000 Value	18.5	15.9	1.6	2.1	2.4
Russell 1000	22.9	19.4	2.4	3.6	1.7
Russell 1000 Growth	30.2	24.5	3.8	8.9	1.1
Russell 1000 Value	18.0	15.8	1.7	2.2	2.5
S&P 500 Index	22.1	19.0	2.4	3.7	1.8
S&P 500 Growth Index	28.5	23.9	4.2	7.2	1.2
S&P 500 Value Index	17.5	15.4	1.6	2.4	2.5
S&P 500 Pure Value Index	11.4	10.4	0.6	1.2	2.8

As of 01.17.20. 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

While we have posted updated Target Prices to theprudentspeculator.com, Jason Clark and Chris Quigley take a look at nine of our companies that were out with news last week of sufficient importance to trigger a review of their respective Target Prices. Note that all stocks are rated as a "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 **JPMorgan Chase** (JPM–$138.15) spiked over two percent Tuesday morning as the nation's largest bank released another solid earnings report, carrying its momentum through year end. The bank earned $2.57 per share against $2.36 of expected earnings, experiencing strong growth in its two largest segments (Consumer and Community Banking and Corporate and Investment Banking), supported by average deposit growth of 7% year over year. JPM continues to earn solid returns on its capital, producing a 17% ROTCE in Q4 and 19% for the full fiscal year, even while maintaining a robust common equity capital ratio of 12.4%.

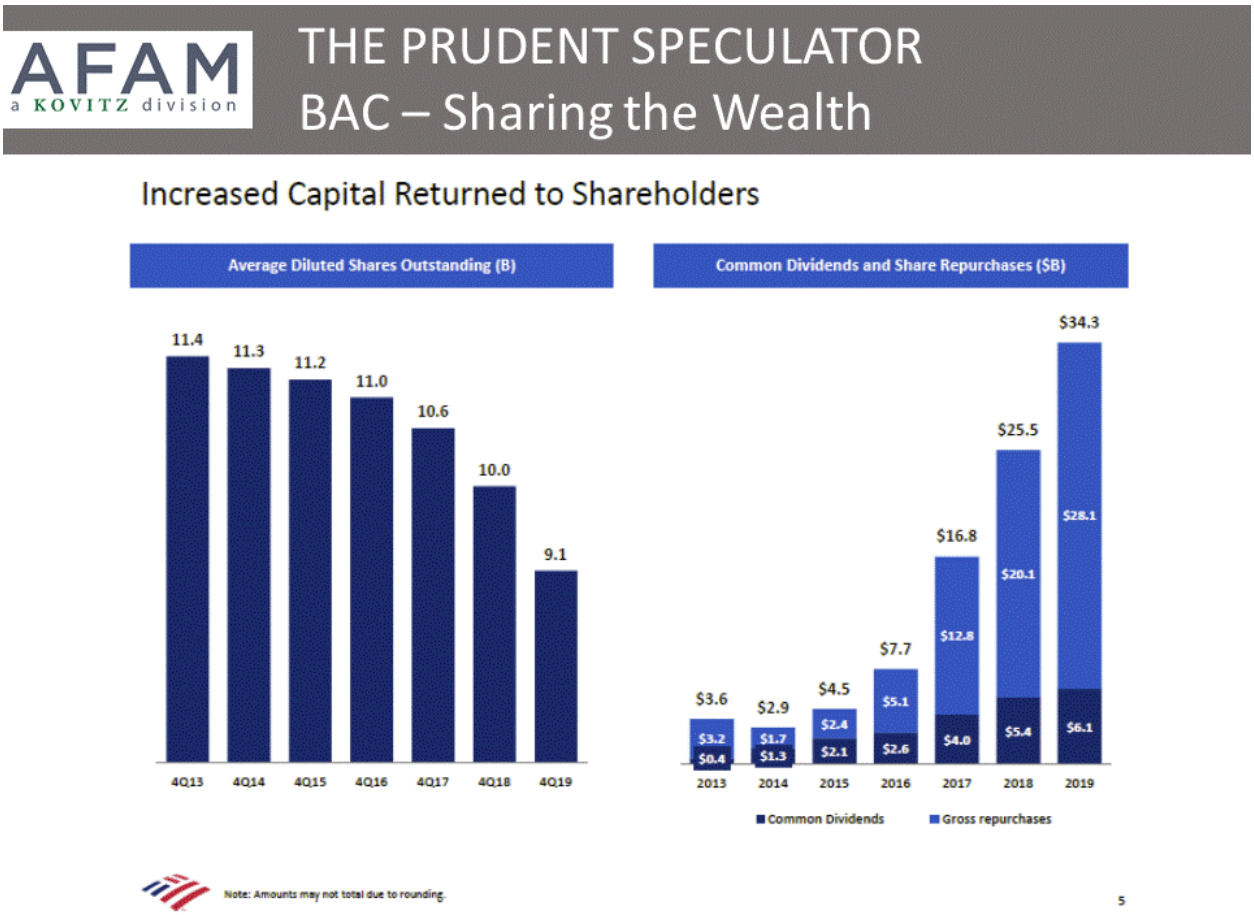
Management intends to provide full-year guidance at its upcoming investor day in February, but in the meantime expects to earn nearly $14 billion in net interest income for the first quarter in 2020.

On the overall trade and economic environment given passage of the "phase one" trade deal with China, CFO Jennifer Piepszak commented, "So the fourth quarter definitely, I would say, stabilized. Things trade certainly stabilized. Things, broadly speaking, stopped getting worse. And so we saw sentiment improve a bit, which I think contributed to the overall success of the fourth quarter. And then, certainly, there are some puts and takes. I mean, the U.S. consumer remains in very strong shape, both from a credit perspective, sentiment, spending. Obviously, labor market is very strong. And the Fed and the ECB on hold. And then capital spending still a bit soft, but sentiment is at least certainly better than it was 6 months ago. So, we have a, broadly speaking, constructive outlook headed in — as we're heading into 2020 here."

We remain quite fond of the bank's fortress balance sheet and the overall business model under CEO Jamie Dimon's guidance. We believe that the deepening budget for investment in technology enabled through existing scale and diversification of revenue sources creates a virtuous circle for the financial behemoth and that the bank will continue to operate at a high level for the foreseeable future. JPM shares are currently trading for just 12.8 times NTM projections, while carrying a dividend yield of 2.6%. Our Target Price for JPM has been elevated to $155.

Diversified financial firm **Bank of America** (BAC – $34.71) reported another solid quarter as adjusted Q4 EPS came in at $0.74, versus consensus estimates of $0.69. The quarter benefited from a 4% increase in average loan growth, continued positive operating leverage and strong asset quality, with credit charge-offs remaining low. The consumer bank grew average deposits 5%. The bank's trading and securities services saw a material improvement in results, and Merrill Lynch realized 25% more net new households than it did in 2018. BAC's efficiency ratio came in at 59%.

CEO Brian Moynihan stated, "In a steadily growing economy marked by solid client activity, our teammates produced another strong quarter and year, allowing us to increase investments in our customers, communities, and employees, while keeping a close eye on expenses. We also delivered for shareholders in 2019 by returning a record $34 billion in excess capital through dividends and share repurchases. As evidenced by a quarter in which our customer deposits surpassed $1.4 trillion and client balances in our wealth management business topped $3 trillion, we enter 2020 with momentum."



CFO Paul Donofrio added, "The company managed well through a period of transition from rising rates to lower rates over a short period of time. Solid client activity in growing loans and gathering deposits helped us offset spread compression. We also are aided by diverse lines of business and operations, with non-interest income comprising nearly half of our revenue."

We continue to be fans of BAC and see it as one of our core financial holdings. While there will continue to be near-term pressure on net interest margin in this low rate environment, we see numerous long-term opportunities upon which BAC can capitalize, from its large deposit base and consumer lending franchise to its "thundering herd" of Merrill Lynch's financial advisors and wealth managers. Credit quality remains solid and the stock is trading for 11.4 times NTM estimated EPS. Our Target Price has been inched up to $44.

Diversified bank **Citigroup** (C – $81.12) reported adjusted Q4 EPS of $1.90 (vs. $1.84 est.). Revenue for the period also came in better than forecasts ($18.38 billion vs. $17.88 billion est.), growing a better-than-expected 7%, with strong results across both the Institutional Clients Group and Global Consumer Banking. Expenses during the quarter were slightly higher than projected, but management reiterated its expectation to keep expenses relatively stable in 2020, noting that efficiency savings will outpace continued investments in the franchise.

Citigroup CEO Michael Corbat commented, “Our earnings of $5 billion for the fourth quarter marked a strong finish to 2019. Our full year Return on Tangible Common Equity of over 12% exceeded our target. Due to good client engagement, we drove balanced growth across our products and geographies, closing the year with 16 consecutive quarters of loan and deposit growth. The U.S. consumer franchise saw continued strong growth in Branded Cards and sustained its momentum in attracting digital deposits. Investment Banking continued to gain share and, despite a lower rate environment, Treasury and Trade Solutions grew revenue as we work to ensure our global network remains indispensable to our clients. With increased revenues and disciplined expense management, we had positive operating leverage, even as we continued to make significant investments in the franchise.”

He continued, “We ended 2019 with a Common Equity Tier One ratio of 11.7% and we are on track to deliver our commitment of returning over $60 billion of capital to our shareholders over a three-year period. We enter 2020 in a strong competitive position, from capital and liquidity to talent and technology. We continue to invest in areas where we see opportunities for client-led growth and in our infrastructure, in light of the enduring need to be an indisputably strong and stable institution.”

With improving operational execution and business lines in faster growth markets around the globe (vs. its U.S. business), offset by headwinds from the potential for lower interest rates for longer, we believe that Citi shares offer investors more upside, despite an extremely strong 2019. C is priced at just 9.4 times NTM adjusted EPS expectations and 98% of book value. We continue to see a more focused and recapitalized Citigroup as prepared to reward investors over the long-term. We like that C has good leverage towards the solid U.S. economy, while also having the potential to show outsized benefits versus its peers from growth in Asia, Latin America and other emerging economies. Even though the company faces plenty of operational hurdles in different segments of its business, we think the bank is on its way to achieving its low-50s efficiency-ratio target by end of 2020. Our Target Price for C has has been bumped up to $109.

Investment banking and securities firm **Goldman Sachs Group** (GS – $249.46) posted Q4 revenue 16% higher than expected led by trading and asset management. Despite the strong top-line results, adjusted earnings per share of $4.69 fell well short of expectations ($5.52) because of materially elevated litigation costs and expenses (much of it the hit coming from the scandal around 1MDB, a Malaysian development fund). Capital ratios and book value increased year-over-year, while Q4 ROE was muted at 9%, materially impacted by the litigation charge, though full-year adjusted ROE was healthy at 12%. The firm ranked #1 in worldwide announced and completed mergers and acquisitions for the year and also ranked #1 in worldwide equity and equity-related offerings and common stock offerings for the year.

CEO Dave Solomon remarked, “Strong performance in the fourth quarter helped us to deliver solid results for the year, while continuing to invest in new businesses. We aim to drive higher returns in the future, and look forward to sharing our strategic goals and financial targets at Investor Day later this month.”

We continue to be long-term fans of GS, and given the strong revenue trends, improving macro backdrop, strategic repositioning towards growth, an improving efficiency ratio and active capital management, we believe the company can achieve stronger growth, operating leverage and a potentially higher multiple than the current forward P/E of 10. The ultimate goal of Goldman's evolution is to change the trading and deal-making titan into a more well-rounded financial firm with more stable consumer and commercial businesses. That said, we won't be surprised if it takes a few years for the efforts to begin to be truly rewarded by investors. Our Target Price now stands at $292.

Global financial services giant **Bank of New York Mellon** (BK – $46.18) posted adjusted Q4 EPS ($1.02 vs. $1.01 est.) Thursday morning that topped analyst projections. Assets under custody and/or administration rose 12% on a year-over-year basis to $37.1 trillion, reflecting higher market values and client inflows, while assets under management climbed 11% to $1.9 trillion, also due to higher market values, as well as the favorable impact of a weaker U.S. dollar (principally against the British pound), though AUM was offset by net outflows. The company also bought back 22.2 million common shares for $1.04 billion during the quarter.

Interim CEO Tom Gibbons elaborated, "[In 2019], We created some exciting partnerships with leading front-office system providers, namely Aladdin, Bloomberg and, most recently, SimCorp, and these will provide our clients with open architecture that gives them choice and flexibility. While still early, these partnerships are strengthening our offering and are helping us win new business. We enhanced our capabilities in alternatives and ETFs, which have strong growth prospects, and we're expanding the range of data and analytical applications available to our clients where our strong position in data management, accounting, performance and distribution analytics position us to deepen our relationships…This is already driving improved client satisfaction and lower attrition rates. In Pershing, we are seeing fee growth coming through and are excited about the future for this business. The industry is evolving, and we are confident that our market leadership and strategy will position us well going forward. We ended the year with the strongest pipeline in many years with both institutional broker-dealers and in the RIA space. We continue to onboard these new clients each quarter and to build the future pipeline. Across the industry, consolidation is helping make Pershing's open architecture increasingly attractive to our clients. We're accelerating investments in the advisory segment, strengthening market leadership in the broker-dealer segment and continuing the development of front-end technology, including integration with third-party providers to deliver state-of-the-art experiences and analytics to advisers and their investors. All of these are making us an even better partner to our clients."

Despite the seemingly good news, shares sank nearly 9% over the next two days as worries about higher expenses and low interest rates spooked investors. On the earnings conference call, management indicated that costs could rise by as much as 2% in 2020, while the company must contend with compression in both net interest and fee income. As a result, analysts are now looking for full-year EPS a little lighter than $4.20. Of course, the current share price hardly seems rich, given that it represents 11 times NTM earnings expectations (historically, BK has traded for 13.5 to 14 times earnings), while we believe the company maintains a strong market position (particularly in its Pershing business and certain other asset services offerings) and that investments in technology will likely lead to a stickier client base in the future. We also

appreciate the bank's generous capital returns to shareholders as evidenced by the reduction of shares outstanding by a little over 6% over the past year, and history of annual dividend increases. Our Target Price for BK now stands at $61.

PNC Financial Services (PNC – $153.36) reported adjusted Q4 2019 earnings that trailed analyst estimates. The regional bank earned $2.89 per share (vs. $2.91 est.) and had net interest margin of 2.78%, down 6 basis points, due to lower interest rates. PNC reported growth in loans, deposits and revenue, but the loan-loss provision expense increased, eating at earnings. The efficiency ratio for the full year was 59%, which management attributed to more than $300 million of cost savings and continuous improvement program (CIP). Even so, the shares sank more than $5 last week.

AFAM a KOVITZ division

THE PRUDENT SPECULATOR

PNC – Didn't See Much that was Bad

Income Statement: **Full Year Positive Operating Leverage**

PNC

$ millions	4Q19	Change vs. 3Q19	FY19	Change vs. FY18	Full Year Highlights
Net interest income	**$2,488**	($16)	**$9,965**	$244	▪ Record net interest income
Fee income	**1,665**	18	**6,389**	183	▪ Fee growth of 3%
Other noninterest income	**456**	114	**1,473**	268	▪ Includes sales of retirement recordkeeping business and proprietary mutual funds
Total revenue	**$4,609**	$116	**$17,827**	695	▪ Record revenue
Noninterest expense	**$2,762**	$139	**$10,574**	$278	▪ Improved efficiency ratio to 59%
Pretax, pre-provision earnings	**$1,847**	($23)	**$7,253**	$417	▪ Effective tax rate of 16.4%
Provision	**$221**	$38	**$773**	$365	▪ Overall credit quality remained strong
Net income	**$1,381**	($11)	**$5,418**	$72	

	4Q19	3Q19	FY19	FY18	
Diluted EPS	**$2.97**	$2.94	**$11.39**	$10.71	▪ 6% EPS growth

– Pretax, pre-provision earnings (Non-GAAP) – See Reconciliation in Appendix.
– FY – Full Year.

6

CEO Bill Demchak commented, "I was very pleased with the continued progress we made this quarter on our key strategic initiatives, including the national expansion of our middle market and retail banking efforts. We remain committed to growing our business but also maintaining an efficient organization capable of achieving positive operating leverage. As 2020 begins, we expect to face uncertainty in the year to come from the economic environment to the ramifications of international trade disputes, the geopolitical situation and a presidential election campaign in the U.S., but we're excited about the momentum with which we've entered the year and along with our increased capital flexibility as a result of the tailoring rules, we believe our

strategy, focus on — our strategy and focus on our customers positions us well to continue to deliver for all of our constituencies."

Despite the prolonged low interest rate environment, stiff competition for deposits and heavy regulatory burden, PNC has found ways to continue to show respectable loan and deposit growth with strong overall credit quality. We think the firm's focus on organic loan growth is an important performance driver and we remain pleased with the company's ability to control costs and drive fee income. We support management's continued effort to expand into new markets, and we think the asset management business will add to the bottom line. Additionally, we note that PNC owns 22% of Blackrock, the largest asset management firm in the world. PNC currently trades for around 13 times NTM earnings and yields 3.0%. Our Target Price is $177.

Oil services concern **Schlumberger Ltd** (SLB — $38.37) earned $0.39 per share in Q4 (vs. $0.37 est.). Revenue of $8.2 billion was roughly flat from Q3 as growth in international markets made up for the continued decline in North America. While the firm doesn't typically provide earnings guidance, management offered its outlook on global energy markets and shed light on strategic plans for the upcoming year. In the recent quarter, headwinds in North America led the company to indefinitely reduce capacity in the region by 30%, making multiple strategic divestitures and using the proceeds to retire $1.3 billion of net debt. In contrast, CEO Olivier Le Peuch expects international markets to remain constructive in the current year as integrated oil companies accelerate drilling offshore, especially in the second half of 2020.

Mr. Le Puech gave the following overview, "We expect the second year of market contraction in the North America land with a decline in the high single-digit to double-digit range. This aligns with the strength of our International franchise and makes the execution of our NAL strategy even more critical to protecting our returns from any further activity downside."

He continued, "With this market outlook, our ambition will be to grow internationally above mid-single digits excluding the impact of recent divestiture, revert Cameron group to growth on the back of long-cycle booking execution and contain North America to high single-digit decline as a consequence of both market conditions and strategy execution. Within this market, the impact of our capital stewardship strategy, particularly the reduction of under-performing business units, will be material. At the same time, the impact of our transformation program should continue to enhance incremental margin performance and cash flow for most of the service product lines. We are confident that the shape and mix of international activity growth will support favorable revenue quality during the next 4 quarters with contribution from new technology adoptions, stronger offshore activity and digital transformation. Offshore activity will increasingly grow towards deep-water basins in later part of 2020, reflecting the acceleration in investment by IOCs and large independents. Therefore, we expect international margins to further expand in 2020, building on the momentum from second half of 2019. In addition, and as an outcome of the NAL strategy execution, we also expect North America margin to expand, despite the headwinds on activity and revenue contraction."

We appreciate that the firm continues to prioritize margin, cash flow and investor returns and think the shift in North America is a prudent one. We also expect SLB's transition from capital heavy and more commodity-like businesses like coiled tubing towards more asset-light ones to

favor its deep base of intellectual capital. As a global leader in oil services, we think the uptick internationally sets the table in Schlumberger's favor, given that roughly two-thirds of revenue is produced outside of North America already. The firm continues to produce significant enough cash flow to support a handsome dividend, with the yield now standing at 5.2%. That said, we know that the stock has long been a disappointment, even as we continue to like the long-term prospects. We have trimmed our Target Price to $68.

Delta Air Lines (DAL – $62.03) reported Q4 2019 results that beat analyst expectations on the top and bottom lines, sending shares up more than 3%. Delta earned an adjusted $1.70 per share in the quarter on revenue of $11.44 billion, compared with analyst consensus estimates of $1.40 and $11.34 billion, respectively.

CEO Ed Bastian said, "The December quarter performance was a great finish to what was truly an outstanding year on all fronts: strategically, with the American Express renewal and the announcement of LATAM and Wheels Up partnerships; operationally, with best-in-class completion factor and on-time performance; and financially, with industry-leading revenue, profits and cash flow. 2019 was the best year in our history. The top line grew 7.5% to $47 billion, positioning Delta as the largest carrier by revenue in the world."

Mr. Bastian concluded, "Our full year earnings outlook of $6.75 to $7.75 per share for 2020 positions Delta for the sixth straight year of pretax profits in excess of $5 billion. Free cash flow is also expected to remain strong at $4 billion in 2020. This would bring Delta's 3-year cumulative free cash flow to over $10 billion by the end of this year. By leveraging a solid financial foundation with increasingly diverse revenue streams and building brand momentum, we are demonstrating an unprecedented level of earnings and free cash flow consistency for this industry. This is enabling us to reinvest in our business at a level that others cannot match. This reinvestment is extending our competitive advantages. And when combined with a great brand powered by the very best people in the business, we have the engine to drive meaningful long-term value for our customers, our employees and our owners."

We think the airline has executed well, reducing denied boardings, adjusting schedules in advance of bad weather, sprucing up its lounges and not alienating big spenders with perk cuts like some of DAL's competitors have. The company recently announced that it was buying a minority stake in private-jet operator Wheels Up, which along with Delta's fleet of 190 corporate aircraft, bolsters DAL's efforts to go after premium passengers. These business improvements, along with deliveries of A321neo airplanes and being lucky to dodge the 737 MAX fallout, put DAL in a strong position for 2020. With the stock trading for just 8.5 times NTM earnings and yielding 2.6%, our Target Price has been elevated to $83.

Shares of general merchandise discount store chain **Target** (TGT – $116.92) fell hard, more than 6%, after the company reported holiday sales results which came in below expectations due to softness in categories Electrics, Toys and Home. Despite the trip-up, TGT kept its EPS guidance range for fiscal 2020 between $6.25 and $6.45. In fiscal Q4, TGT's unchanged EPS estimate range is $1.55 to $1.75.

CEO Brian Cornell explained, “We faced challenges throughout November and December in key seasonal merchandise categories and our holiday sales did not meet our expectations. However, because of the durability of our business model, we are maintaining our guidance for our fourth quarter earnings per share… Given the relative performance of higher-margin versus lower-margin categories, our fourth quarter financial results will benefit from a stronger-than-expected gross margin mix in our holiday sales. In addition, our fourth quarter performance will benefit from productivity improvements in our stores and supply chain, as well as meaningfully lower clearance inventory compared with a year ago.”

Mr. Cornell closed, “I want to thank the entire Target team for all of their work to transform Target’s operational and financial model, which has allowed Target to grow and thrive in a rapidly-changing retail environment. As a result of their efforts, we’ve seen outstanding performance in 2019 and we’re confident we’ll deliver another strong year in 2020, reflective of our durable business model and consistent with our long-term financial algorithm. This algorithm is based on the ability of our business to generate annual sales growth in the low-single digits, mid-single digit growth in operating income, and high-single digit growth in earnings per share.”

Target shares doubled in 2019, so the stumble thus far in 2020 is forgivable. We think that a strong U.S. economy and solid company-wide execution will ultimately win out, despite the near-term disappointment. Of course, there are always challenges on the horizon, including costs of goods concerns related to China, but for now we are happy holding shares with their good rank in our proprietary scoring system, as we think the future still looks bright. Our Target Price for Target, which trades for around 17 times NTM earnings and yields 2.3%, stands at $131.