Market Commentary Monday, May 4, 2020

May 4, 2020

EXECUTIVE SUMMARY

May Newsletter – *TPS 643* Coming by Tuesday AM
Target Prices – New Listing Posted to theprudentspeculator.com
Volatility – Daily Yes, Weekly Not So Much
COVID-19 – Death Toll Continues to Rise; Positive Gilead Drug News
The Great Lockdown – Awful Econ Numbers
Federal Reserve – FOMC Leaves Rates at Zero; Powell Speaks
Emotional Roller Coaster – Stock Prices Seldom Reflect Fair Value
Buffett – Stocks Stacked in Favor of Investors
Stocks vs. Bonds – Low Interest Rates Make Equities Very Attractive for the Long-Term
Sentiment – Still Little in the Way of Optimism
Stock News – Updates on NSC, GILD, CMI, MMM, NYCB, AMGN, ADM, PFE, GOOG, QCOM, JNPR, MSFT & AAPL

Market Review

Work is underway on the May edition of *The Prudent Speculator*. This month, we look at Seasonality as well as Index Composition. If all goes according to plan, *TPS 643* should be emailed out no later than Tuesday morning, May 5. In the interim, we have posted updated Target Prices to our website, theprudentspeculator.com.

Reversing the order of what was seen the week prior, it was a fantastic start and an awful end to another volatile trading week for equities,…

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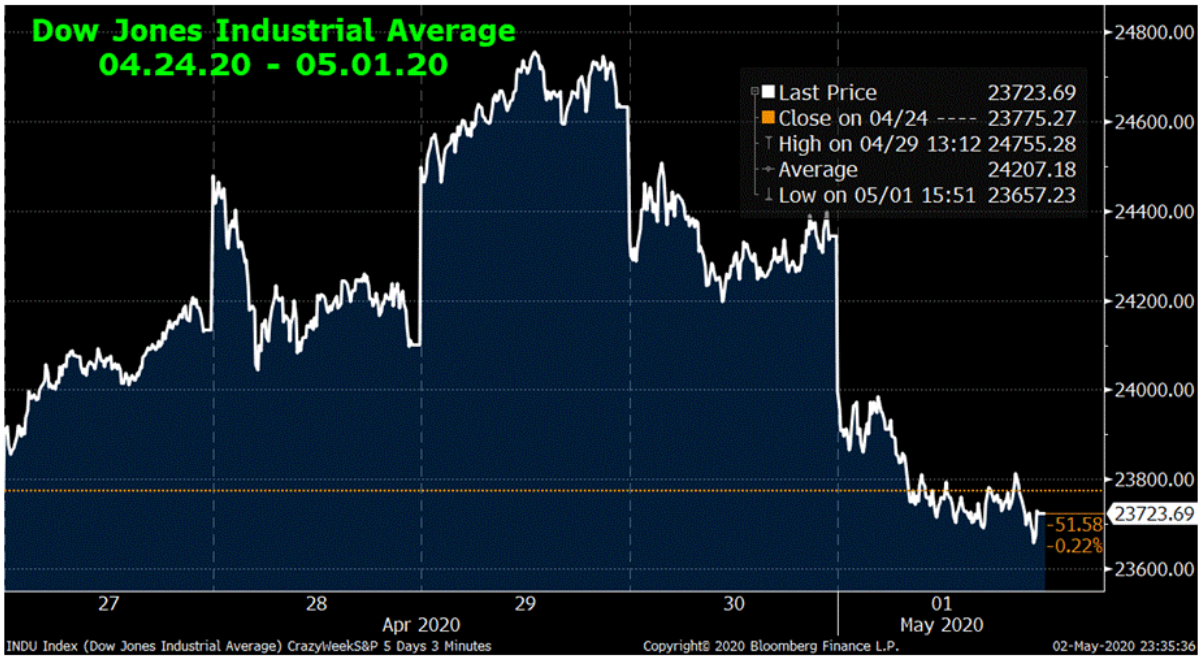
THE PRUDENT SPECULATOR
DJIA Volatility – Daily Yes but Weekly No

Despite tumbling 910 points over the last two days, the Dow Jones Industrial Average ended a very volatile week off just 52 points (0.22%).



…though if one did not pay attention to the daily gyrations it would appear that not a whole lot happened over the full five trading days. After all, the S&P 500 ended only modestly lower, down 0.19%, and the Russell 3000 showed a small advance, up 0.11%, while Value did a little better than Growth, for a change, with the Russell 3000 Value index advancing 0.30%, versus a 0.04% decline for the Russell 3000 Growth index.

Not surprisingly, COVID-19 news continued to dominate the headlines, with more than 40,000 additional deaths around the world over the past seven days,…

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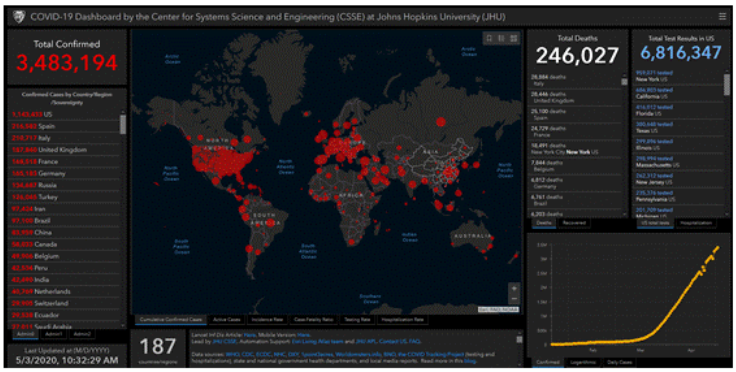
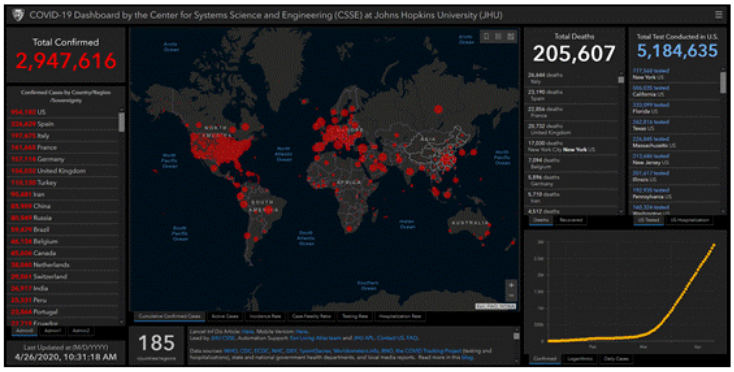
THE PRUDENT SPECULATOR
Slowing COVID-19 Global Spread





Covid-19 confirmed cases and deaths continued to rise in the latest week, with the U.S. now up to more than 66,000 fatalities, but the "curve" continues to flatten. And countries and states are slowly reopening their economies, even as the health threat is hardly contained, though there were favorable results last week from a government-run study of Gilead's antiviral drug remdesivir.

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

…but with a modest dose of good news from biotech giant **Gilead Sciences** (GILD – $79.95), even as its treatment is not close to a magic cure.

Gilead's Remdesivir Effective vs. COVID-19

STAT Topics Coronavirus Opinion Podcast Newsletters Reports Events

BIOTECH

Critical study of Gilead's Covid-19 drug shows patients are responding to treatment, NIH says

By MATTHEW HERPER @matthewherper and ADAM FEUERSTEIN @adamfeuerstein / APRIL 29, 2020

A vial of remdesivir
ULRICH PERREY/POOL/AFP VIA GETTY IMAGES

https://www.statnews.com/2020/04/29/gilead-says-critical-study-of-covid-19-drug-shows-patients-are-responding-to-treatment/

A government-run study of Gilead's remdesivir, perhaps the most closely watched experimental drug to treat the novel coronavirus, showed that the medicine is effective against Covid-19, the disease caused by the virus.

In a statement on Wednesday, the National Institute of Allergy and Infectious Diseases, which is conducting the study, said preliminary data show patients who received remdesivir recovered faster than similar patients who received placebo.

The finding — although difficult to fully characterize without full, detailed data for the study — would represent the first treatment shown to improve outcomes in patients infected with the virus that put the global economy in a standstill and killed at least 218,000 people worldwide.

During an appearance alongside President Trump in the Oval Office, Anthony Fauci, the director of NIAID, part of the National Institutes of Health, said the data are a "very important proof of concept" and that there was reason for optimism. He cautioned the data were not a "knockout." At the same time, the study achieved its primary goal, which was to improve the time to recovery, which was reduced by four days for patients on remdesivir.

The preliminary data showed that the time to recovery was 11 days on remdesivir compared to 15 days for placebo, a 31% decrease. The mortality rate for the remdesivir group was 8%, compared to 11.6% for the placebo group; that mortality difference was not statistically significant.

That is "the first convincing evidence that an antiviral drug can really benefit Covid-19 patients, specifically hospitalized Covid-19 patients," said Frederick Hayden, a professor emeritus of clinical virology and medicine at the University of Virginia School of Medicine. "This will change the standard of care in the United States and other countries for the patients who have been shown to be benefited," he said, adding that determining the exact group that should receive the drug will require further examination of the data.

Still, developments on the coronavirus front have become less bad, though the impact of the Great Lockdown on the economy is starting to come into focus. Indeed, numbers out last week showed the epic hit, as evidenced by ugly Q1 GDP growth (oops, contraction),…

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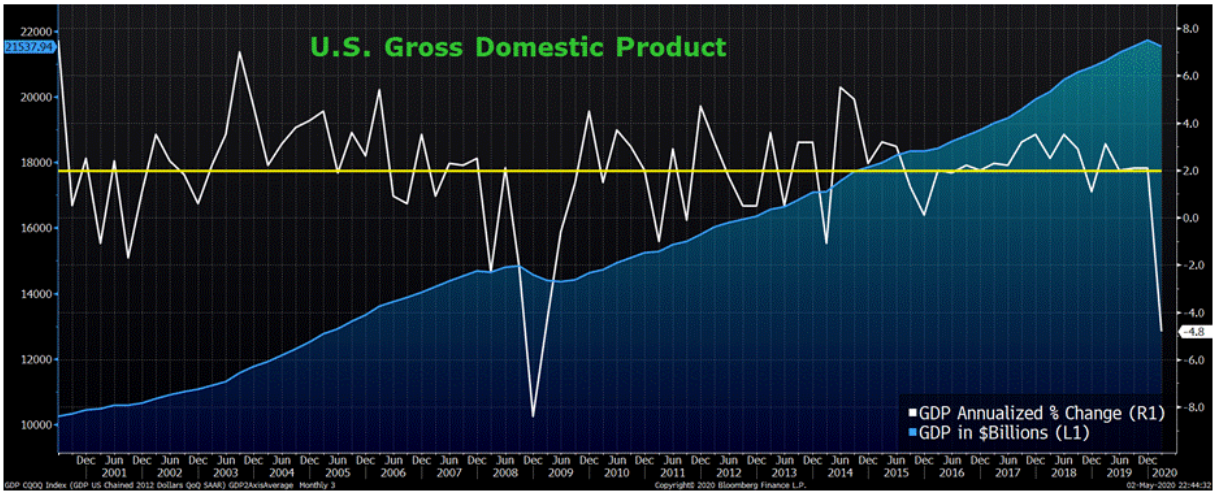
THE PRUDENT SPECULATOR
U.S. GDP Downturn in Q1 Just the Start

While some are projecting a 30% contraction in Q2 GDP, Uncle Sam calculated an annualized real (inflation-adjusted) 4.8% decline in Q1 '20 GDP, the worst quarterly showing in 12 years. Obviously, the Great Lockdown in response to the COVID-19 pandemic is weighing heavily, and the timing and magnitude of a recovery is very much in question.



…as well as dismal data on the health of the factory sector,…

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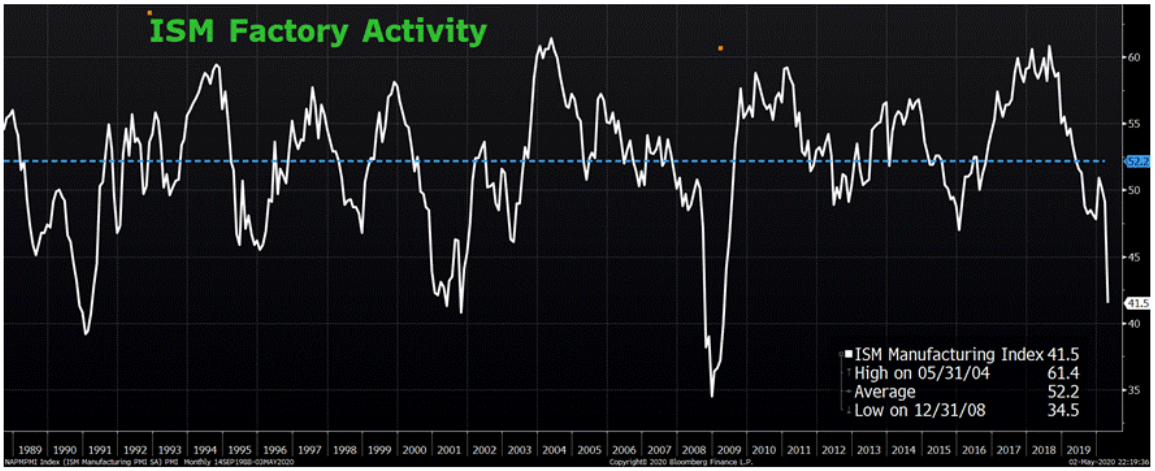
THE PRUDENT SPECULATOR
ISM Manufacturing

The latest read on the health of the manufacturing sector skidded to 41.5 in April. While the measure will undoubtedly weaken further, it was quite a bit better than expected, even as it fell to an 11-year low, with the Institute for Supply Management stating, "The past relationship between the PMI and the overall economy…corresponds to a 0.4% decrease in real gross domestic product (GDP) on an annualized basis."



…consumer confidence,…

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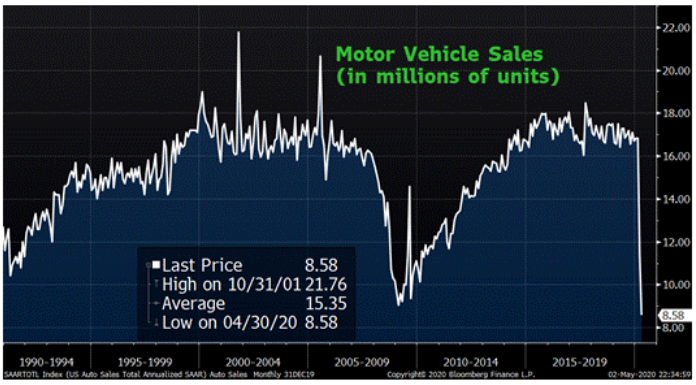
THE PRUDENT SPECULATOR
Consumer Optimism Fading Fast



Not surprisingly, given the stay-at-home orders that continue to grip the country, sales of automobiles fell off a cliff in April to a seasonally adjusted annual rate of 8.6 million vehicles, the lowest tally on record, but actually better than expectations. No doubt, Q2 will be awful for consumer spending, though the plunge in April consumer confidence to 86.9 still left the gauge well above the February 2009 low.

…and consumer spending.

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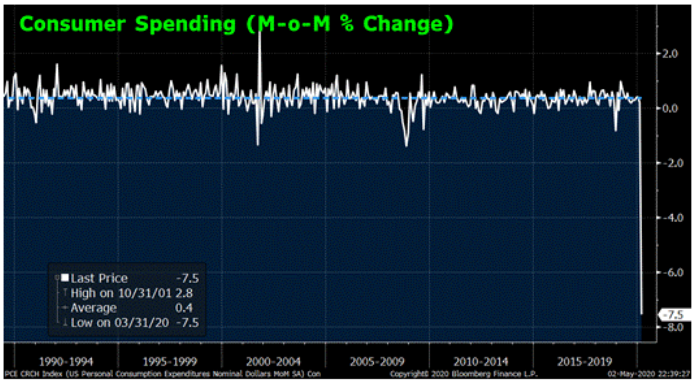
THE PRUDENT SPECULATOR
Consumers Curtailing Spending



Consumer spending dropped by 8.5% in March, the biggest monthly decline on record, even as personal incomes dipped *only* 2.0%. As spending fell faster than income, the savings rate jumped to 13.1% from 8% in February, the highest rate in 39 years. The massive spike in unemployment claims (30 million over the last six weeks) slowed in the latest week, but those not working have a tough time spending.

No doubt, the near-term outlook for the U.S. economy is as bad as it has ever been, but the Federal Reserve continues to do all that it is able to provide support,…

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THE PRUDENT SPECULATOR
FOMC Statement: 4.29.20

The Federal Reserve is committed to using its full range of tools to support the U.S. economy in this challenging time, thereby promoting its maximum employment and price stability goals.

The coronavirus outbreak is causing tremendous human and economic hardship across the United States and around the world. The virus and the measures taken to protect public health are inducing sharp declines in economic activity and a surge in job losses. Weaker demand and significantly lower oil prices are holding down consumer price inflation. The disruptions to economic activity here and abroad have significantly affected financial conditions and have impaired the flow of credit to U.S. households and businesses.

The ongoing public health crisis will weigh heavily on economic activity, employment, and inflation in the near term, and poses considerable risks to the economic outlook over the medium term. In light of these developments, the Committee decided to maintain the target range for the federal funds rate at 0 to 1/4 percent. The Committee expects to maintain this target range until it is confident that the economy has weathered recent events and is on track to achieve its maximum employment and price stability goals.

The Committee will continue to monitor the implications of incoming information for the economic outlook, including information related to public health, as well as global developments and muted inflation pressures, and will use its tools and act as appropriate to support the economy. In determining the timing and size of future adjustments to the stance of monetary policy, the Committee will assess realized and expected economic conditions relative to its maximum employment objective and its symmetric 2 percent inflation objective. This assessment will take into account a wide range of information, including measures of labor market conditions, indicators of inflation pressures and inflation expectations, and readings on financial and international developments.

To support the flow of credit to households and businesses, the Federal Reserve will continue to purchase Treasury securities and agency residential and commercial mortgage-backed securities in the amounts needed to support smooth market functioning, thereby fostering effective transmission of monetary policy to broader financial conditions. In addition, the Open Market Desk will continue to offer large-scale overnight and term repurchase agreement operations. The Committee will closely monitor market conditions and is prepared to adjust its plans as appropriate.

…including keeping interest rates essentially at zero for the foreseeable future,…

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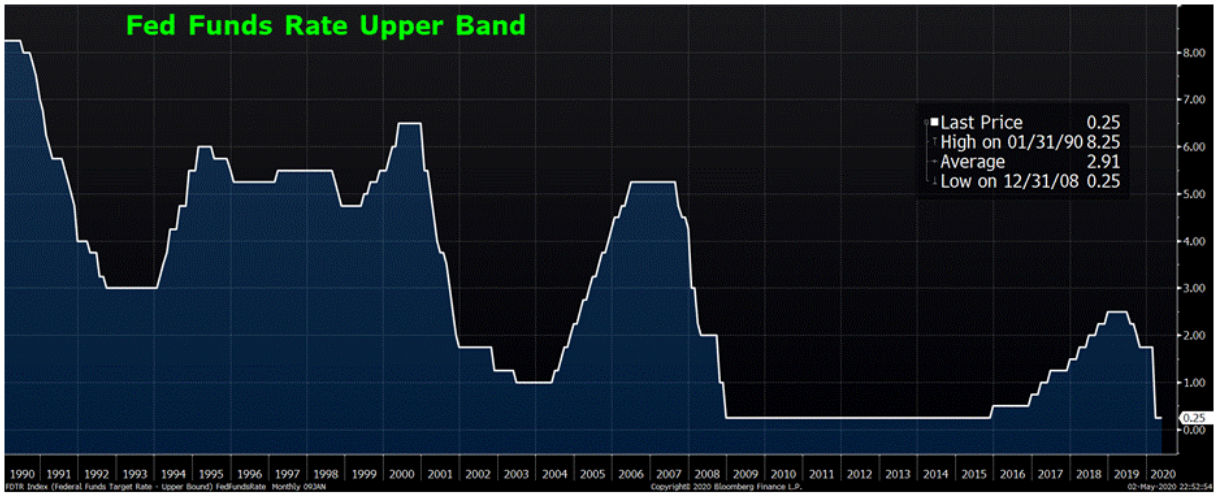
THE PRUDENT SPECULATOR
FOMC Fed Funds Rate Targets: Apr 2020

"Last month, we quickly lowered our policy interest rate to near zero. We stated then and again today that we expect to maintain interest rates at this level until we are confident that the economy has weathered recent events and is on track to achieve our maximum employment and price stability goals." – Federal Reserve Chair Powell



…with Fed Chair Jerome H. Powell acknowledging on Wednesday that Congress and the White House have already provided $2.6 trillion in economic assistance to individuals and businesses but arguing that more will be needed.

Obviously, the Fed and Washington remember that a slow response prolonged the Great Financial Crisis in 2008-09, and Mr. Powell was quick to remind folks that there eventually will be a significant economic recovery.

HOWARD SCHNEIDER. *I wanted to get a little more expansion on the timing of recovery and the connection between the health response. You said earlier, I think, that you thought the second half of the year could see a pretty robust rebound. Is that now out of the question? And do you think a steady recovery is really possible until a vaccine's developed, given the patchwork of measures we've seen taken around the states? Is that going to really lead us to a steady path out absent a vaccine?*

CHAIR POWELL. *You know, as you know, economic forecasts are always uncertain. Today, they're unusually uncertain, and that's really because so much of the performance of the economy depends on the path of the virus and the success of the measures we take to control it. Our success in reopening the economy and also the time it takes to develop new drugs. And our tools, the things that we do, don't affect any of those things. We're not experts on those things either, but what the experts tell us is that the outcomes are highly uncertain. So, this is an unusually new kind of uncertainty added on top of our regular uncertainty.*

But I will say, there, I think there are a few things you can say about the path ahead. First, this time, now, is going to be a time of sharp contraction in economic activity, high unemployment, personal consumption expenditures have declined sharply, business investment as well, unemployment moved up. We're going to see economic data for the second quarter that's worse than any data we've seen for the economy. And they're a direct consequence of the disease and the measures that we're taking to protect ourselves from it.

So, then we will enter this new phase, and we're just beginning to maybe do that, where we will, formal measures that require social distancing will be rolled back gradually and at different paces in different parts of the country. And, in time, during this period, the economy will begin to recover. People will come out of their homes, start to spend again. We'll see unemployment go down; we'll see economic activity pick up. And, you know, when will that be? It's very hard to say. But let's just say, for this purpose, that it's in the third quarter. So, as I mentioned earlier, that could be a fairly, you know, a large increase. Given the size of the fall, the increase could also be substantially large, although it's unlikely that it would bring us quickly all the way back to pre-crisis levels.

Of course, this is the period as well, that carries the risk of new outbreaks of the virus, something we really want to avoid. I think then, after that period, at some point, you will have, you know, the kind of formal social distancing measures will be gone, but you'll still be left with, probably, a level of caution on the part of people who will worry and probably keep worrying for some time. You would think that behavior will change as people gain confidence, so that the sooner we get the virus under control, the sooner people can regain that confidence and regain their economic activity.

I think trying to be really precise about when that might happen and what the numbers might look like is, I think it's very tough to do that.

There is no way of knowing the timing and magnitude of the recovery, and we respect that many think the rebound in stocks since the 03.23.20 lows has come too far too fast, even as the average stock in the Russell 3000 is still off 22.17% in 2020. However, we cannot forget that the financial markets quickly price in future expectations, which are often too optimistic or pessimistic. We would argue that the March plunge priced into stocks the deaths of one to two million Americans from COVID-19, along with a cataclysmic economic wipeout.

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THE PRUDENT SPECULATOR
Bear/Bull Markets Through the Years

S&P 500 Moves (on a Closing Basis) of 20% Without a Comparable Move in the Other Direction

				2/20/1928	9/16/1929	87.97%	BULL
9/16/1929	11/13/1929	-44.57%	BEAR	11/13/1929	4/10/1930	46.77%	BULL
4/10/1930	12/16/1930	-44.29%	BEAR	12/16/1930	2/24/1931	25.83%	BULL
2/24/1931	6/2/1931	-32.86%	BEAR	6/2/1931	6/26/1931	25.82%	BULL
6/26/1931	10/5/1931	-42.54%	BEAR	10/5/1931	11/9/1931	30.61%	BULL
11/9/1931	6/1/1932	-61.81%	BEAR	6/1/1932	9/7/1932	111.59%	BULL
9/7/1932	2/27/1933	-40.60%	BEAR	2/27/1933	7/18/1933	120.61%	BULL
7/18/1933	10/19/1933	-29.43%	BEAR	10/19/1933	2/6/1934	37.28%	BULL
2/6/1934	3/14/1935	-31.81%	BEAR	3/14/1935	3/10/1937	131.64%	BULL
3/10/1937	3/31/1938	-54.47%	BEAR	3/31/1938	11/9/1938	62.24%	BULL
11/9/1938	4/11/1939	-24.44%	BEAR	4/11/1939	10/25/1939	26.78%	BULL
10/25/1939	6/10/1940	-31.95%	BEAR	6/10/1940	11/7/1940	26.70%	BULL
11/7/1940	4/28/1942	-34.42%	BEAR	4/28/1942	5/29/1946	157.70%	BULL
5/29/1946	5/19/1947	-28.47%	BEAR	5/19/1947	6/15/1948	23.89%	BULL
6/15/1948	6/13/1949	-20.57%	BEAR	6/13/1949	8/2/1956	267.08%	BULL
8/2/1956	10/22/1957	-21.63%	BEAR	10/22/1957	12/12/1961	86.35%	BULL
12/12/1961	6/26/1962	-27.97%	BEAR	6/26/1962	2/9/1966	79.78%	BULL
2/9/1966	10/7/1966	-22.18%	BEAR	10/7/1966	11/29/1968	48.05%	BULL
11/29/1968	5/26/1970	-36.06%	BEAR	5/26/1970	1/11/1973	73.53%	BULL
1/11/1973	10/3/1974	-48.20%	BEAR	10/3/1974	11/28/1980	125.63%	BULL
11/28/1980	8/12/1982	-27.11%	BEAR	8/12/1982	8/25/1987	228.81%	BULL
8/25/1987	12/4/1987	-33.51%	BEAR	12/4/1987	3/24/2000	582.15%	BULL
3/24/2000	9/21/2001	-36.77%	BEAR	9/21/2001	1/4/2002	21.40%	BULL
1/4/2002	7/23/2002	-31.97%	BEAR	7/23/2002	8/22/2002	20.68%	BULL
8/22/2002	10/9/2002	-19.31%	BEAR	10/9/2002	10/9/2007	101.50%	BULL
10/9/2007	11/20/2008	-51.93%	BEAR	11/20/2008	1/6/2009	24.22%	BULL
1/6/2009	3/9/2009	-27.62%	BEAR	3/9/2009	2/19/2020	400.52%	BULL
2/19/2020	3/23/2020	-33.92%	BEAR	3/23/2020	4/29/2020	31.38%	BULL
	Average Drop	-34.83%			Average Gain	107.38%	

While investors suffered a stomach-churning 5-week Bear Market plunge of 33.92% in the S&P 500 from 2.19.20 to 3.23.20, the eighth drop of 20% or greater since the launch of *The Prudent Speculator* in 1977, those who stayed the course are in Bull Market #9. Happily, history shows that on average far more money has been made during the rallies than has been lost in the downturns.

Obviously, there are no guarantees that we do not have another 1918-1919 Spanish Flu when it comes to mortality or another Great Depression when it comes to the economy, but when stock prices already reflect a disastrous or horrendous future, adjectives like terrible and awful can be cause for cheer and a big equity market bounceback. Semantics, we know, but we continue to be puzzled by those who think stock prices are not properly reflecting the future today, but that somehow valuations were accurate on March 23, or for that matter on February 19.

Given that investors ride an emotional roller-coaster, we believe that equities hardly ever reflect fair value, while these days the lack of individual stock liquidity can quickly drive stocks up and down for little reason. Friday offered vivid illustration as shares of long struggling luxury goods company **Tapestry** (TPR – $15.16) rose 1.8% on an otherwise abysmal day for consumer discretionary names simply because the two Wall Street analysts raising their price targets were evidently more widely followed than the two that cut their targets. Or, consider high-flying electric car maker Tesla, shares of which shed nearly $15 billion of market capitalization on Friday when CEO Elon Musk strangely tweeted, “Tesla stock price is too high imo.”

Certainly, no one can predict the future, or how stock prices might gyrate even if we could somehow have advance access to the headlines, but we continue to believe that equities are the place to be for those with a long-term orientation. We very much like the Warren Buffett quotation,…

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THE PRUDENT SPECULATOR
The Secret to Success in Stocks…

"Of course, the immediate future is uncertain; America has faced the unknown since 1776. It's just that sometimes people focus on the myriad of uncertainties that always exist while at other times they ignore them (usually because the recent past has been uneventful). American business will do fine over time. And stocks will do well just as certainly, since their fate is tied to business performance. Periodic setbacks will occur, yes, but investors and managers are in a game that is heavily stacked in their favor."

– Warren Buffett

…and we note that this past weekend, the Oracle of Omaha reiterated that belief at the Berkshire Hathaway Annual Shareholders Meeting. Mr. Buffett also touched on the fact that while he has no idea where prices will go in the short run, low interest rates make stocks very appealing today for the long term relative to bonds,…

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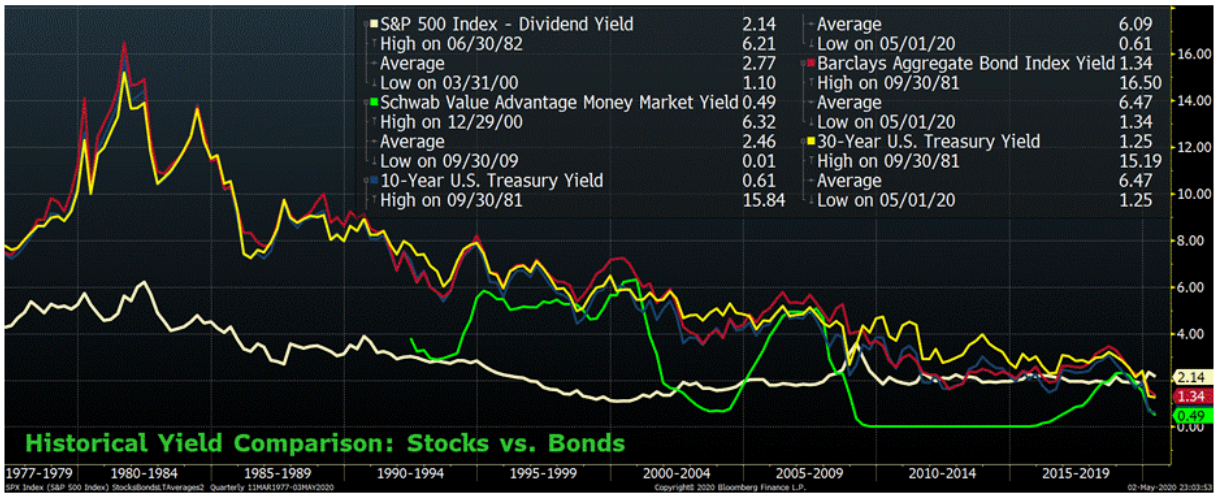
THE PRUDENT SPECULATOR
Equity vs. Fixed Income Yields

Though stocks are not necessarily a substitute for cash, government or corporate bonds, the payout on the S&P 500 (2.14%) is extraordinarily generous versus the income provided by fixed income, especially given the recent plunge in rates. Incredibly, equities yield more than four times as much today as does a prominent money market fund!



…while we will close our Market Review with the observation that we are pleased from a contrarian perspective that we had not been seeing much in the way of excitement about the recent rebound in stock prices.

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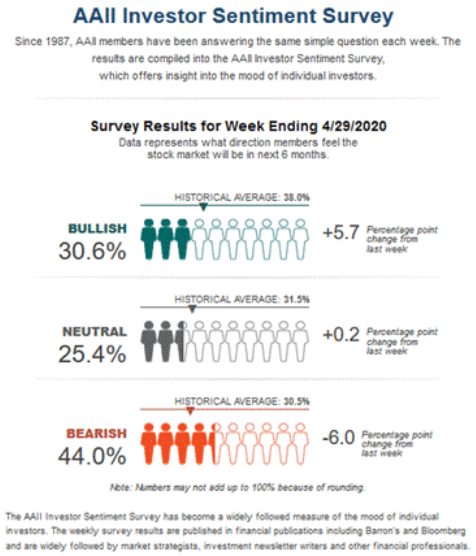
THE PRUDENT SPECULATOR
Sentiment: Saying & Doing

The latest Sentiment Survey of AAII members saw Bearishness (44.0%) remain very pessimistic, given a 30.5% historical average.



Mutual fund and ETF investors, per data from ICI, have rediscovered fixed income, despite extraordinarily low interest rates, with U.S. stocks seeing outflows in the latest period, reversing a three-week trend.

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

Week Ended	4/22/2020	4/15/2020	4/8/2020	4/1/2020	3/25/2020
Total Equity	-9,454	4,677	6,461	12,498	-40,783
Domestic	-1,522	8,937	8,504	12,502	-30,198
World	-7,933	-4,261	-2,043	-4	-10,585
Hybrid	-507	4,853	-2,655	3,911	-17,765
Total Bond	9,739	6,110	-10,526	-30,444	-100,791
Taxable	9,115	4,796	-7,623	-28,995	-80,697
Municipal	624	1,314	-2,903	-1,449	-20,094
Commodity	4,815	4,012	2,192	3,064	2,814
Total	4,594	19,651	-4,528	-10,971	-156,525

Source: Investment Company Institute

Stock Updates

Q1 earnings reporting season remains in high gear, and Jason Clark, Chris Quigley and Zach Tart look at a baker's dozen of our companies that posted quarterly results last week. Not surprisingly, our work has had to shift toward financial liquidity and business viability, versus the usual focus on price-related financial metrics. Readers should keep in mind 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/.

East coast railroad operator **Norfolk Southern** (NSC – $170.73) posted earnings of $2.58 per share in fiscal Q1 2019 (vs. $2.25 est.). Shares closed the week up over 6% despite the selloff on Thursday and Friday. The railroad's adjusted operating ratio improved to 63.7%, closer to management's target of 60%, while it sold 703 locomotives in the period.

Management is using the economic lull to accelerate the implementation of its TOP21 program (Precision Scheduled Railroading – PSR), which is now in its third and final phase. COO Michael Wheeler detailed, "I'm very proud of how Norfolk Southern's railroaders have dealt with both the threat and the business impact of the pandemic. We took early proactive measures to protect our workforce and make sure that being at work continue to be the safest part of an NS

employee's day. Because the railroad was very fluid and service levels were very high, we were able to quickly store surplus equipment while also mobilizing employees to provide extra manpower in hot zones like Northern New Jersey. We made special efforts to assist customers by expediting shipments of goods in short supply or that were urgently needed. All the while, we maintained service levels and the railroad has run even faster in April. Tactically, we very quickly, over just a few days, removed the blocks in trains carrying auto parts and finished vehicles from our TOP21 plan. Crew starts dropped almost as quickly as volume, enabling us to preserve leverage even as shipment counts declined. We will again redesign the operating plan as auto volume rebounds, using our operating leverage to handle returning volumes in the most efficient way possible. While we do not yet know the shape of the recovery curve, we are taking this time of lower traffic as an opportunity to challenge ourselves and our capabilities to improve our TOP21 operating plan in the long term. For example, we are successfully handling carload traffic on premium intermodal trains, blending previously separate service networks in a way that allows us to maintain service frequency and train size while reducing costs. In addition, we are taking hard looks at our yard and terminal network, testing what we can live without."

Rail remains a preferred mode of freight transport, claiming quadruple the fuel efficiency of trucking per ton-mile, and while the rail sector carries 7% of global freight, it represents only 2% of total transport energy demand. We expect operating metrics across class I railroads to converge in the coming years, and NSC stands to benefit from efficiency gains more than others that have more fully reaped the benefits of measures like PSR. Even as the stock has recovered mightily from the lows in March, we continue to think shares are attractive for long-term investors, especially considering execution of management's TOP21 program well ahead of schedule. We do not think that there are any liquidity concerns at Norfolk and that the dividend is secure (the yield is 2.2%). Our Target Price has been adjusted to $217.

Shares of the aforementioned **Gilead Sciences** bounced 7.5% on Wednesday as the U.S. government released positive news related to the hopeful COVID-19 treatment remdesivir. The biotech giant also posted adjusted EPS of $1.68, versus the consensus analyst estimate of $1.57, on revenue of $5.5 billion, roughly in line with projections. Sales of HIV portfolio products grew by 14% to $4.1 billion, although $200 million of revenue was pulled forward due to patient stocking in the U.S. and Europe. Gilead continues to use its massive cash hoard to make strategic purchases, and closed its acquisition of Forty Seven in April, which adds to the company's core area of expertise in virology and immunomodulation.

CEO Daniel O'Day addressed the pertinent info related to remdesivir, which received FDA emergency use approval on Friday.

The study results shared yesterday from the randomized placebo-controlled Phase III NIAID study and from our own open-label Phase III simple study in patients with severe disease are important progress as we seek to understand the role that remdesivir might play in easing the burden of COVID-19 around the world. These trials are part of a suite of clinical trials investigating the effects of remdesivir. We designed the clinical research program to ask multiple questions in parallel, including which groups of patients are most likely to respond and when to treat and for how long. Various study designs were used from placebo-controlled to open-label to answer very specific questions in each case. We expected that the answers would emerge

around the same time and taken together, they would form a clear picture of how remdesivir might best be used for patients.

Yesterday, we answered important questions with the initial results of the NIAID trial and simple trial. The NIAID data demonstrated that patients with COVID-19, who received remdesivir recovered faster than similar patients who received placebo. The results from the Gilead-sponsored simple study addressed a critical question about dosing. The data from the first of the simple studies showed similar clinical improvements in patients with severe symptoms of COVID-19 regardless of whether they received 5 or 10 days of treatment.

The ability to shorten duration for severely ill patients is very important. It means patients can go home earlier, hospital resources can be freed up and it has a positive impact, of course, on our supply. We have calculated having 1.5 million doses by the end of May, amounting to 140,000 treatment courses at a 10-day treatment duration. The Gilead simple study suggests we may now be able to significantly increase the number of courses available with a 5-day treatment duration for certain patients. As we announced previously, we are donating our entire existing supply, frankly, because this is the right thing to do at this time and the human health need in the pandemic.

While the spotlight is centered on remdesivir, we expect Gilead will continue to focus on its HIV franchise, where revenue has been growing nicely. The company is also allowing its recent acquisition Kite Pharma to innovate and operate as its own oncology cell therapy unit. With filgotinib (rheumatoid arthritis treatment) coming this year, we think that there is still a lot of promise at Gilead. We also might expect the continued strong cash generation to facilitate more acquisitions, additional share buybacks and elevated dividend payouts. GILD shares trade at 14.8 times NTM adjusted EPS consensus projections while the recently declared dividend puts the yield at 3.4%. Our Target Price for GILD has been fine tuned to $98.

Thanks to the reporting of Q1 top- and bottom-line results that topped projections, shares of **Cummins Inc.** (CMI – $157.43) advanced more than 6% last week. Adjusted EPS came in at $3.41, versus consensus analyst estimates of $2.18. CMI's quarterly revenue of $5.01 billion was 2.5% better than forecasts. The company benefited from lower warranty costs, "less bad" sales than anticipated and better-than-expected joint venture income from India and China.

CEO Tom Linebarger explained, "We delivered strong profitability in the first quarter, supported by the commitment of our employees to serve our customers and the benefit of cost reduction actions we initiated in the second half of 2019. Amidst the unprecedented COVID-19 pandemic, the health and safety of our employees and the communities in which we operate is our top priority. Our teams are working hard to support the global economy, leveraging our flexibility and strong supplier network to help our customers deliver essential products and support response efforts. Given the significant impact the pandemic will have on demand across our industry in the second quarter and beyond, we are continuing to take actions to reduce cost and boost our already strong liquidity."

He continued, "During our 100-year history, we have encountered several unforeseen crises, and I am confident we will successfully navigate this one as we have done before, to emerge

stronger. Cummins enters this period of uncertainty in a position of strength with an experienced leadership team that has led through multiple cycles and a strong balance sheet. Our deep customer and supplier relationships combined with our leading positions in global markets leave us well positioned to deliver strong growth when the global economy recovers."

Additionally, CMI announced on Friday that it had entered an agreement to increase its revolver capacity by $2 billion. "The company ended the first quarter with cash, cash equivalents and marketable securities of $2 billion and committed borrowing capacity of $1.9 billion," said CFO Mark Smith. "The agreement we entered into today boosts our already strong liquidity by $2 billion."

There is no doubt that Q2 will most likely be a difficult one for Cummins given the current state of much of the world. Past the pandemic though, we continue to believe that Cummins will increasingly enjoy long-term benefits from its overseas exposure (especially via emerging economies), as its leading-edge technology in truck engines helps it gain market share. We also are constructive on management aggressively pursuing next-generation technologies, such as electrical powertrains. Our Target Price is now $185.

Shares of industrial conglomerate **3M** (MMM – $148.60) rallied nearly 5% Tuesday morning as the company released its financial results, but faded later in the week as enthusiasm for stocks waned. 3M produced $2.16 of earnings per share versus the $2.03 expected by the Street. Higher selling prices and lower material costs padded gross margins to the tune of 40 basis points, which management expects to persist throughout the remainder of the year. The company should have plenty of liquidity to meet its $1.2 billion of debt maturities this year, aided by significant cash flow from the business and $4.5 billion in cash and marketable securities on the balance sheet.

CEO Mike Roman commented, "As you know, compared to prior emergencies, COVID-19 has caused an unprecedented explosion in demand. When the virus broke out, we were able to immediately activate our surge capacity and maximize production to support the public health response. Beginning in January, 3M doubled our global output of N95 respirators to 1.1 billion per year or about 100 million per month, including 35 million per month in the U.S. We've made additional investments and are also working with the Department of Defense to double annual production, once again, to 2 billion by the end of this year, with additional capacity already beginning to come online. In the U.S., we will be producing N95 respirators at a rate of roughly 50 million per month in June, a 40% increase from current levels. We are also partnering with other companies on innovative solutions to protect those on the front lines. In collaboration with multiple sterilization companies, we have introduced new methods for hospitals to safely clean and reuse their N95 respirators. We are also working with Ford and Cummins to expand production of 3M's powered air purifying respirators, with a plan to increase capacity by tenfold within the next 60 to 90 days. Protecting people in this crisis is not just a 3M challenge, it's an industry-wide challenge."

He continued, "In this crisis, I'm especially encouraged of the benefits we are seeing from the new global operating model we rolled out at the start of this year. As part of our new model, we consolidated manufacturing, supply chain and customer operations into a seamless end-to-end enterprise operations organization. This team is enabling us to maintain strong customer service,

streamlined decision-making and adjust faster than ever to the external environment. As an example, we have reduced our production planning cycle times by 70% across our portfolio of businesses. In addition, our new corporate affairs organization has increased our collaboration with governments around the world, while enhancing our employee and community engagement. Beyond our operations, we are also executing financial actions to deliver 2020 and set us up for success in 2021 and beyond."

Robust personal protective equipment demand in the wake of COVID-19 should offer a ballast to other business segments affected negatively by the virus and is certainly a change of pace from headlines detailing MMM's PFAS troubles. Although restructuring efforts have at times tested investor patience, we appreciate the effects of actions taken to lean-out and decentralize the company's various businesses. Although share repurchases have been suspended, management conveyed the board's commitment to the dividend. Shares yield 4.0%. Our Target Price now resides at $195.

New York Community Bancorp (NYCB – $10.71) released financial results last Wednesday that beat analyst expectations ($0.20 vs $.18). Shares were up 9% for the week and have outperformed the KBW banking index by nearly 26% year-to-date. Deposits grew at an annualized rate of 4%, while net charge-offs were 0.02% of average loans, with a 20% decrease in the bank's non-performing assets. Management said that roughly 10% of its multi-family loan

portfolio had entered 4-6-month deferral agreements as an accommodation amid the current health pandemic. Like much of the country, close to 100% of office employees are working remotely, as in-store branches are temporarily closed.

Given the bank's exposure, CEO Joseph Ficalora had the following to say regarding the multi-family real estate market in New York City: "I would like to clear up some misperceptions regarding trends in the rent-regulated multifamily market in New York City. We are not a newcomer to this market. If you recall, at this point, we have been doing this type of lending for over 50 years. We have relationships with some of the largest property owners in the city, and we have very strong ties to some of the biggest commercial real estate brokers, including the largest one servicing, the New York City marketplace. We also have a — as directors, several real estate professionals who participate in this market for a living, providing us with a unique perspective on the multifamily market. Over the past week or so, there has been some discussion about the level of rent collections in our market. With our conservative view on underwriting, we closely monitor a number of trends in the multifamily market. And when things change, we reevaluate. During the month of April, we surveyed a wide gamut of our borrowers, including some of our top 20 borrowers. We broke — we spoke to brokers, and we also reached out to a number of industry experts. Based on our market intelligence, April rent collections on the rent-regulated buildings in our portfolio are estimated to be in a range of 80% to 85%. On the market rent properties, it is even higher. This is very encouraging given the impact on the New York City area given the COVID-19 pandemic. While there are still many uncertainties regarding how COVID-19 crisis will ultimately unfold, to what degree it will impact the economy over the long run, we believe that we are better positioned than most other financial institutions to navigate through it, given our strong credit culture and low operating model. While no 2 economic cycles are alike, I would impress upon you the fact that throughout various cycles, our actual loan loss experience has been much lower than the rest of the industry."

While there are definitely operating headwinds given the turmoil in NYC, we like that NYCB has a solid balance sheet and is an experienced player in its market. Long-term, we believe there will be ample opportunity for NYCB to grow its balance sheet, redeploy excess cash into higher yielding assets and continue to tighten expense controls to drive EPS growth. Shares yield 6.3%. Our Target Price is presently $14.

Despite posting what we saw as a solid Q1, shares of **Amgen** (AMGN – $230.98) ended the week down. The biotech giant reported earnings per share of $4.17 for the first quarter of 2020, beating the consensus estimate of $3.80. The company reported revenue of $6.16 billion, 11% higher than in the first quarter of 2019, and better than investor expectations. The quarterly results were driven by immunology drug Otezla (which Amgen purchased in 2019) and ongoing volume growth from cholesterol drug Repatha, osteoporosis drugs Prolia and Evenity, and biosimilars Mvasi and Kanjinti.

Despite the current environment, Amgen reaffirmed its previously issued guidance for 2020 revenue of $25.0 billion to $25.6 billion, and its previously issued guidance for adjusted earnings per share of $14.85 to $15.60.

“I am inspired by the many ways my colleagues at Amgen and others across the industry are stepping up to meet the greatest public health challenge of our lifetime,” said CEO Robert A. Bradway. “We are committed to delivering an uninterrupted supply of our medicines to patients; advancing potential new medicines to treat serious diseases, including COVID-19; making a difference in the communities where we live and work; and creating long-term value for shareholders.”

We continue to be bullish on AMGN shares and feel like we were supported by a solid Q1 and its full-year reaffirmation of its guidance. While the COVID-19 pandemic adds stiffer near-term headwinds, we like that Amgen has shifted the conversation from legacy products to its growth products and shown that its opportunistic purchases and partnerships have added value. The firm’s strong free-cash-flow generation, solid financial footing and 2.8% dividend yield are also a plus. Our Target Price for AMGN currently resides at $266.

Global agricultural concern **Archer Daniels Midland** (ADM – $35.12) saw its shares drop sharply late last week after reporting Q1 financial results. During Q1, revenue of $14.97 billion came in well below consensus expectations of $15.71 billion (definitely impacted by the COVID-19 pandemic). However, adjusted EPS for the period was $0.64, more than 16% greater than average forecasts. The quarter was driven by improved results in ag services and oilseeds, partially offset by a decline in the carbohydrate solutions segment (which includes its ethanol business).

“I’m extremely grateful to our 38,000 global colleagues, whose commitment, ingenuity and agility are powering ADM as we support the global food supply chain and provide nutrition around the world,” said CEO Juan Luciano. “Our performance is a testament to the resilience of our people, the strength of our business model, and the breadth and depth of our capabilities to fulfill customer needs, even in a market environment that is changing rapidly due to the COVID-19 pandemic. Our first priority during this extraordinary time is supporting our colleagues, and we are focused on that every single day. We’ve put into place detailed guidelines and protocols to help protect our teams and support continuity of operations, and I’m proud that we are operating around the globe with very minimal disruptions. We’ve also taken steps to bolster our already strong balance sheet and liquidity position to further enhance our ability to run our business.”

Mr. Luciano continued, “Even amid the challenge of COVID-19, the team is doing a great job advancing our important work to make ADM a better company. From improving underperforming businesses, to driving Readiness, to harvesting our investments — particularly in Nutrition — we remain committed to delivering our strategy and focusing on the business drivers under our control. There are many unknowns, and ADM isn’t immune from some of the negative effects of this pandemic, but we are confident in the ability of our great team to shift to whatever our customers need, and continue to deliver nutrition around the globe.”

We continue to like the longer-term global secular growth trends in agriculture, and we think that ADM’s scale gives it advantages over regional competitors. We also note that the company continues to work to strengthen its balance sheet, reshape its portfolio and return cash to shareholders. ADM currently yields 4.1%. Our Target Price is now $55.

Shares of **Pfizer** (PFE – $37.64) were up ever so slightly last week on the heels of the company's Q1 financial release. Revenue for the quarter was $12.03 billion, which was about 2% better than expectations, and bottom-line results of $0.80 were almost 13% better than the consensus forecast of $0.71. Management said that while the rate of new prescriptions for some products was down, and vaccination rates slowed, those headwinds were and would be somewhat offset in part by patients taking out larger prescription refills to stock up for the COVID-19 stay-in-place mandates. PFE also saw increased demand for some products, which it said may be attributable to doctors prescribing them to treat COVID-19 or related conditions.

CEO Dr. Albert Bourla stated, "Our strong performance in the first quarter highlights the resiliency of our business even during the most challenging times. The Biopharma business grew 12% operationally, driven by strong performances from many key brands. Upjohn faced two expected headwinds this quarter — generic competition for Lyrica in the U.S. and the nationwide expansion of the VBP program in China — while continuing to progress toward a successful close of our transaction with Mylan, now expected in the second half of 2020."

CFO Frank D'Amelio added, "Today we reaffirmed our 2020 financial guidance for revenues and Adjusted diluted EPS and updated certain other guidance components primarily to reflect actual and anticipated impacts from the COVID-19 pandemic. Importantly, our guidance for total company revenues absorbs a $0.6 billion unfavorable impact from changes in foreign exchange rates since mid-January 2020. Likewise, our guidance for Adjusted diluted EPS absorbs a $0.04 impact from unfavorable foreign exchange. The decrease in our guidance for Adjusted SI&A expenses reflects incremental cost-savings opportunities, as well as actual and anticipated COVID-19- related spending reductions. These actual and projected Adjusted SI&A expense reductions were offset by an increase in our guidance for Adjusted R&D expenses, which now includes anticipated incremental investments to develop potential therapies and a potential vaccine to combat COVID-19. While our near-term outlook has greater macroeconomic uncertainty than usual due to COVID-19, we are confident that the long-term outlook for our businesses remains solid."

Mr. D'Amelio concluded, "Despite the impact of COVID-19, 2020 is still expected to be a transformational year for Pfizer. Following the pending close of the Upjohn-Mylan transaction, New Pfizer will be positioned to deliver revenue and Adjusted diluted EPS growth that is expected to be among the industry leaders. New Pfizer will be a smaller, science based company with a singular focus on innovation while also continuing to allocate significant capital directly to shareholders, primarily through dividends."

Key Takeaways

- Delivered a strong start to 2020, including 12% operational revenue growth from our Biopharma business, despite the challenges of operating in the midst of the current global health crisis
  - All of our manufacturing facilities around the world are operational and product supply has not been significantly impacted to date
- Reaffirmed financial guidance ranges for Revenues and Adjusted Diluted EPS[1], absorbing unfavorable FX changes
- Key product and pipeline milestones achieved since our previous quarterly update
  - FDA approved Braftovi in combination with cetuximab for the treatment of adult patients with metastatic colorectal cancer with a $BRAF^{V600E}$ mutation, as detected by an FDA-approved test, after prior therapy
  - EC approved Vyndaqel, a 61 mg once-daily oral capsule, for the treatment of wild-type or hereditary ATTR-Cardiomyopathy
  - FDA accepted for review a BLA for tanezumab to treat patients with chronic pain due to moderate-to-severe osteoarthritis
  - Announced final overall survival results from the PROSPER trial of Xtandi in men with non-metastatic CRPC, demonstrating a significant improvement in patients treated with Xtandi plus androgen deprivation therapy (ADT) versus placebo plus ADT
  - Announced positive top-line results from the Phase 3 JADE COMPARE study of abrocitinib (JAK1 inhibitor) in adults with moderate-to-severe atopic dermatitis
  - Announced Phase 3 top-line results for PCV20 in adults age 18 or older not previously vaccinated against pneumococcal disease
- Paid $2.1 billion in dividends to shareholders in Q1 2020

We Remain Committed to Delivering Attractive Shareholder Returns in 2020 and Beyond

(1) See Slide 18 for definitions and Slide 19 for additional information regarding Pfizer's 2020 financial guidance

Breakthroughs that change patients' lives 16

While the UpJohn divestiture creates understandable questions for investors, we still believe that the market under-appreciates the New Pfizer's emerging pipeline of products and management's increasing confidence in its organic growth potential. We also like that during these unprecedented times, the company generates solid free cash flow. With a yield of 4.0%, our Target Price for PFE has been bumped up to $46.

Search engine and internet technology leader **Alphabet** (GOOG – $320.61) earned $11.63 per share in fiscal Q1 2020 (vs. $13.97 est.). GOOG had sales of $33.7 billion (vs. $32.6 billion est.). Shares climbed 8.9% following the announcement and finished the volatile trading week up 3.2%.

CEO Sundar Pichai explained, "Q1 was, in many ways, the tale of 2 quarters. For our advertising business, the first 2 months of the quarter were strong. In March, we experienced a significant and sudden slowdown in ad revenues. The timing of the slowdown correlated to the locations and sectors impacted by the virus and related shutdown orders. As the impact of COVID-19 came into view, we delayed some ad launches and prioritized supporting our customers as many adjusted their strategies. We are focused on products where we can help most advertisers and merchants during the crisis. For example, under our new leader of commerce, Bill Ready, last week, we announced that merchants can list products in Google Shopping for free. It's been

widely rolled out in the U.S., with more countries to come, and the response has been positive. Overall, recovery in ad spend will depend on a return to economic activity."

Mr. Pinchai continued, "For the rest of the year, we are taking a long view and continuing to invest in our long-term priorities but are being thoughtful in the short term. We made the decision to slow down the pace of hiring for the remainder of 2020, while maintaining momentum in a small number of strategic areas. We are also recalibrating the focus and pace of our investments in areas like data centers and machines and nonbusiness essential, marketing and travel. We'll also continue to thoughtfully manage our Other Bets portfolio. Waymo raised $2.25 billion in its first external investment round, a terrific validation of their technology and long-term business model. Wing saw a surge in deliveries and new users, increasing its daily volume fivefold with great momentum in test programs in Australia and Virginia."

CFO Ruth Porat added, "We remain optimistic about the underlying strength of our business over the long term. On a daily basis, our products play an important role for consumers and businesses globally. This has been evident throughout the crisis. We're humbled that users continue to turn to us as much as they do at a time of global need and uncertainty. We take that responsibility very seriously. Users clearly are depending on us to provide useful and accurate information. They are looking to YouTube for information, education and entertainment constantly as they study, create and work from home. They are using our G Suite products to collaboratively communicate, connect and work. Although users may not be focused as much on purely commercial activities right now, over the long term, the value we provide to billions of users globally serves us well. Our previous investments in technical infrastructure ensure that we have the capacity and resilience to meet the increased demand from our users in this extraordinary time. We are redoubling our efforts to help our advertising customers and partners by sharing insights and developing new tools to keep them connected to their customers and help them be best positioned for recovery."

Total cost of revenue and traffic acquisition costs (TAC) were up 19% year-over-year, with costs associated with the company's data centers and content acquisition driving the increase. Shares of Alphabet are down about 1% this year, having risen strongly from the low of $1054 on March 23. Google, like many IT companies, stands to benefit substantially from the shift to remote work and by increased viewing of YouTube. However, the company's sizable exposure to advertising–historically a major strength–is likely to adversely impact results in the nearer term. We think the long term for Alphabet remains bright, and while the company's valuation is on the expensive end (including a forward P/E near 30), we believe the terrific balance sheet ($100 billion in net cash or $145 per share) and great opportunity ahead make it an attractive holding. While Alphabet still doesn't pay a dividend, we see the ongoing share buyback as a near-equal. Our Target Price has been raised to $1,670.

Semiconductor firm **Qualcomm** (QCOM – $75.64) earned $0.88 per share in Q2 2020 (vs. $0.78 est.). QCOM had sales of $5.2 billion (vs. $5.0 billion est.). Since the release, shares fell 4.2% amid a broader market decline on Friday, but still managed to finish the week nearly flat.

CEO Steve Mollenkopf commented, "The global stay-at-home orders highlight the critical role that broadband has played in facilitating remote workforce, distance learning, entertainment,

telemedicine, communications and many other things. With billions of people around the world using Qualcomm technology, our mission to invent and commercialize breakthrough wireless technologies, like 5G, has been reinforced and amplified. In Q2, we transitioned to a totally different working environment with the safety of our employees as our highest priority. As a result of the many operational changes we have made over the last several years, we were able to respond quickly when the work-from-home orders began in mid-March with minimal disruption to our operations. Importantly, we were able to limit our on-site essential workforce to a very small number and remain on schedule with our product commitments. From an engineering and operations perspective, we have maintained very high levels of productivity. We continue to advance the 5G road map and support customers while meeting a very complex set of R&D and supply chain requirements. We have also implemented remote access to labs, transition to cloud-based collaboration, and enabled remote device testing without the need for physical access. We were also able to mitigate the COVID-19 impact to our global supply chain."

Mr. Mollenkopf continued, "Despite the challenging environment, where in Q2, we estimate the overall handset market was down approximately 21%, our Q2 non-GAAP earnings of $0.88 per share was at the midpoint of our guidance range we gave in early February, in the early stages of the pandemic. Our QCT growth drivers of 5G design wins, along with higher share of dollar content, are very much intact, as you can see in our revenue per MSM, and as virtually all our 5G design wins continue to be powered by our RF front end solutions. Turning to the handset market. Fiscal Q2 China demand saw a sharp decrease, coinciding with COVID-19 restrictions followed by month-over-month growth as restrictions subsided. This provides a basis to model rest of world handset demand trends. As I mentioned earlier, the overall handset market was down approximately 21% in the March quarter, principally, from the China impact. In the June quarter, we estimate the overall handset market to be down approximately 30%, driven by the impact of shutdowns in the rest of the world, while benefiting from the rebound we are seeing in China. Total demand will depend on the speed of the economic recovery. However, we see no change in our calendar year 2020 5G smartphone forecast."

CFO Akash Palkhiwala said, "We returned approximately $2.3 billion to stockholders during the second fiscal quarter, including $705 million in dividends and $1.6 billion in stock repurchases. Additionally, we announced a 5% increase to our quarterly dividend to $0.65 per share. Given the current economic landscape, we have performed scenario planning with a focus on liquidity, and we will continue to evaluate our cash flow and capital policy as the situation evolves. In these challenging times, we are glad to have a strong balance sheet, liquidity position and debt rating."

Qualcomm expects Q3 revenue to come in between $4.4 billion and $5.2 billion, with adjusted EPS between $0.60 and $0.80. The company also expects minor delays in 5G deployment in a handful of regions, but generally the 5G adoption should continue on schedule. We have plenty of exposure to coronavirus-impacted businesses in our broadly diversified portfolios, so we appreciate the balancing effect QCOM has had. The shares have still tumbled this year, which makes the price more attractive to us, as the forward P/E ratio is now 17. Given the lack of 5G headwinds, analysts forecast fiscal '21 EPS to be near $5.79, while fiscal '22 should grow to $6.40, resulting in an inexpensive two-year-out P/E below 12. Our Target Price for QCOM has been increased to $103. QCOM shares yield 3.4%.

Juniper Networks (JNPR – $21.82), a provider of internet infrastructure, earned $0.23 per share in fiscal Q1 2020 (vs. $0.24 est.). JNPR had revenue of $998.0 million, versus the $1.004 billion estimate. Since the release, shares have fallen 8.9% as the COVID-19 pandemic impacted JNPR's supply chain and caused a drop in customer lead time and corresponding revenue recognition. Demand for Juniper products remained strong, growing 10% year-over-year.

CEO Rami Rahim said, "I believe we are well positioned to not only navigate the current crisis, but also to emerge a stronger player. In the meantime, we are helping to support the fight against COVID-19 by offering free secure wireless connectivity kits to pop up field hospital and getting back to the community through the Juniper Foundation, which is working to support those in need during these difficult times."

Mr. Rahim continued, "Based on our Q1 results and recent orders, we still expect to modestly grow our Cloud business in 2020. We maintain strong durable franchises at each of our hyperscale customers and should be well positioned to benefit from the capacity growth in use cases we own. We continue to remain optimistic regarding our potential to win net new hyperscale use cases during the 400-gig cycle. We are in the process of working through customer qualification and believe we have delivered the software systems and silicon needed to gain share within the opportunities we are targeting. While we are ready to meet our customers' requirements, we do anticipate some risk to 400-gig time line in light of the current COVID-19 challenges, which may slow testing and cause some customers to focus more on scaling existing footprint and less on deployment of new network architectures. While our Service Provider business declined 14% year-over-year during Q1, this business was most heavily impacted by COVID-19-related supply chain challenges."

CFO Ken Miller added, "While we are seeing uncertainty in our business due to the COVID-19 pandemic, we expect to see sequential revenue and earnings growth in the second quarter. Confidence in our forecast is driven by strong backlog and healthy momentum with our Service Provider and Cloud customers. We believe these factors should help offset increased uncertainty in certain segments of the Enterprise market. Due to the uncertain macro environment, we have widened our revenue range for the second quarter. We expect non-GAAP gross margin to be essentially flat sequentially relative to the first quarter. We expect to see sequential volume-driven improvements in margins during the June quarter to be offset by certain strategic insertion opportunities in addition to increased logistics and other supply chain-related costs due to the COVID-19 pandemic."

While JNPR announced that it will pay Q2's $0.20 quarterly dividend, the company will also "remain opportunistic with respect to share buybacks" and "place a greater emphasis on building liquidity." We understand that to mean that share buybacks are effectively paused, while Juniper shores up its finances. The company has $55 million of net cash on its balance sheet and $500 million available on debt that matures in 2024. Cloud customers continue to be of chief importance to JNPR, as the restructuring of the sales force is a move we view positively despite the initial cost. JNPR trades with a forward P/E less than 14 and yields a rich (for a tech stock) 3.7%. Our Target Price is $34.

Computing giant **Microsoft** (MSFT – $174.57) earned $1.40 per share in fiscal Q3 2020 (vs. $1.28 est.). MSFT had sales of $35.0 billion (vs. $33.7 billion est.). Shares climbed 1% following the announcement, but were flat for the week overall despite the bumpy trading.

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THE PRUDENT SPECULATOR
MSFT – Spectacular Quarter

Q3 Financial Summary

FY20 Q3	(billions, except per share, GM % and OI %)	Growth	CC growth*
Productivity and Business Processes	$11.7	15%	16%
Intelligent Cloud	$12.3	27%	29%
More Personal Computing	$11.0	3%	4%
Revenue	$35.0	15%	16%
Gross margin	$24.0	18%	20%
Gross margin percentage	69%	2 pts	
Operating income	$13.0	25%	28%
Operating income percentage	37%	3 pts	
Net income	$10.8	22%	26%
Diluted earnings per share	$1.40	23%	27%

** See Appendix for reconciliation of GAAP and non-GAAP measures, including constant currency ("CC").*
All growth comparisons in this presentation relate to corresponding period of last fiscal year unless otherwise noted. Numbers may not foot due to rounding.

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Microsoft CEO Satya Nadella commented, "We delivered double-digit top line and bottom line growth once again this quarter, driven by the strength of our commercial cloud. As COVID-19 impacts every aspect of our work and life, we have seen 2 years' worth of digital transformation in 2 months. From remote teamwork and learning to sales and customer service to critical cloud infrastructure and security, we are working alongside customers every day to help them stay open for business in a world of remote everything. There is both immediate surge demand and systemic structural changes across all of our solution areas that will define the way we live and work going forward. Our diverse portfolio, durable business models and differentiated technology stack across the cloud and the edge position us well for what's ahead."

CFO Amy Hood offered the outlook, "We expect COGS of $11.55 billion to $11.75 billion and operating expense of $11.8 billion to $11.9 billion. Other income and expense should be negative $100 million as interest expense is expected to more than offset interest income. And finally, we expect our Q4 effective tax rate to be approximately 18%, slightly higher than our full year tax rate of 17% due to the geographic mix of the revenue. Our focus remains on strategically managing the company for the long term, with decisions optimized for delivering greater

customer value and long-term financial growth and profitability. With that, we will continue to provide increased support to our customers and partners as they navigate the uncertain future ahead, deepening our engagement and adding increased value. We will continue to aggressively expand our cloud infrastructure to support not only the usage surges of today but the growing customer demand for our unique and differentiated cloud offerings in the future. We will continue to make significant investments against the strategic growth opportunities Satya outlined, organically and through strategic acquisitions like that of Affirmed Networks this quarter. And we have the flexibility given our strong financial position and free cash flow generation to do all of this and support our commitment to capital return."

MSFT returned $9.9 billion to shareholders via dividends and share repurchases in fiscal Q3, a 33% increase year-over-year. Including dividends, shares have gained more than 10% since the end of 2019, a big gain when the major indexes are well into negative territory. While some of Microsoft's revenue is likely to be temporary, a result of companies scrambling to setup remote workforces, we think that the majority will be permanent. Offices will surely open again in the future and life will return to quasi-normal, however, some of the benefits of working remotely and geographically spreading out a workforce for risk management seem like worthwhile improvements that will stick around. The stock sports a 3.3% free cash flow yield and a 1.1% dividend yield, to go along with significant growth potential, though the shares remain a little pricey with a forward P/E ratio of 29. Of course, analysts still expect the company's EPS growth rate to be at least 10% for each of the next three fiscal years, with earnings growing from $3.88 in 2018 to an estimated $7.10 in fiscal 2022. We are keeping an eye on MSFT for another possible trim, especially as the position remains relatively large in our portfolios, but for the time being our Target Price has been boosted again, this time to $196.

Technology hardware designer and manufacturer **Apple** (AAPL – $289.07) posted earnings per share of $2.55, versus the $2.26 estimate in Q2 2020. AAPL had sales of $58.3 billion (vs. $54.2 billion est.). Shares slid 1.6% following the announcement, though they traded as high as $299.00 and as low as $285.85 in Friday's trading session.

CEO Tim Cook said, "I want to speak just for a bit on COVID-19. This is something Apple has been contending with since January, and I think that how we have responded, what we have been inspired to do tells an important story about Apple's great durability as a business and the enduring importance of our products in our customers' lives. It also speaks to Apple's unmatched capacity to be creative, to think always in terms of the long term and to forge ahead when others may feel an instinct to pull back. Before COVID-19 was on the horizon, we anticipated that Q2 was going to be a prolific and energetic period for Apple. And when the pandemic did strike, our teams not only succeeded in growing the business, in introducing powerful new products and in meeting our customers' needs, but they also rose to the occasion in terms of meeting our broader obligations to the communities in which we live and work."

Mr. Cook continued, "When you consider all the ways COVID-19 has touched Apple, our customers and the way we work, this may not have been the quarter it could have been absent this pandemic, but I don't think I can recall a quarter where I've been prouder of what we do or how we do it. As I said at the outset, we achieved revenue of $58.3 billion, and underneath that was product revenue of $45 billion. The performance of our product business had 3 very

different phases during the March quarter. Based on Apple's performance during the first 5 weeks of the quarter, we were confident we were headed toward a record second quarter at the very high end of our expectations. In the next 5 weeks of the quarter, as COVID-19 started impacting China, iPhone supply was temporarily affected as well as demand for our products within China. This caused us to withdraw our revenue guidance in February. At that point, demand for our products outside of China was still strong and in line with our expectations. During the last 3 weeks of the quarter, as the virus spread globally and social distancing measures were put in place worldwide, including the closure of all our retail stores outside of Greater China on March 13 and many channel partner points of sales around the world, we saw downward pressure on demand, particularly for iPhone and Wearables."

Mr. Cook concluded, "Given the lack of visibility and certainty in the near term, we will not be issuing guidance for the coming quarter. Over the long term though, we have a high degree of confidence in the enduring strength of our business. Our global supply chain is profoundly durable and resilient. We have shown the consistent ability to meet and manage temporary supply challenges like those caused by COVID-19… So while we can't say for sure how many chapters are in this book, we can have confidence that the ending will be a good one. Apple will continue to do everything we can do to help the global response and to keep our customers learning, creating, sharing and connecting so that life can remain as normal as it can during this challenging time."

Arguably one of its best-timed launches, Apple released the next generation of the iPhone SE, an affordable and powerful iPhone that has some parts from each of its great iPhones and its packaged together at a more-affordable price point starting at $349. While FaceTime is a big hit in a quarantined world, it does not have the monetary upside that software like Zoom or Microsoft Teams has. That's certainly not the end of the world, though, as we think Apple's ecosystem as a whole is tremendously valuable, rather than individual components. Apple's 2020 earnings estimates have been whacked by analysts from $14.00 on January 31 to $12.40. Still, we think that Apple continues to earn its spot as a core holding in our broadly diversified portfolios and we have raised our Target Price to $336. Shares yield 1.1%, with the payout having been boosted this year from $0.77 to $0.82 quarterly.