Market Commentary March 9, 2020

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EXECUTIVE SUMMARY

Newsletter Portfolio Moves – MCK Tendered and 5 New Purchases
Volatile Week – Big Swings
COVID-19 – Little in the Way of Positive News
Historical Perspective – 2009 H1N1
Econ Outlook – Recession Still Not Yet the U.S. or Global Forecast
Domestic Numbers – Very Good Pre-COVID-19 Numbers
Emergency Fed Rate Cut – Powell Commentary
Income Options – Dividend Yields Far Superior to Treasury Yields for Long-Term-Oriented Investors
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Market Review

A little housekeeping before this week's missive… We did move forward with tendering our shares of **McKesson** (MCK – $141.49) for shares of **Change Healthcare** (CHNG – $13.10), as we endeavored to take advantage of the decent premium that was being offered. On Thursday, McKesson announced the final exchange ratio of 11.4086 CHNG shares for each MCK share, meaning that as of Friday's close, the value of the Change shares we will receive, assuming we are not pro-rated, would equal $149.45. We will watch both CHNG and MCK to see if we want to swap back into McKesson, retain CHNG or swap into another undervalued stock.

As discussed in the March edition of *The Prudent Speculator*, on Thursday morning, we bought 302 shares of **Pinnacle West Capital** (PNW – $99.31) for TPS Portfolio at $99.052 and 52 shares of **3M** (MMM – $153.65) for Buckingham Portfolio at $152.868. In our hypothetical accounts, we added 50 shares of **Lockheed Martin** (LMT – $382.47) at $393.92 to PruFolio, as well as $10,000 of **Snap-on** (SNA – $141.77) at $147.49 and 437 **ViacomCBS** (VIAC – $21.57) at $22.85 to Millennium Portfolio.

One of your Editor's favorite books on investing is Jason Zweig's *Your Money and Your Brain*, which deals with the science of neuroeconomics. As the dust jacket states, "Neuroeconomics is a fascinating new discipline that combines psychology, neuroscience, and economics to better understand financial decision making."

While there is plenty of good stuff in his tome, I especially like a passage starting on Page 31 under the subheading, "Stocks have prices; business have values." Mr. Zweig writes: "In the short run, a stock's price will change whenever someone wants to buy or sell it and whenever something happens that seems like news…In the long run a stock has no life of its own; it is only

an exchangeable piece of an underlying business. If that business becomes more profitable over the long term, it will become more valuable, and the price of its stock will go up in turn. It's not uncommon for a stock's price to change as often as a thousand times in a single trading day, but in the world of real commerce, the value of a business hardly changes at all on any given day. Business values change over time, not all the time. Stocks are like weather, altering almost continuously and without warning; businesses are like climate, changing more gradually and predictably. In the short run, it's the weather that gets our notice and appears to determine the environment, but in the long run it's the climate that really counts."

Certainly, the equity weather was highly variable last week, with stocks initially rebounding mightily on Monday from the prior week's massive plunge, skidding again on Super Tuesday, then soaring on Wednesday following the strong showing of Joe Biden in the Democratic Primaries. Thursday brought about another tumble that carried over to Friday, before a late rally pared that day's losses. While the average stock in the Russell 3000 index had a miserable five days, losing another 2.7%, the Dow Jones Industrial Average and S&P 500 ended higher for the week, even as the mainstream media chose to accentuate the negative and downplay the short-term positive.

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THE PRUDENT SPECULATOR
Bad News Sells More Papers

While the graphics below are not easy to read, we were not surprised to see the big daily stumbles in equity prices make the front page of *The New York Times*, while the giant rebounds were nowhere to be seen.

02.28.20


The New York Times

STOCKS TAKE DIVE NOT SEEN SINCE 2008 OVER VIRUS CRISIS

03.03.20


The New York Times

03.04.20


The New York Times

BIG NIGHT FOR BIDEN SERVES NOTICE TO SANDERS

03.05.20


The New York Times

BLOOMBERG EXITS RACE, GIVING BIDEN BIG FINANCIAL LIFT

Obviously, the catalyst for the drastic change in the stock market weather over the past few weeks is the continuing spread of the coronavirus (COVID-19), with the headlines remaining

disconcerting over the weekend as the number of confirmed cases worldwide jumped above 110,000 and the death count, sadly, rose to more than 3,800,…

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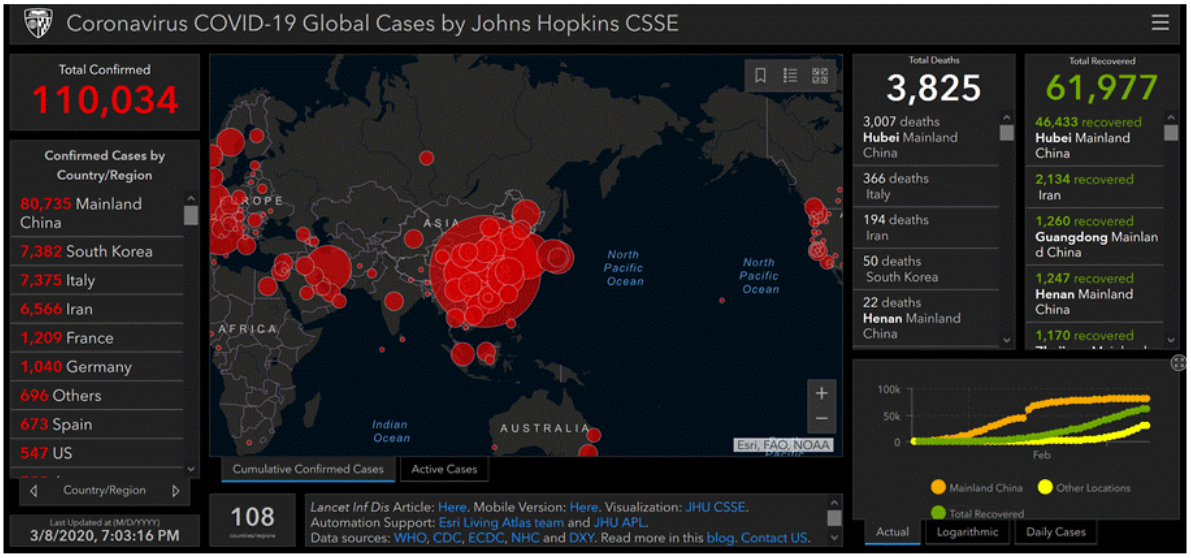
THE PRUDENT SPECULATOR
COVID-19's Global Spread

The good folks at Johns Hopkins have created a Coronavirus COVID-19 tracking app, with the tally of confirmed cases, including 547 in the U.S., standing at more than 110,000 as of March 8.



https://www.arcgis.com/apps/opsdashboard/index.html#/bda7594740fd40299423467b48e9ecf6

…even as traffic congestion and pollution statistics in China would seem to suggest that life is beginning to become more normal in the world's most populous country, while the World Health Organization (WHO) reported that there were "only" 84 new cases in Mainland China on Sunday, the number trending in the right direction.

Also, given that chart above indicates a greater-than-3% death rate for those who contract coronavirus, the latest numbers out of South Korea, with far better access to testing,…

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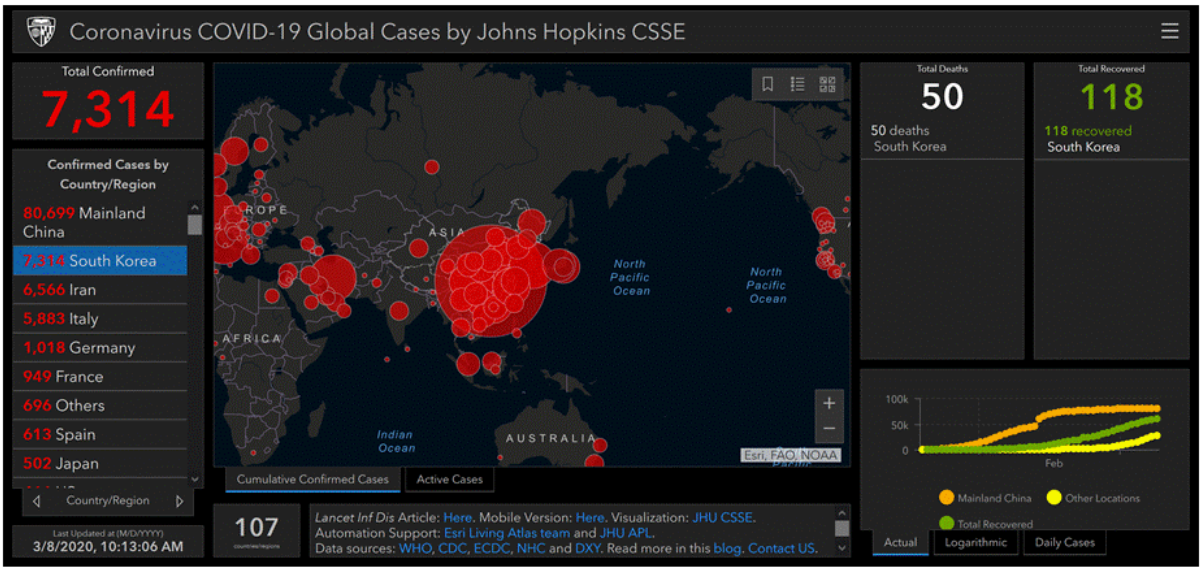
THE PRUDENT SPECULATOR
COVID-19 South Korea Mortality Data

With far better access to testing than most countries, including the U.S., South Korea's mortality rate (it is still early and the data are changing constantly) of less than 1% would seem to be a more reasonable figure.



https://www.arcgis.com/apps/opsdashboard/index.html#/bda7594740fd40299423467b48e9ecf6

…would seem to provide more credence to the *New England Journal of Medicine* editorial that stated, "If one assumes that the number of asymptomatic or minimally symptomatic cases is several times as high as the number of reported cases, the case fatality rate may be considerably less than 1%. This suggests that the overall clinical consequences of Covid-19 may ultimately be more akin to those of a severe seasonal influenza (which has a case fatality rate of approximately 0.1%) or a pandemic influenza (similar to those in 1957 and 1968) rather than a disease similar to SARS or MERS, which have had case fatality rates of 9% to 10% and 36%, respectively."

Of course, nobody knows what twists and turns the disease will take and we are all taking crash courses in epidemiology to attempt to determine the implications on our health and wealth, but we endeavor, especially given the garbage that can be found online, to provide facts and figures from what we believe to be reliable sources.

WHO: COVID-19 versus Flu

Q. How are COVID-19 and influenza viruses similar?

Firstly, COVID-19 and influenza viruses have a similar disease presentation. That is, they both cause respiratory disease, which presents as a wide range of illness from asymptomatic or mild through to severe disease and death.

Secondly, both viruses are transmitted by contact, droplets and fomites. As a result, the same public health measures, such as hand hygiene and good respiratory etiquette (coughing into your elbow or into a tissue and immediately disposing of the tissue), are important actions all can take to prevent infection.

Q. How are COVID-19 and influenza viruses different?

The speed of transmission is an important point of difference between the two viruses. Influenza has a shorter median incubation period (the time from infection to appearance of symptoms) and a shorter serial interval (the time between successive cases) than COVID-19 virus. The serial interval for COVID-19 virus is estimated to be 5-6 days, while for influenza virus, the serial interval is 3 days. This means that influenza can spread faster than COVID-19. Further, transmission in the first 3-5 days of illness, or potentially pre-symptomatic transmission –transmission of the virus before the appearance of symptoms – is a major driver of transmission for influenza. In contrast, while we are learning that there are people who can shed COVID-19 virus 24-48 hours prior to symptom onset, at present, this does not appear to be a major driver of transmission.

The reproductive number – the number of secondary infections generated from one infected individual – is understood to be between 2 and 2.5 for COVID-19 virus, higher than for influenza. However, estimates for both COVID-19 and influenza viruses are very context and time-specific, making direct comparisons more difficult.

Children are important drivers of influenza virus transmission in the community. For COVID-19 virus, initial data indicates that children are less affected than adults and that clinical attack rates in the 0-19 age group are low. Further preliminary data from household transmission studies in China suggest that children are infected from adults, rather than vice versa.

While the range of symptoms for the two viruses is similar, the fraction with severe disease appears to be different. For COVID-19, data to date suggest that 80% of infections are mild or asymptomatic, 15% are severe infection, requiring oxygen and 5% are critical infections, requiring ventilation. These fractions of severe and critical infection would be higher than what is observed for influenza infection.

Those most at risk for severe influenza infection are children, pregnant women, elderly, those with underlying chronic medical conditions and those who are immunosuppressed. For COVID-19, our current understanding is that older age and underlying conditions increase the risk for severe infection.

Mortality for COVID-19 appears higher than for influenza, especially seasonal influenza. While the true mortality of COVID-19 will take some time to fully understand, the data we have so far indicate that the crude mortality ratio (the number of reported deaths divided by the reported cases) is between 3-4%, the infection mortality rate (the number of reported deaths divided by the number of infections) will be lower. For seasonal influenza, mortality is usually well below 0.1%. However, mortality is to a large extent determined by access to and quality of health care.

Q. What medical interventions are available for COVID-19 and influenza viruses?

While there are a number of therapeutics currently in clinical trials in China and more than 20 vaccines in development for COVID-19, there are currently no licensed vaccines or therapeutics for COVID-19. In contrast, antivirals and vaccines available for influenza. While the influenza vaccine is not effective against COVID-19 virus, it is highly recommended to get vaccinated each year to prevent influenza infection.

https://www.who.int/emergencies/diseases/novel-coronavirus-2019/situation-reports/

Certainly, we understand that COVID-19 is not the flu, and there are today no vaccines or antivirals available, though long-struggling **Gilead Sciences** (GILD – $80.22) is said to be making solid progress on the latter, while many experts are worried that the death count could go markedly higher if containment is not successful. Still, we think it interesting to look back at the last major global pandemic to hit the United States, H1N1 in 2009. True, Tamiflu (oseltamivir) and Relenza (zanamivir) were available to treat H1N1, which was also known as Swine Flu, the absence of the word flu in the name of the disease being a big psychological differentiator this time around. But, as the report (which is also available on the Centers for Disease Control (CDC) website) below highlights, there were more than 60 million cases in the U.S. and more than 12,000 people died.

Infectious Diseases Society of America

To calculate the burden of 2009 pandemic influenza A (pH1N1) in the United States, we extrapolated from the Centers for Disease Control and Prevention's Emerging Infections Program laboratory-confirmed hospitalizations across the entire United States, and then corrected for underreporting. From 12 April 2009 to 10 April 2010, we estimate that approximately 60.8 million cases (range: 43.3–89.3 million), 274 304 hospitalizations (195 086–402 719), and **12 469 deaths (8868–18 306) occurred in the United States due to pH1N1. Eighty-seven percent of deaths occurred in those under 65 years of age with children and working adults having risks of hospitalization and death 4 to 7 times and 8 to 12 times greater, respectively, than estimates of impact due to seasonal influenza covering the years 1976–2001.** In our study, adults 65 years of age or older were found to have rates of hospitalization and death that were up to 75% and 81%, respectively, lower than seasonal influenza.

https://academic.oup.com/cid/article/52/suppl_1/S75/499147

Comparison of Impact to Seasonal Influenza

Children were hospitalized due to pH1N1 at a rate of approximately 117 per 100 000 (Table 4). This is approximately 7 times greater than previously published rates of seasonal influenza–related hospitalization during the years 1979–2001 as estimated by Thompson et al. [4] (Table 4). Adults aged 18–64 years had approximately 4 times greater risk of being hospitalized compared to these published estimated rates. Adults 65 years of age or older, however, were hospitalized at a rate of 70 per 100 000, 75% lower than estimated hospitalization rates for this age group (Table 4).

Table 4.

Comparing Impact: 2009 Pandemic Influenza A (pH1N1) vs Seasonal Influenza: Deaths and Hospitalizations per 100,000 by Age Groups

Age (years)	Numbers per 100,000 (ranges)			
	Deaths		Hospitalizations	
	Median pH1N1a	Average 1990 to 1999b	Median pH1N1a	Average 1979 to 2001c
0–17	1.7	0.2	117.4	15.8
	(1.2–2.5)	(.03–.4)	(83.5–172.4)	(3.6–32.3)
18–64	5.0	0.4	83.8	20.8
	(3.6–7.3)	(.07–1.0)	(59.6–123.0)	(4.8–42.4)
65+	4.2	22.1	70.1	282
	(3.0–6.1)	(3.8–54.1)	(49.9–103.0)	(64.8–575.2)
All	4.1	3.1	90.2	52.4
	(2.9–6.0)	(.5–7.6)	(64.2–132.4)	(12.1–107.0)

And, per the CDC website, "Additionally, CDC estimated that 151,700-575,400 people worldwide died from (H1N1) virus infection during the first year the virus circulated. Globally, 80 percent of (H1N1) virus-related deaths were estimated to have occurred in people younger than 65 years of age. This differs greatly from typical seasonal influenza epidemics, during which about 70 percent to 90 percent of deaths are estimated to occur in people 65 years and older."

Sounds frightening, especially as so many in the prime of life were struck down, compared to the COVID-19 mortality numbers thus far that skew toward older and less healthy casualties, but H1N1 did not derail the U.S. equity market recovery from the Financial Crisis depths. In fact, during the run of the illness domestically (from 04.12.09 to 04.10.10), the S&P 500 enjoyed a massive 42.4% positive return.

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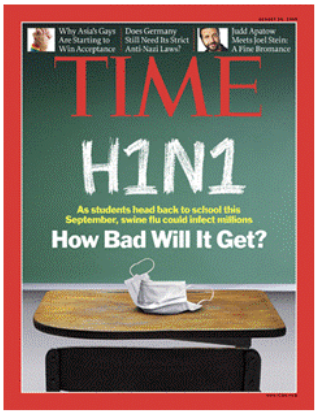
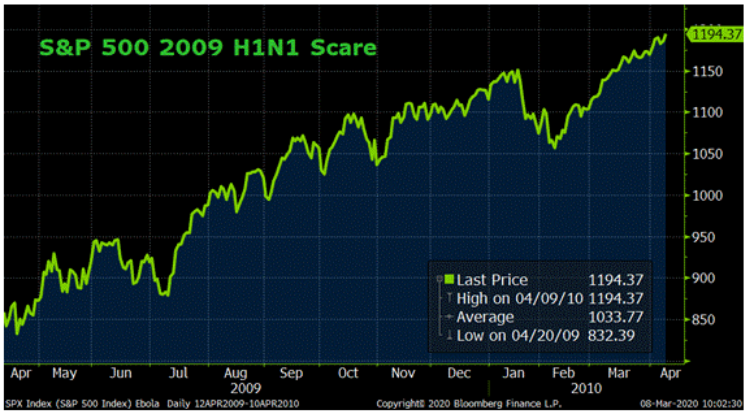
THE PRUDENT SPECULATOR
Most Relevant Virus (H1N1) Scare in 2009

No doubt, COVID-19 remains extremely serious, with the case and death counts rising every day, and Italy taking the drastic measure of attempting to quarantine millions of its people. While nobody knows how the disease will evolve, **the most relevant comparison is likely to the 2009 pandemic influenza A (pH1N1), which saw 60.8 million cases, 274,000 hospitalizations and more than 12,000 deaths, just in the U.S.** Incredibly, the S&P 500 returned 42.4% as that pandemic ran its course.





To be sure, in 2009, we did not have consumers racing to buy canned goods, hand sanitizer and toilet paper, while businesses and schools did not shut down and/or engage in wholesale telecommuting. We also did not see numerous conferences and conventions cancelled, events like South by Southwest called off and sports leagues discussing plans to play in front of empty arenas and stadiums. And, we did not witness massive quarantines, such as the one just announced in Northern Italy, while the global supply chain was not severely disrupted. But, it is interesting that the Swine Flu (despite its 12,469 deaths in the U.S.) did not even merit a place on the list of supposedly frightening events that stocks have overcome over the last 11 years that we have long been citing.

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THE PRUDENT SPECULATOR
Keep Calm and Carry On

Memories tend to fade over time, but since the end of the nasty Financial Crisis Bear Market in March 2009, there have been more than a few frightening events, yet stocks have still managed to move higher.

Event	Date	S&P End Value	3 Months Later	6 Months Later	12 Months Later	36 Months Later	60 Months Later	Event thru Present
Flash Crash	5/6/2010	1,128.15	-1%	9%	19%	43%	84%	163%
Japan Tsunami	3/11/2011	1,304.28	-3%	-12%	5%	43%	55%	128%
S&P Downgrade	8/6/2011	1,199.38	4%	12%	16%	60%	82%	148%
Hurricane Sandy	10/22/2012	1,433.82	4%	9%	22%	43%	80%	107%
Fiscal Cliff	1/1/2013	1,426.19	10%	13%	30%	43%	87%	108%
Taper Tantrum	5/22/2013	1,655.35	0%	9%	14%	24%	65%	80%
Russia and Ukraine	2/20/2014	1,839.78	2%	8%	15%	28%	51%	62%
Ebola Scare	9/4/2014	1,997.65	4%	5%	-4%	24%	47%	49%
Charlie Hebdo	1/7/2015	2,025.90	2%	3%	-4%	35%	60%	47%
Greek Default	6/30/2015	2,063.11	-7%	0%	2%	32%		44%
China Devalues Yuan	8/10/2015	2,104.18	-1%	-12%	3%	35%		41%
Paris Bataclan	12/13/2015	2,012.37	0%	3%	13%	32%		48%
U.S. Interest Rate Hike	12/16/2015	2,073.07	-2%	0%	9%	25%		43%
China GDP Slowing	1/19/2016	1,881.33	12%	15%	20%	42%		58%
Brexit Vote	6/23/2016	2,113.32	2%	7%	15%	40%		41%
Trump Victory	11/8/2016	2,139.56	7%	12%	21%	45%		39%
Price Changes Only								
Does Not Include Dividends		**Averages:**	**2%**	**5%**	**12%**	**37%**	**68%**	**75%**

Source: Kovitz Investment Group using data from Bloomberg. As of 3.6.20

No doubt, all the actions taken in response to COVID-19 will weigh on economic growth, with Laurence Boone, Chief Economist for the Organisation for Economic Co-operation (OECD), writing early last week, “The OECD expects a sharp slowdown in world growth in early 2020. We have revised our projection for the year from an already low 3% in November to only 2.4%, lower than in any year since the financial crisis. In a downside-risk scenario where epidemics break out in some other countries across the globe, the slowdown will be sharper and more prolonged. Our modelling suggests that the level of world GDP would fall as low as 1.5% this year, halving the OECD’s previous 2020 projection from last November of 3%. Containment measures and fear of infection would hit production as well as spending hard and drive many of the epidemic affected countries into outright recession.”

OECD Interim Economic Outlook projections

Real GDP growth

%, year-on-year. Arrows indicate the direction of revisions since the November 2019 Economic Outlook

	2019	2020	2021		2019	2020	2021
World	2.9	2.4 ↓	3.3 ↑	**G20**	3.1	2.7 ↓	3.5 ↑
Australia	1.7	1.8 ↓	2.6 ↑	**Argentina**	-2.7	-2.0 ↓	0.7 →
Canada	1.6	1.3 ↓	1.9 ↑	**Brazil**	1.1	1.7 →	1.8 →
Euro area	1.2	0.8 ↓	1.2 →	**China**	6.1	4.9 ↓	6.4 ↑
Germany	0.6	0.3 ↓	0.9 →	**India**[1]	4.9	5.1 ↓	5.6 ↓
France	1.3	0.9 ↓	1.4 ↑	**Indonesia**	5.0	4.8 ↓	5.1 →
Italy	0.2	0.0 ↓	0.5 →	**Mexico**	-0.1	0.7 ↓	1.4 ↓
Japan	0.7	0.2 ↓	0.7 →	**Russia**	1.0	1.2 ↓	1.3 ↓
Korea	2.0	2.0 ↓	2.3 →	**Saudi Arabia**	0.0	1.4 →	1.9 ↑
United Kingdom	1.4	0.8 ↓	0.8 ↓	**South Africa**	0.3	0.6 ↓	1.0 ↓
United States	2.3	1.9 ↓	2.1 ↑	**Turkey**	0.9	2.7 ↓	3.3 ↓

↓ downward by 0.3 pp and more ↓ downward by less than 0.3 pp → no change ↑ upward by less than 0.3 pp ↑ upward by 0.3 pp and more

Note: Difference in percentage points based on rounded figures. The European Union is a full member of the G20, but the G20 aggregate only includes countries that are members in their own right.
1. Fiscal years starting in April.
Source: OECD Economic Outlook database; and OECD calculations.

3

Interestingly, the OECD is still suggesting that the global and U.S. economies will manage to avoid recession, despite the significant COVID-19 headwind, though not without massive economic stimulus from countries around the world. Such an attempt to provide stimulus came this past Tuesday, when the U.S. Federal Reserve announced an emergency (there was an FOMC meeting coming in two weeks) 50-basis-point cut to the Federal Funds rate to a range of 1.0% to 1.25%, down from the previous range of 1.5% to 1.75%. In addition to the comments below, Fed Chair Jerome H. Powell said, “We do recognize that a rate cut will not reduce the rate of infection, it won’t fix a broken supply chain. We get that. We don’t think we have all the answers. But we do believe that our action will provide a meaningful boost to the economy.”

Jerome H. Powell Comments 03.03.20

Earlier today the Federal Open Market Committee announced a ½ percentage point reduction in the target range for the federal funds rate, bringing that range to 1 to 1¼ percent. My colleagues and I took this action to help the U.S. economy keep strong in the face of new risks to the economic outlook.

The fundamentals of the U.S. economy remain strong. The unemployment rate has been near half-century lows for well more than a year, the pace of job gains has been solid, and wages have been rising. These strong labor market conditions have underpinned solid household spending, which has been the key driver of economic growth over the past year. At the time of our FOMC meeting in January, prospects for continued economic growth remained favorable, and we judged that monetary policy was well positioned to support that outlook.

Since then, the spread of the coronavirus has brought new challenges and risks. The virus has afflicted many communities around the world, and our thoughts and prayers go out to those who've been harmed. The outbreak has also disrupted economic activity in many countries and has prompted significant movements in financial markets. The virus and the measures that are being taken to contain it will surely weigh on economic activity both here and abroad for some time. We are beginning to see the effects on the tourism and travel industries, and we are hearing concerns from industries that rely on global supply chains. The magnitude and persistence of the overall effects on the economy, however, remain highly uncertain, and the situation remains a fluid one.

Against this background, the Committee judged that the risks to the U.S. outlook have changed materially. In response, we have eased the stance of monetary policy to provide some more support to the economy. Of course, the ultimate solutions to this challenge will come from others, particularly health professionals. We can and will do our part, however, to keep the U.S. economy strong as we meet this challenge. As always, our actions are guided by our congressional mandate to promote maximum employment and price stability.

In the weeks and months ahead, we will continue to closely monitor developments and their implications for the economic outlook, and we will use our tools and act as appropriate to support the economy.

Those strong economic fundamentals that the Fed Chair mentioned, were supported by the latest (pre-COVID-19 escalation) data on the health of the factory sector,…

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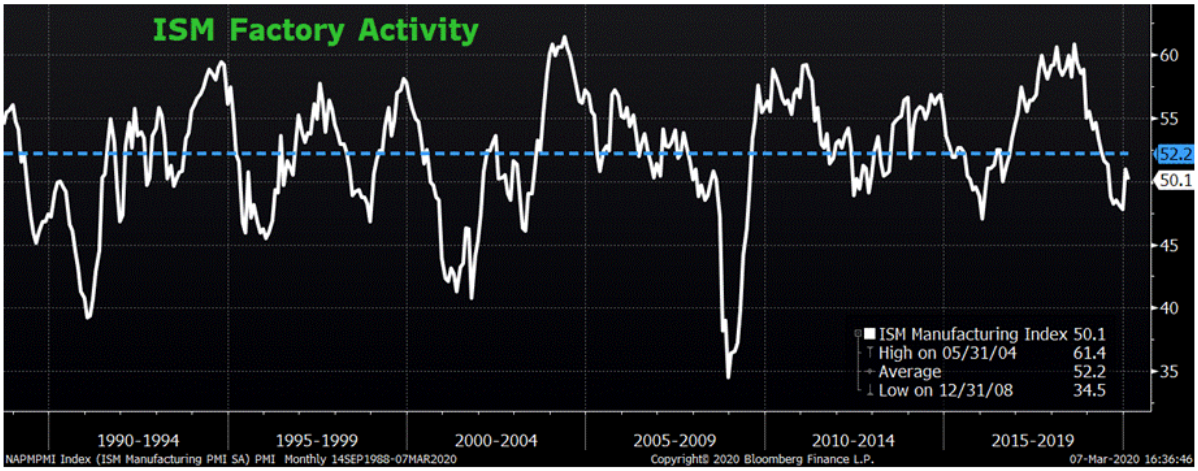
THE PRUDENT SPECULATOR
ISM Manufacturing = 2.1% GDP Growth

The latest read on the health of the manufacturing sector eased to 50.1 in February. The measure was weaker than expected, but was relatively healthy, all things considered, given disruptions in the global supply chain. Per the Institute for Supply Management, "The past relationship between the PMI and the overall economy…corresponds to a 2.1% increase in real gross domestic product (GDP) on an annualized basis."



…and the service sector,…

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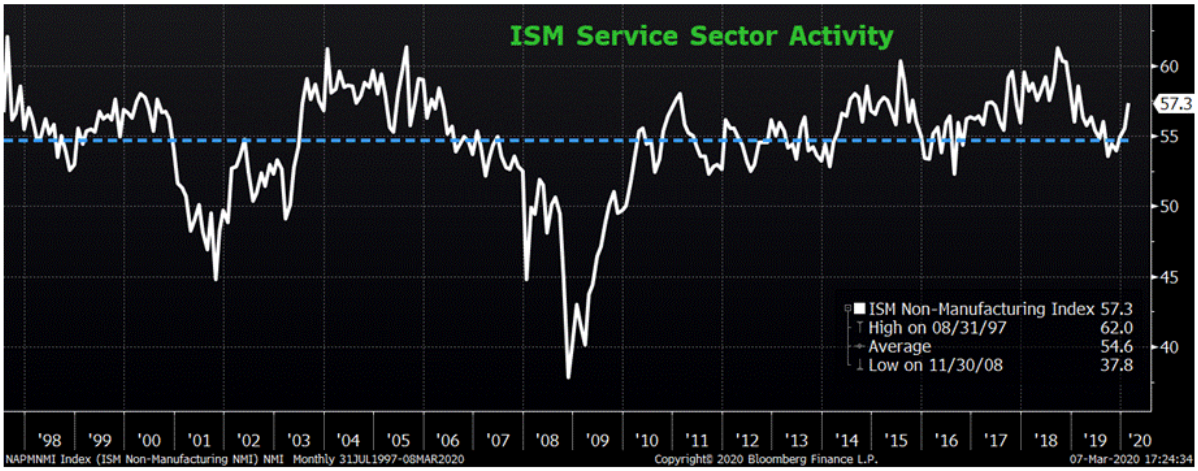
THE PRUDENT SPECULATOR
ISM Non-Manufacturing Climbs Again

The February reading on the health of the service sector (NMI) came in much better than expected at 57.3, even with concerns about the coronavirus and its supply chain impact. The Institute for Supply Management added, "The past relationship between the NMI and the overall economy…corresponds to a 3.0% increase in real gross domestic product (GDP) on an annualized basis."



…and the labor market,…

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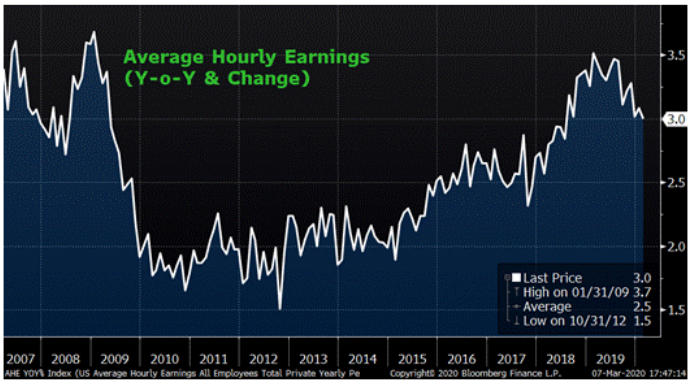
THE PRUDENT SPECULATOR
Terrific Employment Report



The number of new jobs created during February came in at 273,000, blowing away estimates and showing that the labor market had strong momentum ahead of the coronavirus scare. The January tally was also revised higher by 48,000 to 273,000, while the annual gain in average hourly earnings totaled an as-expected 3.0%, continuing to suggest that inflation in the labor market remains in check.

…with five-decade lows in the jobless rate and first-time filing for unemployment benefits.

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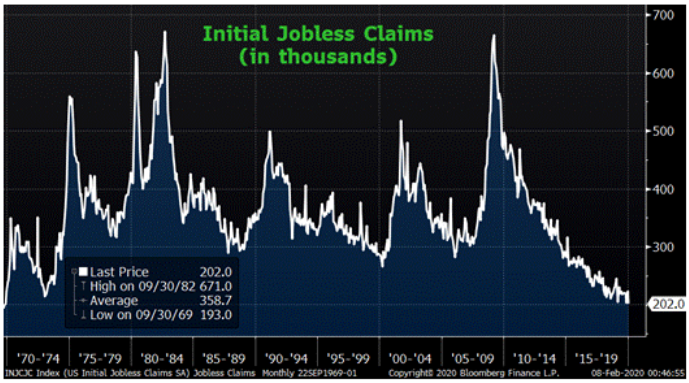
THE PRUDENT SPECULATOR
Historic Lows in Jobless Numbers



The jobs number in February, led by gains in health care, came in well above forecasts, and the unemployment rate ticked lower to 3.5%, back at a 50-year low, while the labor participation rate held steady at 63.4%. And, the latest figures on initial claims for unemployment benefits saw just 216,000 new filings, still near lows last seen back in December 1969, when the workforce was significantly smaller than it is today.

Yes, those statistics will likely crumble over the next few months, which is a big reason for the exodus from stocks and rush into the perceived safety of U.S. Treasuries that has seen interest rates plunge to all time lows, with the dividend yield on the S&P 500 ending last week more than 125 basis points above that of the 10-year Treasury and nearly 75 basis points higher than the 30-year Treasury.

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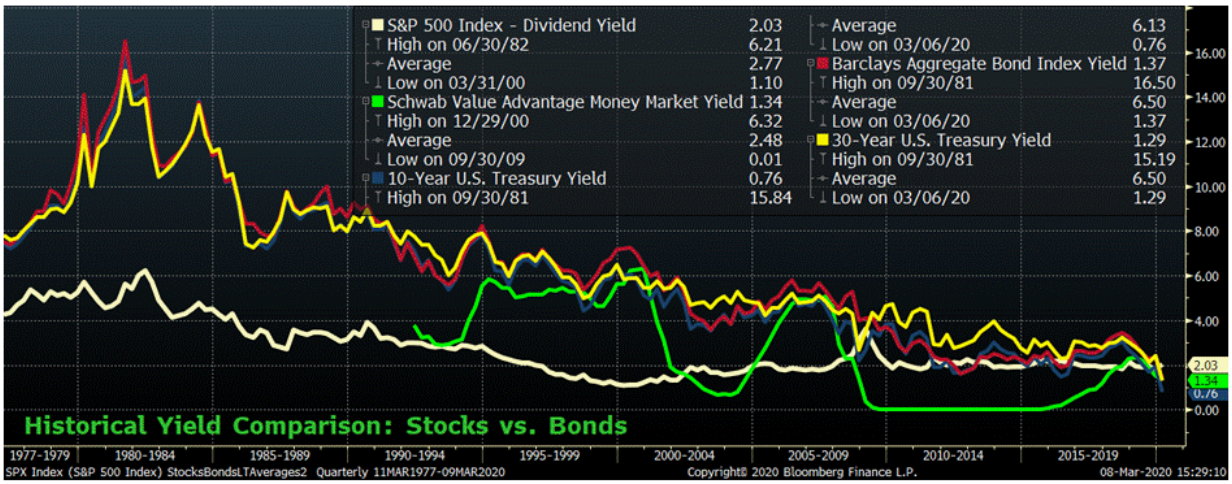
THE PRUDENT SPECULATOR
Equity vs. Fixed Income Yields

Though stocks are not necessarily a substitute for government or corporate bonds, the current payout on the S&P 500 (2.03%) is extraordinarily generous versus the income provided by fixed income, especially given the recent plunge in rates. And, the comparisons to the average yields for the securities below very much favors equities.



Dividend payments are not guaranteed, of course, but we note that corporate balance sheets generally are in good shape to weather near-term turbulence, with even the Financial Crisis leading to only a relatively short retreat in the trend toward escalating distributions over time.

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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.

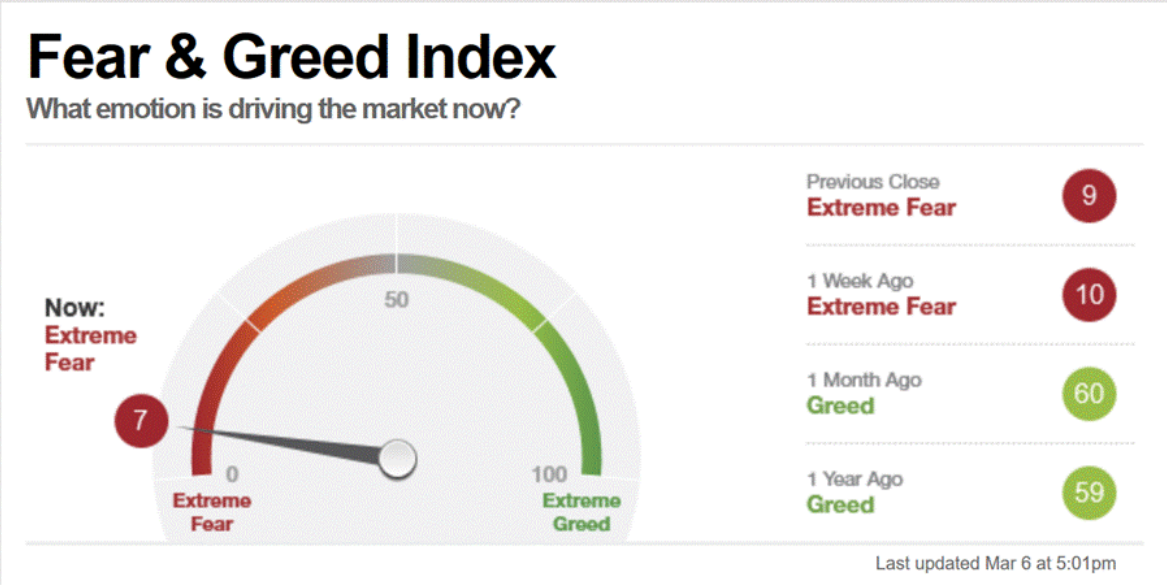
COUNT OF S&P 500 DIVIDEND ACTIONS	INCREASES	INITIATIONS	DECREASES	CESSATIONS
2020 (as of 3.5.20)	115	1	0	0
2019	355	6	7	0
2018	374	6	3	0
2017	351	5	9	2
2016	344	7	19	2
2015	344	7	16	3
2014	375	8	8	0
2013	366	15	12	0
2012	333	15	11	1
2011	320	22	5	0
2010	243	13	4	1
2009	151	6	68	10
2008	236	5	40	22
2007	287	11	8	4

Source: Standard & Poor's.

S&P 500 DIVIDENDS PER SHARE	
2021 (Est.)	$66.19
2020 (Est.)	$63.07
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 3.6.20

We understand that new trading week is now expected to begin on a very ugly note,…



CNN Money 3.6.20. Seven Fear & Greed Indicators All Showing Extreme Fear: 1. Put and Call Options; 2. Market Volatility; 3. Market Momentum; 4. Stock Price Strength; 5. Junk Bond Demand; 6. Stock Price Breadth; 7. Safe Haven Demand

…with the collapse in the price of oil adding to the seemingly gale-force near-term headwinds. Still, as difficult as it can be to endure the volatility, we are comforted by dividend yields on our portfolios of what we believe to be undervalued stocks that now equal as much as four times the income available on the 10-year Treasury.

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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	12.8	11.1	1.0	1.8	3.3
Select Value	13.6	11.8	1.1	1.8	2.9
Select Dividend	12.9	11.4	0.9	1.9	3.7
Select Focused Dividend	13.0	11.3	0.9	2.1	3.7
Select Focused Value	13.4	12.0	1.3	2.1	2.9
Select SMID Dividend	11.7	10.3	0.5	1.3	3.7
Russell 3000	20.9	17.9	1.9	3.0	2.0
Russell 3000 Growth	28.0	23.2	3.0	7.4	1.2
Russell 3000 Value	16.1	14.1	1.4	1.8	2.9
Russell 1000	20.4	17.6	2.1	3.2	2.0
Russell 1000 Growth	27.1	22.5	3.4	7.8	1.2
Russell 1000 Value	15.8	14.1	1.4	1.9	2.9
S&P 500 Index	19.5	17.2	2.1	3.3	2.0
S&P 500 Growth Index	25.0	21.8	3.8	6.5	1.3
S&P 500 Value Index	15.3	13.8	1.4	2.0	2.9
S&P 500 Pure Value Index	8.9	8.3	0.5	0.9	3.8

As of 03.07.20. 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.

Anything can happen in the short run, especially as we might have hoped for greater investor pessimism in last week's sentiment numbers,…

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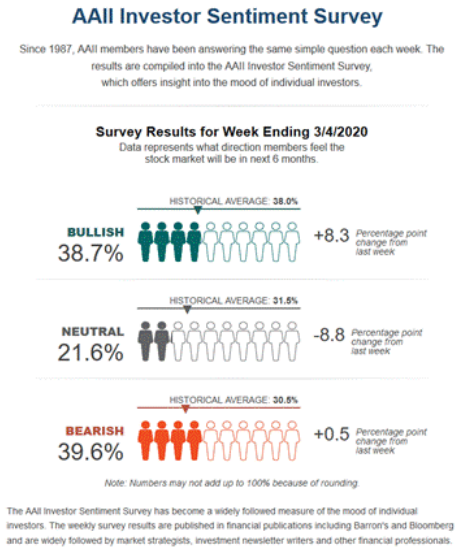
THE PRUDENT SPECULATOR
Sentiment: Saying and Doing

The latest Sentiment Survey of AAII members showed a jump in Bullishness to 38.7%, near the historical average.

After two weeks of inflows, the exodus out of U.S. stocks accelerated as folks feverishly sold domestic stock exchange traded and mutual funds in the latest week, per ICI data, though the love affair with bonds continues.



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

Week Ended	2/26/2020	2/19/2020	2/12/2020	2/5/2020	1/29/2020
Total Equity	-13,916	276	7,597	12,902	-9,154
Domestic	-13,536	-3,256	4,357	5,875	-12,571
World	-380	3,532	3,240	7,028	3,416
Hybrid	-1,421	201	409	406	24
Total Bond	3,250	14,888	19,113	13,673	13,352
Taxable	206	12,245	15,859	10,684	10,164
Municipal	3,044	2,643	3,253	2,989	3,188
Commodities	229	841	541	832	696
Total	-11,860	16,207	27,659	27,814	4,916

Source: Investment Company Institute

…but we remain focused on the three-to-five year-and-longer prospects of the businesses in which we are invested, especially as we like what the total return tables suggest for the chances of equity outperformance.

While fixed income investments generally boast lower volatility, it is hard to fathom why anyone with a truly long-term time horizon would favor U.S. Treasuries today, given the improving odds as holding periods lengthen that stocks will beat a modest 2% return that would dwarf the 0.8% yield now available to buyers and holders of a 10-year bond.

PATIENCE IS VIRTUOUS

	VALUE STOCKS			DIVIDEND PAYERS		
	Count >2%	Count <=2%	Percent >2%	Count >2%	Count <=2%	Percent >2%
1 Month	689	421	62.1%	685	425	61.7%
3 Months	730	378	65.9%	733	375	66.2%
6 Months	764	341	69.1%	774	331	70.0%
1 Year	780	319	71.0%	800	299	72.8%
2 Year	876	211	80.6%	896	191	82.4%
3 Year	924	151	86.0%	887	188	82.5%
5 Year	916	135	87.2%	923	128	87.8%
7 Year	973	54	94.7%	954	73	92.9%
10 Year	953	38	96.2%	939	52	94.8%
15 Year	923	8	99.1%	909	22	97.6%
20 Year	871	0	100.0%	871	0	100.0%

From 07.31.27 through 12.31.19. Value stocks represented by 50% small value and 50% large value returns rebalanced monthly. Dividend payers represented by 30% top of dividend payers, 40% of middle dividend payers, and 30% bottom of dividend payers rebalanced monthly. SOURCE: Kovitz Investment Group using data from Professors Eugene F. Fama and Kenneth R. French

We will grin and bear the short-term, just as we always have throughout the many difficult periods over the history of *The Prudent Speculator*. Believe it or not, Tuesday marks the 43rd anniversary of the launch of the newsletter back on 03.10.77, and we will close our Market Review with some words of wisdom from our founder Al Frank. Back in September 1998, after a particularly nasty decline in his portfolio, Al wrote: "As I struggle to maintain the tranquility and perspective of long-term investing, which has been a bit shaken by recent actions in the stock market, I hope you too can maintain the belief that 'this too shall pass away.' Life is pain and suffering as well as joy and triumph, but not necessarily In equal amounts. I think there are many who believe life is a hard struggle with intermittent periods of relief, while others believe that life is generally good with intermittent moments of trauma and darkness. Let us belong to the positive, optimistic class and not let the plethora of seemingly negative events, in the stock market and elsewhere, shake our faith in the good we now have."

Stock Updates

While company-specific news is very much overshadowed by market, economic and health-related headlines these days, Jason Clark, Chris Quigley and Zach Tart take a look at several of our companies for which recent events were of sufficient importance to trigger a review of their 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/.

COVID-19 fears have devastated any and everything travel related, with only a very small silver lining being the collapse of oil prices for those that provide transportation services. Our airline holdings have taken a beating in recent weeks, a direct result of the worldwide outbreak of the coronavirus. A sharp increase in corporate travel restrictions, cancelled vacations and work-from-home semi-quarantines have resulted in operational nightmares for the airlines around the world. The airlines are offering discounts, making reassurances and waiving fees in an effort to keep their planes at least somewhat full. **Alaska Air Group** (ALK – $45.21) is presently offering mileage bonuses and fee waivers for many flights (dependent on booking time and origin/destination), while slashing fares on many routes (LAX – SJC could be had for $20, one-way; West Coast-Hawaii could be had for $99, one-way). **Delta Air Lines** (DAL – $45.89) cut capacity and is considering accelerating scheduled retirements for its McDonnell Douglas MD-88/90 fleet. American Airlines and Hawaiian Airlines have cut flights to Asia and Italy (American only; Hawaiian does not use its equipment to Europe).

Lufthansa, the German airline, is considering a plan to temporarily park its A380 fleet, while both JetBlue and United each reduced capacity by up to 20% through May. Travel to Japan and continental Asia has slowed to a halt, with some airlines stopping service completely and shuffling aircraft on domestic routes. The virus was also the death blow for British outfit Flybe, which collapsed on March 5, leaving 2,000 staff without jobs and travelers without return trips. To be fair, Flybe was in bad shape already; but the outbreak hastened the demise.

We believe that the airline profits and revenue losses associated with COVID-19 are permanent. That is, we think they are not going to be shifted into another period in the same way that if a restaurant closes for a month, one wouldn't go back there and eat two dinners in one night to make up for it. It's our belief that folks who have travel plans next year (firm or not) are not cancelling those bookings. Should the virus outbreak slow down or a suitable antiviral hit the market, normal travel will resume near its usual pace very quickly. The upshot, then, is that the near-term pain is likely to be significant and it'll cut deep, but the stock prices have plummeted beyond what we think is justified.

This is true as our longer-term thesis is that the airlines will be able to ride out this disease using the strong balance sheets they've built up over the last decade. As the airlines relate to our broadly diversified portfolios, we think that the near-term suffering is worth sustaining for the long-term potential. Although we might have hoped Friday's bounce was reflective of a bottom, we would not be surprised if there was more downside on the way. And to the extent that it makes sense, we'll continue to take advantage of those "on sale" opportunities to improve the return prospects of our portfolios, while carefully weighing the risks of boosted exposures. Our Target Prices for Alaska and Delta are $87 and $76, respectively.

Cruise operators have been hit even harder, with **Carnival Corp** (CCL – $27.15) and **Royal Caribbean** (RCL – $65.01) now down some 46% and 51%, respectively, this year. Obviously, the massive coronavirus outbreak on board the Diamond Princess and the more modest infection aboard the Grand Princess are devastating events for the industry, and the near-term outlook for

cruising is problematic, to say the least, with the U.S. Government over the weekend issuing the following warning:

U.S. citizens, particularly travelers with underlying health conditions, should not travel by cruise ship. CDC notes increased risk of infection of COVID-19 in a cruise ship environment. In order to curb the spread of COVID-19, many countries have implemented strict screening procedures that have denied port entry rights to ships and prevented passengers from disembarking. In some cases, local authorities have permitted disembarkation but subjected passengers to local quarantine procedures. While the U.S. government has evacuated some cruise ship passengers in recent weeks, repatriation flights should not be relied upon as an option for U.S. citizens under the potential risk of quarantine by local authorities.

For its part, Royal Caribbean issued the following update late last week…

With COVID-19 adding uncertainty to travel plans around the world, Royal Caribbean Group said it will give guests greater control over their vacation decisions, allowing guests to cancel cruises as late as two days before departure.

The "Cruise With Confidence" policy allows guests on Royal Caribbean International, Celebrity Cruises, Azamara and Silversea to cancel up to 48 hours before a sailing. Guests will receive a full credit for their fare, usable on any future sailing of the guest's choice in 2020 or 2021. The policy applies to both new and existing cruise bookings.

"Our previous policy set earlier deadlines for guests to cancel their cruises, and that added unnecessary stress," said Richard Fain, the company's chairman and CEO. "Trying to guess a month or more in advance where areas of concern about coronavirus might be is challenging for medical experts, much less a family preparing for vacation.

"When circumstances are as fast-changing as they have been recently, it's good to know you have the option to take a rain check," Fain said. "We think putting more control in our guests' hands helps them make informed decisions about whether to keep their existing vacation plans or trade out for a more convenient time or itinerary."

In addition to easing concerns for booked guests, Fain said the policy would also give consumers more confidence in making new bookings, knowing that they could later adjust their plans without penalty.

The policy applies to all cruises with a sailing date on or before July 31, 2020, and will be offered by the company's global brands: Royal Caribbean International, Celebrity Cruises, Azamara and Silversea. Full details of the "Cruise with Confidence" policy can be found at the respective brand websites.

In response to the State Department warning, RCL said Sunday evening,

We are staying focused on development of an aggressive, responsive plan as agreed to during the meeting with Vice President Pence that goes beyond the already significantly enhanced protocols in place, which we believe are a model for others.

We thank the Vice President for a productive meeting marked by our shared focus on public health. We have committed to do even more to protect our guests, our crew and the communities where we sail. This includes more stringent boarding procedures, adding additional onboard medical resources and temperature screenings at embarkation. We will also develop industry funded protocols to care for guests on land in the event of an incident to eliminate future incidents of onboard quarantine. We are pleased to know the government agencies are prepared to work with us in developing these aggressive new measures. We expect to report back this week with further details of this enhanced approach to protecting public health.

To be sure, we do not know what the long-term impact will be on the cruise industry, but we believe that both Carnival and Royal Caribbean are financially strong enough to weather the unprecedented hurricane that they are both now facing. They have persevered through SARS, H1N1 and Zika outbreaks, as well as the Costa Concordia sinking and assorted norovirus issues. Ultimately, we believe that steps will be put in place to provide enough confidence for governments around the world to allow passengers to come ashore and for the passengers themselves to want to resume seaborne travel, though we respect that the situation is very fluid.

For now, our Target Prices are $50 for CCL and $123 for RCL.

Despite turning in a decent quarterly result, shares of **Kohl's** (KSS – $34.65) continued their free fall since last spring. In terms of fiscal Q4 2020 numbers, management said adjusted earnings per share totaled $1.99, versus the consensus analyst estimate of $1.88. Revenue of $6.54 billion was slightly above forecasts of $6.52 billion. While same store sales were flat for the period (slightly better than expected), we were glad to see some positive momentum in January, which seemingly rescued the quarter. That said, women's apparel continued to underperform, while online sales gained momentum.

CEO Michelle Gass explained, "While 2019 was a year in which our financial results did not meet our expectations, it was also a year of innovation and investment that further strengthened Kohl's differentiation in the market. We are encouraged by the acceleration of traffic and new customer acquisition in our stores and online driven by the unprecedented level of new brands and partnerships we launched during the year. I want to thank all of our associates for their ongoing commitment to Kohl's and I am confident that we will build on our strengths in 2020 to stabilize and position the business for future growth."

Despite the continued investment in the short-term to drive long-term operational performance, we continue to like Kohl's evolution and are optimistic about the initiatives to drive foot and online traffic and boost sales in the long-term. Yes, there could be additional near-term performance pressure caused by the coronavirus epidemic, but we continue our belief that in the quarters to come, KSS' evolution will result in shareholder gain. We look forward to the March 16 Investor Day to hear more about how Kohl's is going to utilize its stores and real estate, from

potentially turning large stores in to side by side with "the other side" potentially being a Planet Fitness or an Aldi's, or how they might right-size stores.

Our Target Price for KSS is now $61, but we note that the stock presently trades for 7.9 times estimated earnings, while the dividend was just hiked, yes hiked, by 5%, pushing the yield to a massive 8.1%, more than ten times greater than that of the 10-year U.S. Treasury.

Shares of general merchandise discount store chain **Target** (TGT – $105.95) ended up last week on the back of fiscal Q4 financial results that showed that the company's digital sales continue to gain momentum. While TGT's revenue of $23.1 billion came in below expectations, from weaker than expected holiday sales which the company previously warned about, adjusted EPS of $1.69 came in above the consensus analyst estimate of $1.66. In digital sales, we were pleased to see Target's same-day fulfillment options continue to outgrow conventional ship-to-home, as pickup and same-day delivery have better economics (the former because shipping costs are omitted and the latter due to fees).

Target CEO Brian Cornell commented, "With eleven consecutive quarters of positive comparable sales growth, driven by healthy performance in both our stores and digital channels, Target's results demonstrate that we've built a sustainable business model that drives strong topline growth and consistent bottom line performance. The strategic investments we've made over the past several years to elevate the shopping experience, curate our multi-category assortment at scale, and deliver ease and convenience through our fulfillment capabilities are deepening our relationship with our guest. As we look ahead to 2020 and beyond, we are well positioned to build on this strong foundation to further differentiate Target and drive long-term, profitable growth."

In first quarter 2020, Target expects a low-single digit increase in comparable sales and a mid-single-digit increase in operating income. The company expects adjusted EPS of $1.55 to $1.75. For full-year 2020, Target expects a low-single-digit increase in comparable sales and a mid-single-digit increase in operating income. The company expects adjusted EPS of $6.70 to $7.00. Obviously, there is an unknown potential impact from the coronavirus outbreak. That said, because Target sells food and household items, they could also realize a spike in near-term sales if people continue to stockpile those items.

Target shares doubled in 2019, so the stumble thus far in 2020 is forgivable. Like other retailers, Target could run into some brisk near-term headwinds if the coronavirus scare continues to grow, but we think that a solid underlying U.S. economy and much improved company-wide execution will ultimately win out. 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 15 times NTM earnings and yields 2.5%, stands at $129.

Shares of **Kroger Co.** (KR – $32.04) jumped more than 14% last week after the grocery store operator reported fiscal Q4 2020 financial results. KR earned $0.57 per share in the period, versus the expected $0.55, and had revenue of $28.9 billion versus the consensus analyst

estimate of $28.8 billion. The company announced that for its full-year, non-fuel same sales increased 2%, while digital sales spiked 29% and the company was able to capture $1 billion in cost savings.

“We are pleased with our 2019 results and improving trends in our supermarket business. We delivered on our commitments for ID sales without fuel, adjusted FIFO operating profit, and cost savings in addition to generating over $100 million of incremental operating profit through alternative profit streams in 2019. We also delivered strong adjusted free cash flow during the year, consistent with the total shareholder return model outlined at our Investor Day,” said CEO Rodney McMullen

Mr. McMullen added, “More importantly, the way that we delivered the year is consistent with our long-term financial model and sets us up to connect with customers in a deeper way. Restock Kroger is the right strategic framework to position the company for sustainable growth in the future, continue to improve the core business, and deliver strong total shareholder return. This transformational foundation supports our competitive moats today – Fresh, Our Brands and Personalization – as well as building a seamless ecosystem of the future.”

Management said that consistent with its financial strategy, Kroger reduced net total debt by $1.1 billion over the last four quarters. Additionally, Kroger returned $951 million to shareholders in 2019, repurchasing $400 million in shares in the fourth quarter of 2019 under its $1 billion board authorization announced November 5, 2019. Also in 2019, Kroger increased the dividend by 14%, from $0.56 to $0.64 per year, marking the 13th consecutive year of increases.

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 14 times NTM adjusted EPS projections and its dividend yield of 2% is still attractive, while the near-panic buying of supplies by American shoppers has kept the cash registers ringing of late. Our Target Price for KR is now $36.