Market Commentary Monday, June 29, 2020

June 29, 2020

EXECUTIVE SUMMARY

Newsletter Trades – Sold DBI & CM
July Newsletter – TPS 645 Coming on Friday
Week in Review – Lousy Five Days
COVID-19 – Spike in Cases, but Likely Massive Drop in Mortality Rates
Econ Outlook – Awful First Half of 2020, but Green Shoots Have Sprouted
Equity Disconnect – Future is Unknowable, but Average Stock and Interest Rates Down Significantly in 2020
Sentiment – Hardly Any Enthusiasm for Stocks
Stock News – Updates on MSFT, AAPL, INTC and Bank Stocks

Market Review

A little housekeeping before this week's missive. As indicated on our June 19, 2020, *Sales Alert*, and waiting our usual two trading days to transact, we sold 1,250 shares of **Designer Brands** (DBI – $5.97) held in TPS Portfolio at $6.713 on June 23. We will use that same price to close out the Designer Brands positions held in our hypothetical Millennium Portfolio (592 shares) and PruFolio (977 shares).

As indicated on our June 22, 2020, *Sales Alert*, and also waiting our usual two trading days to transact, we sold 343 and 64 shares of **Canadian Imperial Bank of Commerce** (CM – $65.75) respectively held in TPS Portfolio and Buckingham Portfolio at $68.6549 on June 24. We will use that same price to close out the Canadian Imperial positions held in our hypothetical Millennium Portfolio (117 shares) and PruFolio (248 shares).

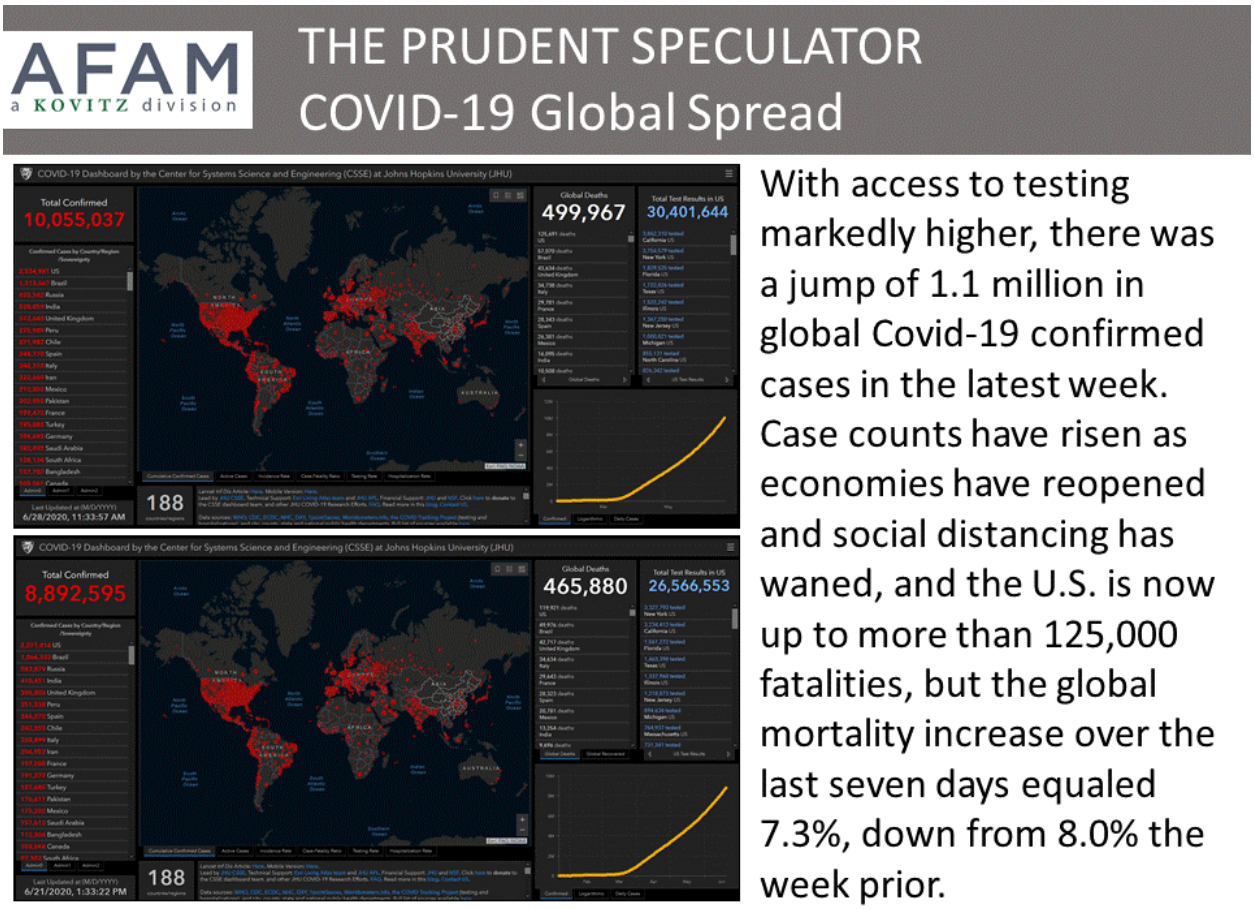
While we will be posting updated Target Prices to theprudentspeculator.com later this week, work will soon be underway on the July edition of *The Prudent Speculator*. This month, in addition to at least two first-time recommendations, we plan to offer our semiannual Sector and Industry Group Weightings and Value vs. Growth Sector Attribution. If all goes according to plan, we expect to email *TPS 645* by Friday afternoon, July 3.

With two days in which the Dow Jones Industrial Average skidded more than 700 points, it was not exactly a great week for equities in general and undervalued stocks in particular. Indeed, while the Dow dropped "only" 3.31% over the five days, the Russell 3000 Value index fell 4.16% on a total return basis and the S&P 500 Pure Value index sank by 5.74%.

Alas, the cause of the selling was a spike in coronavirus cases in the U.S., with *The New York Times* writing in its Saturday edition, "For the first time, some governors are backtracking on reopening their states, issuing new restrictions for parts of the economy that had resumed."

Those states included populous Texas and Florida, while California Governor Gavin Newsom closed bars on Sunday in seven counties, including Los Angeles.

To be sure, health concerns remain front and center, as the global COVID-19 death toll is now at 500,000, with the case count at 10 million, of which 2.5 million are in the U.S., but the increase in mortality has slowed, for the time being at least,…



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

…while the average age of those recently diagnosed has fallen considerably, which would seem to bode well for bringing down the overall fatality rate, given that older folks have had the worst outcomes. And, if new information out last week from the U.S. Centers for Disease Control and Prevention (CDC) is accurate, the suggestion that 25 million people (10 times the 2.5 million that have been diagnosed thus far) in the U.S. are either currently infected or have recovered,…

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THE PRUDENT SPECULATOR
CDC: 10 Times More Have Antibodies

National Center for Health Statistics First 21-Weeks-of-the Year U.S. Mortality Statistics

Year	Total Deaths	Year-over-Year Change	Versus 7-Year Average
2014	1,086,332		92%
2015	1,145,998	5.5%	97%
2016	1,132,713	-1.2%	96%
2017	1,180,936	4.3%	100%
2018	1,207,187	2.2%	103%
2019	1,188,611	-1.5%	101%
2020	1,301,187	9.5%	110%

Source: National Center for Health Statistics (NCHS) mortality surveillance data.

In a press briefing on June 25, Dr. Robert Redfield, director of the U.S. Centers for Disease Control and Prevention (CDC), said that ***the current official count of COVID-19 cases in the U.S. may actually be a drastic underestimate****.*

Redfield said the new, much-higher estimate, is based on growing data from antibody testing, which picks up the presence of immune cells that react to SARS-CoV-2, the virus that causes COVID-19. ***People will test positive for antibodies to the virus if they have been infected—whether or not they ever got sick or even developed symptoms****.*

*Previously, testing was focused only on those with symptoms. But because so many who become infected with SARS-CoV-2 could either have mild disease or not know they were infected at all, Redfield said, current information on the burden of cases is an underestimate. "The traditional approach of looking for symptomatic illness, and diagnoses obviously under estimated the total number of infections," Redfield said. "****Now that serology tests are available, which test for antibodies, the estimates we have right now show about 10 times more people have antibodies in the jurisdictions tested than had documented infections****."*

That fact may also be contributing to the recent downward trend in the average age of people being diagnosed, since, as Redfield noted, those people were likely not being diagnosed in the past—younger people are less likely to experience the severe symptoms that bring them to the attention of the health care system, where the early cases were documented. ***Now that testing is more widely available in the community, it's becoming clear that more people are currently infected or have recovered from COVID-19 than was previously believed****.*

Time.com, June 25, 2020

…might be construed as good news in that the fatality rate would be far lower than initially feared, even as none of us would likely look favorably on a 0.5% chance (125,000 divided by 25 million) of dying. Of course, the statistics show that 0.7% of Americans die each year of all causes.

THE PRUDENT SPECULATOR
Death is an Unfortunate Fact of Life

Certainly, the 179,000 American deaths from COVID-19 through October 1, 2020, that is now expected by the Institute for Health Metrics and Evaluation could be much worse as economies reopen and stay-at-home edicts are rescinded, but that mortality count would be #3 on the rankings of the leading cause of death each year in the United States.

Data table for Figure 2. Number of deaths, percentage of total deaths, and age-adjusted death rates for all causes and the 10 leading causes of death in 2018: United States, 2017 and 2018

Rank[1]	Cause of death (based on *International Classification of Diseases, 10th Revision* [ICD–10])		2017 Number	2017 Percent	2017 Rate[2]	2018 Number	2018 Percent	2018 Rate[2]
…	All causes		2,813,503	100.0	731.9	2,839,205	100.0	723.6
1	Diseases of heart	(I00–I09,I11,I13,I20–I51)	647,457	23.0	165.0	655,381	23.1	163.6
2	Malignant neoplasms	(C00–C97)	599,108	21.3	152.5	599,274	21.1	149.1
3	Accidents (unintentional injuries)	(V01–X59,Y85–Y86)	169,936	6.0	49.4	167,127	5.9	48.0
4	Chronic lower respiratory diseases	(J40–J47)	160,201	5.7	40.9	159,486	5.6	39.7
5	Cerebrovascular diseases	(I60–I69)	146,383	5.2	37.6	147,810	5.2	37.1
6	Alzheimer disease	(G30)	121,404	4.3	31.0	122,019	4.3	30.5
7	Diabetes mellitus	(E10–E14)	83,564	3.0	21.5	84,946	3.0	21.4
8	Influenza and pneumonia	(J09–J18)	55,672	2.0	14.3	59,120	2.1	14.9
9	Nephritis, nephrotic syndrome and nephrosis	(N00–N07,N17–N19,N25–N27)	50,633	1.8	13.0	51,386	1.8	12.9
10	Intentional self-harm (suicide)	(*U03,X60–X84,Y87.0)	47,173	1.7	14.0	48,344	1.7	14.2
…	All other causes	(residual)	731,972	26.0	…	744,312	26.2	…

… Category not applicable.
* Code not included in ICD–10.
[1]Based on number of deaths.
[2]Deaths per 100,000 U.S. standard population.
SOURCE: NCHS, National Vital Statistics System, Mortality.

Data Brief 355. Mortality in the United States, 2018

Obviously, wealth takes a back seat to health, and we respect that the outlook for global and domestic economic growth this year is awful, but even the relatively pessimistic forecasts out last week from the International Monetary Fund call for a significant rebound in GDP in 2021,…

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THE PRUDENT SPECULATOR
IMF: Huge Downward GDP Revision

Latest World Economic Outlook Growth Projections

(real GDP, annual percent change)	2019	PROJECTIONS 2020	2021
World Output	**2.9**	**-4.9**	**5.4**
Advanced Economies	**1.7**	**-8.0**	**4.8**
United States	2.3	-8.0	4.5
Euro Area	1.3	-10.2	6.0
Germany	0.6	-7.8	5.4
France	1.5	-12.5	7.3
Italy	0.3	-12.8	6.3
Spain	2.0	-12.8	6.3
Japan	0.7	-5.8	2.4
United Kingdom	1.4	-10.2	6.3
Canada	1.7	-8.4	4.9
Other Advanced Economies	1.7	-4.8	4.2
Emerging Markets and Developing Economies	**3.7**	**-3.0**	**5.9**
Emerging and Developing Asia	5.5	-0.8	7.4
China	6.1	1.0	8.2
India	4.2	-4.5	6.0
ASEAN-5	4.9	-2.0	6.2
Emerging and Developing Europe	2.1	-5.8	4.3
Russia	1.3	-6.6	4.1
Latin America and the Caribbean	0.1	-9.4	3.7
Brazil	1.1	-9.1	3.6
Mexico	-0.3	-10.5	3.3
Middle East and Central Asia	1.0	-4.7	3.3
Saudi Arabia	0.3	-6.8	3.1
Sub-Saharan Africa	3.1	-3.2	3.4
Nigeria	2.2	-5.4	2.6
South Africa	0.2	-8.0	3.5
Low-Income Developing Countries	5.2	-1.0	5.2

Source: IMF, *World Economic Outlook Update*, June 2020

Note: For India, data and forecasts are presented on a fiscal year basis, with FY2020/2021 starting in April 2020. India's growth is -4.9 percent in 2020 based on the calendar year.

INTERNATIONAL MONETARY FUND IMF.org

A Crisis Like No Other, An Uncertain Recovery

Global growth is projected at -4.9% in 2020, 1.9 percentage points below the April 2020 World Economic Outlook (WEO) forecast. The COVID-19 pandemic has had a more negative impact on activity in the first half of 2020 than anticipated, and the recovery is projected to be more gradual than previously forecast. In 2021 global growth is projected at 5.4%. Overall, this would leave 2021 GDP some 6½ percentage points lower than in the pre-COVID-19 projections of January 2020. The adverse impact on low-income households is particularly acute, imperiling the significant progress made in reducing extreme poverty in the world since the 1990s.

As with the April 2020 WEO projections, there is a higher-than-usual degree of uncertainty around this forecast. The baseline projection rests on key assumptions about the fallout from the pandemic. In economies with declining infection rates, the slower recovery path in the updated forecast reflects persistent social distancing into the second half of 2020; greater scarring (damage to supply potential) from the larger-than-anticipated hit to activity during the lockdown in the first and second quarters of 2020; and a hit to productivity as surviving businesses ramp up necessary workplace safety and hygiene practices. For economies struggling to control infection rates, a lengthier lockdown will inflict an additional toll on activity. Moreover, the forecast assumes that financial conditions—which have eased following the release of the April 2020 WEO—will remain broadly at current levels. Alternative outcomes to those in the baseline are clearly possible, and not just because of how the pandemic is evolving.

International Monetary Fund – June 2020

…while there have been more than a few green shoots in the U.S., with the week just ended seeing better-than-expected data on housing…

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THE PRUDENT SPECULATOR
May Housing Data Better than Projected

Sales of new homes came in well above expectations in May, rising to a seasonally adjusted annual rate of 676,000, up 16.6% from April's downwardly revised 580,000 tally. The fact that this number is based on contract signings reflects the full COVID-19 fallout, though existing home sales skidded 9.7% in May to a seasonally adjusted annual rate of 3.91 million, but that total actually exceeded expectations.

…and a strong bounce in consumer spending,…

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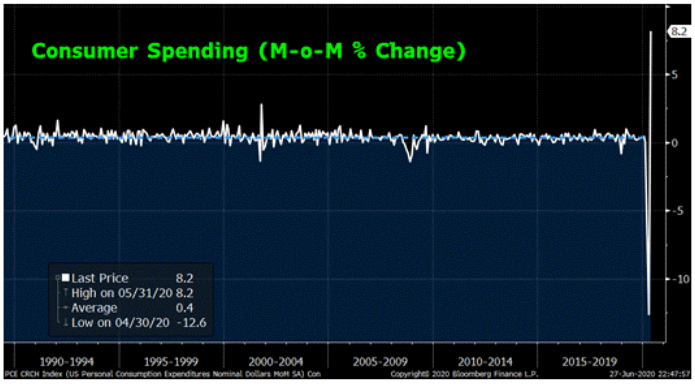
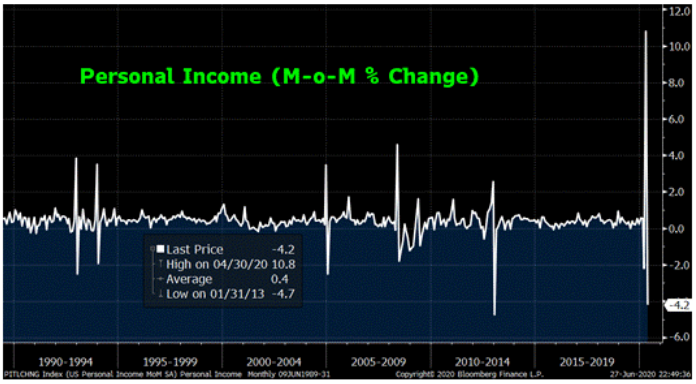
THE PRUDENT SPECULATOR
Spending Soars But Incomes Sink





Consumer spending vaulted 8.2% in May, the biggest monthly increase on record, even as personal incomes tumbled by 4.2%, following the huge advance the month prior thanks to government stimulus checks hitting bank accounts. As spending jumped and incomes fell, the savings rate pulled back to a still hefty 23% from its record-high of 33% in April, with consumers remaining cautious in opening up their pocketbooks.

…and durable goods orders.

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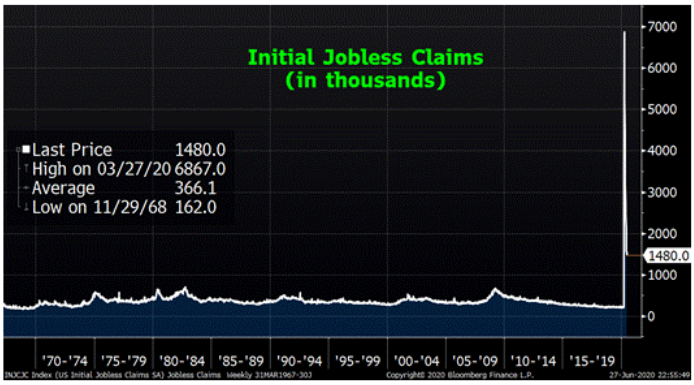
Mixed Economic Numbers



The headline number for durable goods orders in May came in well above estimates at 15.8%, one of the best monthly upturns on record dating back to 1990. Excluding volatile transportation orders, durable goods orders rose 4%. That said, first-time filings for unemployment benefits continue to be massive, with 1.48 million claims in the latest week, bringing the total for the last 14 weeks to more than 47 million.

That said, with 47 million Americans having filed for unemployment benefits since March and nearly 20 million of those still receiving traditional jobless support, we realize that we are a long way from being out of the economic dark woods, even as Lawrence Yun, chief economist for the National Association of Realtors, commented last week, “Home sales will surely rise in the upcoming months with the economy reopening, and could even surpass one-year-ago figures in the second half of the year.”

Other economists have expressed far less optimism. Case in point, data provider IHS Markit announced last week that the flash U.S. service sector purchasing managers index rose to a 4-month high of 46.7 in June from 37.5 in the previous month, and the flash manufacturing sector purchasing managers index rose to a 4-month high of 49.6 from 39.8 in May. Both numbers were well above expectations, but that didn’t impress Chris Williamson, Chief Business Economist at IHS Markit.

Mr. Williamson wrote, “The flash PMI data showed the US economic downturn abating markedly in June. The second quarter started with an alarming rate of collapse, but output and jobs are now falling at far more modest rates in both the manufacturing and service sectors. The improvement will fuel hopes that the economy can return to growth in the third quarter. However, although brief, the downturn has been fiercer than anything seen previously, leaving a deep scar which will take a long time to heal. We anticipate that the U.S. economy will contract

by just over 8% in 2020. The coming months will therefore see the focus turn to just how much recovery momentum the economy can muster to recoup this lost output."

Mr. Williamson's 2020 GDP U.S. contraction projection of 8.0% is hardly unusual, as it matches that of the International Monetary Fund, which also stated what would seem to be on the minds of many investors…or at least those who pontificate on the equity markets. The IMF said, "The extent of the recent rebound in financial market sentiment appears disconnected from shifts in underlying economic prospects—as the June 2020 Global Financial Stability Report (GFSR) Update discusses—raising the possibility that financial conditions may tighten more than assumed in the baseline."

This apparent disconnect is puzzling in our mind in that many pundits are claiming that stocks must be priced incorrectly today, given the current economic outlook, and all that is seemingly wrong with the world, yet they somehow think that they have been priced correctly every other day.

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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%	167%
Japan Tsunami	3/11/2011	1,304.28	-3%	-12%	5%	43%	55%	131%
S&P Downgrade	8/6/2011	1,199.38	4%	12%	16%	60%	82%	151%
Hurricane Sandy	10/22/2012	1,433.82	4%	9%	22%	43%	80%	110%
Fiscal Cliff	1/1/2013	1,426.19	10%	13%	30%	43%	87%	111%
Taper Tantrum	5/22/2013	1,655.35	0%	9%	14%	24%	65%	82%
Russia and Ukraine	2/20/2014	1,839.78	2%	8%	15%	28%	51%	64%
Ebola Scare	9/4/2014	1,997.65	4%	5%	-4%	24%	47%	51%
Charlie Hebdo	1/7/2015	2,025.90	2%	3%	-4%	35%	60%	49%
Greek Default	6/30/2015	2,063.11	-7%	0%	2%	32%		46%
China Devalues Yuan	8/10/2015	2,104.18	-1%	-12%	3%	35%		43%
Paris Bataclan	12/13/2015	2,012.37	0%	3%	13%	32%		50%
U.S. Interest Rate Hike	12/16/2015	2,073.07	-2%	0%	9%	25%		45%
China GDP Slowing	1/19/2016	1,881.33	12%	15%	20%	42%		60%
Brexit	6/23/2016	2,113.32	2%	7%	15%	40%		42%
Trump Victory	11/8/2016	2,139.56	7%	12%	21%	45%		41%
Price Changes Only								
Does Not Include Dividends		**Averages:**	**2%**	**5%**	**12%**	**37%**	**68%**	**78%**

Source: Kovitz Investment Group using data from Bloomberg. As of 6.26.20

No doubt, stock prices are supposed to reflect the collective wisdom on the masses, but as no one can predict what will happen in the short term,…

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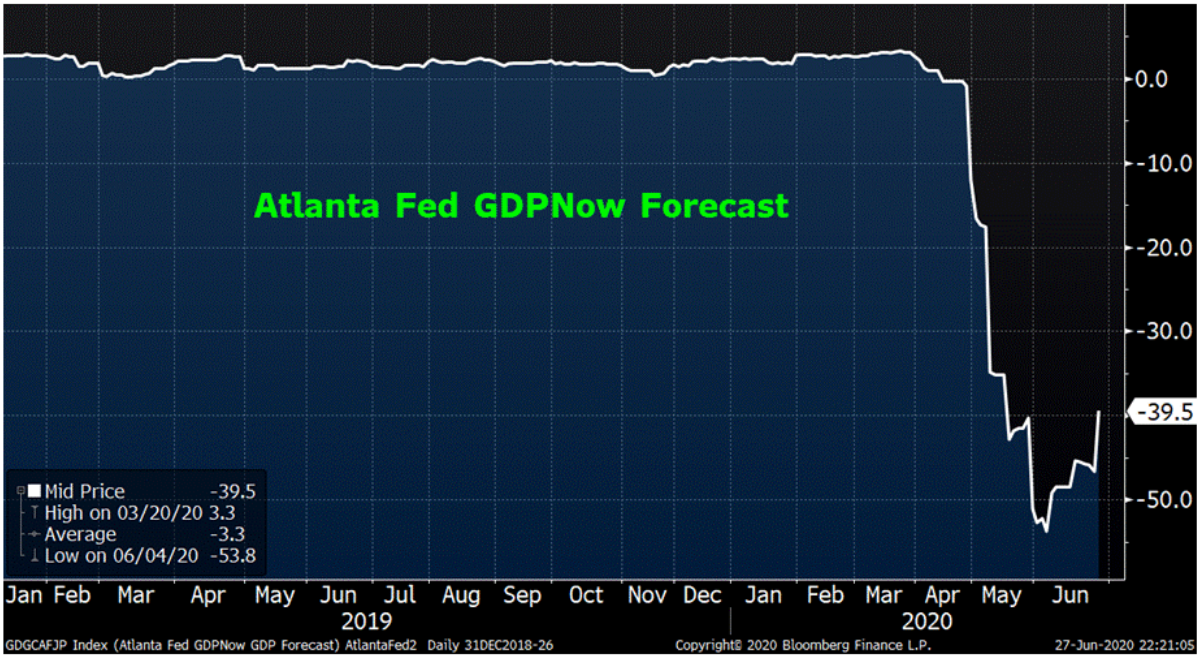
THE PRUDENT SPECULATOR
Horrible, but Improving Q2 GDP Forecast

The estimate for the contraction is unbelievably bad, with the Atlanta Fed now projecting a 39.5% drop in GDP for Q2 on an annualized basis.



…much less the long run, it is hard to challenge the assertion that equity prices can never accurately reflect the true discounted value of the underlying long-term earnings power of the corporations that make up the market.

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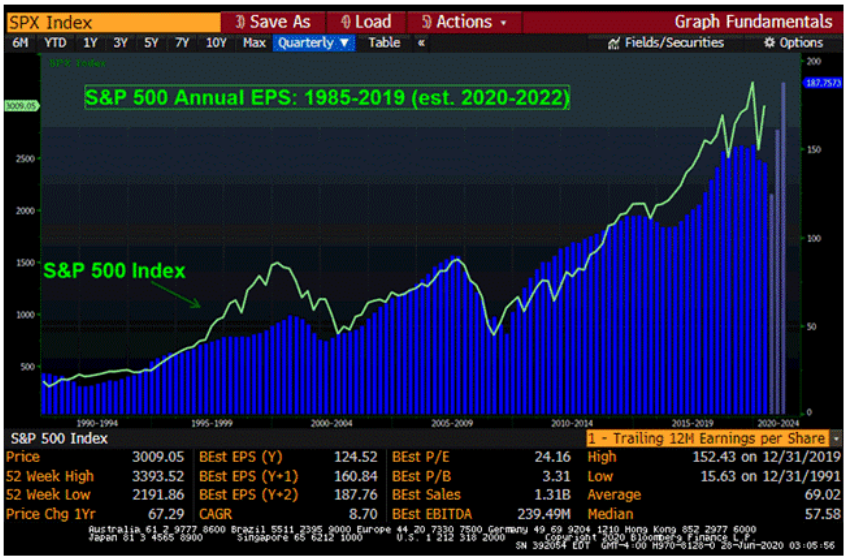
THE PRUDENT SPECULATOR
EPS to Plunge in '20 and Rebound in '21

Analysts are likely still too high in lowering their projections for COVID-19-impacted earnings this year, but it is hardly unreasonable to expect a significant rebound in corporate profits in 2021.



S&P 500 Earnings Per Share		
Quanter Ended	Bottom Up Operating EPS 3 Month	Bottom Up Operating EPS 12 Month
ESTIMATES		
12/31/2021	$44.64	$161.51
9/30/2021	$42.03	$152.75
6/30/2021	$37.99	$141.75
3/31/2021	$36.85	$126.83
12/31/2020	$35.88	$109.48
9/30/2020	$31.03	$112.78
6/30/2020	$23.07	$121.56
3/31/2020	$19.50	$138.63
ACTUAL		
12/31/2019	$39.18	$157.12
9/30/2019	$39.81	$152.97
6/30/2019	$40.14	$154.54
3/31/2019	$37.99	$153.05
12/31/2018	$35.03	$151.60
9/30/2018	$41.38	$150.42
6/30/2018	$38.65	$140.37
3/31/2018	$36.54	$132.23
12/31/2017	$33.85	$124.51
9/30/2017	$31.33	$118.56
6/30/2017	$30.51	$115.92
3/31/2017	$28.82	$111.11
12/31/2016	$27.90	$106.26

Source: Standard & Poor's. As of 6.25.20

Only in time can we know if valuations in the past were cheap or dear, but the long-term path for equity prices, happily, has been higher,…

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THE PRUDENT SPECULATOR
Volatility is Normal: Value/Divs Win Race

Selloffs, downturns, pullbacks, corrections and even Bear Markets are events that equity investors always have had to endure on their way to the best long-term performance of any of the financial asset classes.

Advancing Markets

Minimum Rise %	Average Gain	Average # Days	Count	Frequency (in Years)	Last Start	Last End
20.0%	110.8%	973	27	3.4	3/23/2020	6/8/2020
17.5%	66.4%	568	39	2.4	3/23/2020	6/8/2020
15.0%	66.2%	553	45	2.1	3/23/2020	6/8/2020
12.5%	44.1%	332	72	1.3	3/23/2020	6/8/2020
10.0%	34.7%	243	98	0.9	3/23/2020	6/8/2020
7.5%	23.6%	148	156	0.6	3/23/2020	6/8/2020
5.0%	14.7%	72	303	0.3	4/1/2020	6/8/2020

Declining Markets

Minimum Decline %	Average Loss	Average # Days	Count	Frequency (in Years)	Last Start	Last End
-20.0%	-35.4%	286	26	3.5	2/19/2020	3/23/2020
-17.5%	-30.4%	217	38	2.4	2/19/2020	3/23/2020
-15.0%	-28.4%	189	44	2.1	2/19/2020	3/23/2020
-12.5%	-22.8%	138	71	1.3	2/19/2020	3/23/2020
-10.0%	-19.6%	102	97	0.9	2/19/2020	3/23/2020
-7.5%	-15.5%	65	155	0.6	3/13/2020	3/23/2020
-5.0%	-10.9%	37	303	0.4	6/8/2020	6/11/2020

From 02.20.28 through 06.11.20. Price return series. We defined a Declining Market as an instance when stocks dropped the specified percentage or more without a recovery of equal magnitude, and an Advancing Market as in instance when stocks appreciated the specified percentage or more without a decline of equal magnitude. SOURCE: Kovitz using data from Bloomberg, Morningstar and Ibbotson Associates

LONG-TERM RETURNS

	Annualized Return	Standard Deviation
Value Stocks	12.7%	26.0%
Growth Stocks	9.4%	21.5%
Dividend Paying Stocks	10.4%	18.1%
Non-Dividend Paying Stocks	8.8%	29.4%
Long-Term Corporate Bonds	6.1%	7.6%
Long-Term Gov't Bonds	5.7%	8.6%
Intermediate Gov't Bonds	5.2%	4.4%
Treasury Bills	3.3%	0.9%
Inflation	2.9%	1.8%

From 06.30.27 through 04.30.20. Growth stocks = 50% Fama-French small growth and 50% Fama-French large growth returns rebalanced monthly. Value stocks = 50% Fama-French small value and 50% Fama-French large value returns rebalanced monthly. The portfolios are formed on Book Equity/Market Equity at the end of each June using NYSE breakpoints via Eugene F. Fama and Kenneth R. French. Dividend payers = 30% top of Fama-French dividend payers, 40% of middle Fama-French dividend payers, and 30% bottom of Fama-French dividend payers rebalanced monthly. Non-dividend payers = Fama-French stocks that do not pay a dividend. Long term corporate bonds represented by the Ibbotson Associates SBBI US LT Corp Total Return index. Long term government bonds represented by the Ibbotson Associates SBBI US LT Govt Total Return index. Intermediate term government bonds represented by the Ibbotson Associates SBBI US IT Govt Total Return index. Treasury bills represented by the Ibbotson Associates SBBI US 30 Day TBill Total Return index. Inflation represented by the Ibbotson Associates SBBI US Inflation index. SOURCE: Kovitz using data from Professors Eugene F. Fama and Kenneth R. French and Ibbotson Associates

…albeit with plenty of ups and downs along the journey.

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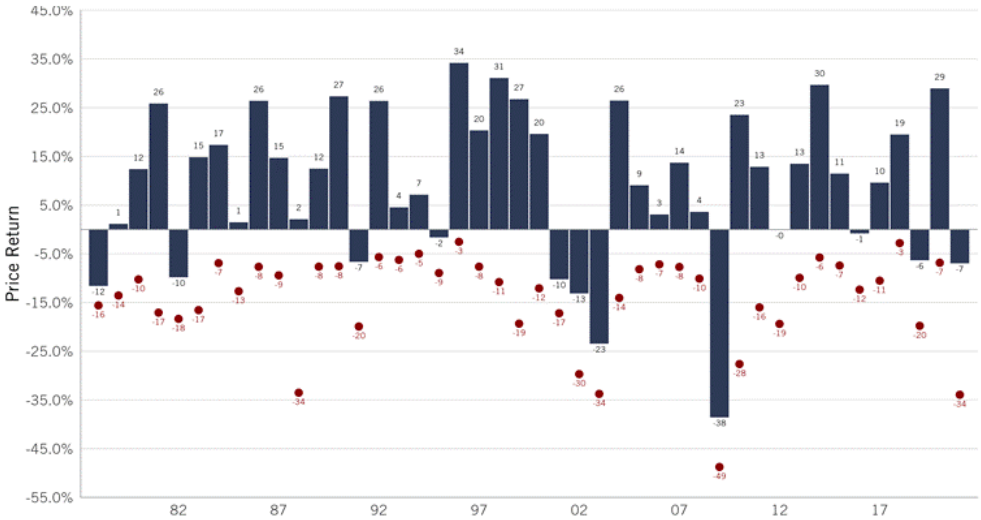
THE PRUDENT SPECULATOR
A Big Selloff Happens Almost Every Year

While the S&P 500 has enjoyed excellent long-term returns and endured a relatively small number of negative full years since the founding of *The Prudent Speculator* in 1977, there have been corrections of 10% or more in 27 of the 44 years, including a 34% one (on a closing basis) this year.



From 12.31.76 through 06.26.20. Price returns do not include dividends. Intra-year drops refer to the largest drops between high and low close prices during a calendar year. 2019 return is year to date. SOURCE: Kovitz using data from Bloomberg Finance L.P.

That said, we think the fact that the vast majority of stocks are down significantly in price since the February 19 high and for the full year,…

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THE PRUDENT SPECULATOR
Miserable Year for Most Stocks

While a handful of mega-cap Growth stocks have helped the S&P 500 and Russell 3000 indexes, most stocks are deep in the red in 2020.

Total Returns Matrix

Since 3.23.20	Since 2.19.20	Year to Date	1-Year	3-Year	5-Year	7-Year	10-Year	15-Year	20-Year	Name
6.04	2.75	2.97	4.46	11.44	19.82	18.74	32.36	68.26	148.00	Bloomberg Barclays Global-Aggregate Bond
5.05	4.06	6.14	9.10	16.07	24.23	31.89	46.23	90.53	173.82	Bloomberg Barclays US Aggregate Bond
35.39	-14.00	-11.26	-3.38	25.43	57.61	98.86	216.76	256.03	284.58	Dow Jones Industrial Average
33.20	-16.75	-15.48	-7.66	6.98	20.28	53.95	124.00	140.79	170.42	New York Stock Exchange Composite
44.41	-11.13	-6.60	3.12	20.13	32.02	90.43	208.14	248.61	172.31	Russell 2000 Growth
30.33	**-25.89**	**-27.44**	**-19.28**	**-16.49**	**-1.43**	**26.67**	**89.63**	**99.42**	**316.88**	**Russell 2000 Value**
38.06	-18.08	-16.79	-7.79	1.46	15.58	57.50	145.33	168.36	249.26	Russell 2000
42.50	-2.94	5.78	19.65	58.37	93.73	177.30	342.56	375.85	185.07	Russell 3000 Growth
29.80	**-20.14**	**-19.34**	**-10.99**	**1.10**	**17.99**	**55.34**	**145.47**	**137.59**	**227.04**	**Russell 3000 Value**
36.91	-10.95	-6.40	4.60	28.49	53.58	110.99	235.34	243.43	219.33	Russell 3000
35.18	-10.50	-5.95	5.34	30.94	58.60	116.64	244.09	245.34	206.11	S&P 500
40.14	-3.76	4.67	15.08	52.38	88.44	168.96	331.64	355.75	207.29	S&P 500 Growth
28.58	**-18.72**	**-17.96**	**-6.11**	**8.65**	**27.52**	**66.07**	**161.60**	**148.01**	**186.48**	**S&P 500 Value**
46.36	-7.13	-0.34	7.94	36.07	59.48	134.04	306.55	358.50	265.36	S&P 500 Pure Growth
36.49	**-30.67**	**-32.57**	**-25.52**	**-15.81**	**-4.36**	**34.65**	**132.95**	**145.93**	**415.48**	**S&P 500 Pure Value**
8.17	-23.50	-22.57	-15.89	4.70	25.46	55.32	114.13	218.05	389.83	Berkshire Hathaway B

As of 6.26.20. Source Kovitz using data from Bloomberg

…and that the relative appeal of equities from an income perspective has increased substantially,…

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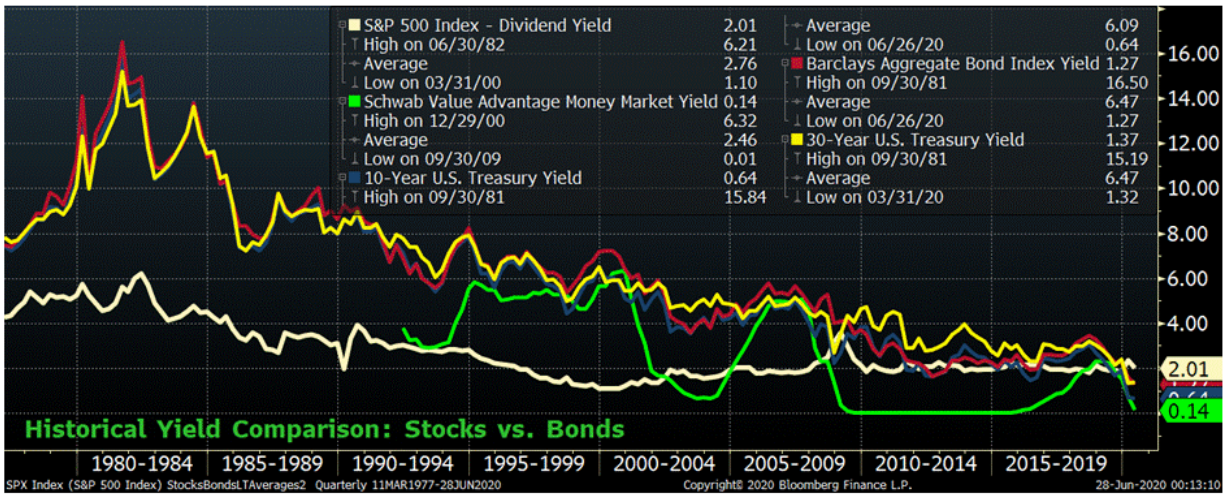
THE PRUDENT SPECULATOR
Equity vs. Fixed Income Yields

Though stocks are not necessarily a substitute for cash, government or corporate bonds, the payout on the S&P 500 (2.01%) is extraordinarily generous versus the income provided by fixed income, especially given the recent plunge in rates. Incredibly, **equities yield more than 14 times** as much today as does a prominent *Prime* money market fund (SWVXX)!



…argues strongly that the markets have priced in a good deal of near- and intermediate-term COVID-19 and economic bad news, so the view that prices are somehow disconnected from reality ignores a lot of evidence to the contrary. After all, it isn't as if money is pouring into U.S. equities, while folks are hardly jumping up and down about the market outlook for the next six months,…

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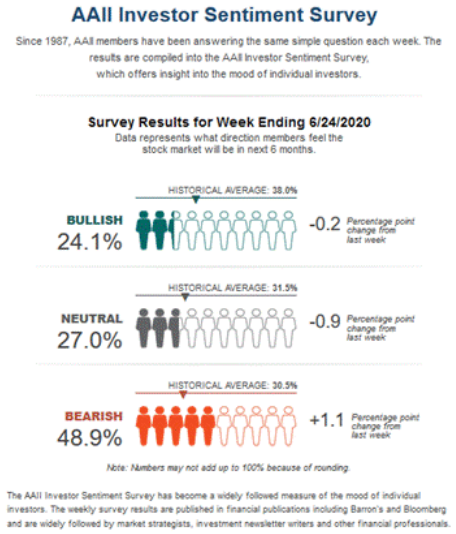
THE PRUDENT SPECULATOR
Sentiment: No Enthusiasm for Stocks

Optimism declined to its lowest level and pessimism rose to its highest level in six weeks. Bullish sentiment remains at an unusually low level and bearish sentiment remains at an unusually high level for the second consecutive week.

The love affair with bonds continues, per the latest data from ICI, but mutual and exchange traded fund investors had a one-week buying binge in U.S. stocks, right before the big 7% drop in the Dow on 6.11.20.



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

Week Ended	6/17/2020	6/10/2020	6/3/2020	5/27/2020	5/20/2020
Total Equity	-9,275	13,052	-11,138	-2,362	-13,728
Domestic	-5,939	15,883	-5,903	1,601	-8,129
World	-3,337	-2,831	-5,235	-3,963	-5,599
Hybrid	-1,999	1,998	1,253	249	-1,099
Total Bond	18,969	25,564	25,991	17,447	18,479
Taxable	16,026	21,378	22,884	15,508	16,173
Municipal	2,942	4,186	3,106	1,939	2,307
Commodities	313	197	1,527	822	1,953
Total	8,007	40,812	17,633	16,156	5,606

Source: Investment Company Institute

…which history shows is a positive for those of us with the courage to stick with our broadly diversified portfolios of what we believe to be undervalued stocks through thick and thin.

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THE PRUDENT SPECULATOR
AAII Sentiment – Contrarian Buy Signal

The modest 0.2-point drop in Bullishness and small 1.1-point bump in Bearishness for the week ending 06.25.20 put the AAII Bull-Bear Spread at -24.8, keeping the sentiment indicator in the lowest decile, which history shows offers investors the best average near-term returns!

AAII Bull-Bear Spread

Decile	Low Reading of the Range	High Reading of the Range	Count	R3K Next 1-Week Arithmetic Average TR	R3K Next 1-Week Geometric Average TR	R3K Next 1-Month Arithmetic Average TR	R3K Next 1-Month Geometric Average TR	R3K Next 3-Month Arithmetic Average TR	R3K Next 3-Month Geometric Average TR	R3K Next 6-Month Arithmetic Average TR	R3K Next 6-Month Geometric Average TR
	Below & Above Median Bull Bear Spread = 8.0										
BELOW	-54.0	8.0	879	0.25%	0.21%	1.21%	1.08%	3.30%	2.92%	6.36%	5.65%
ABOVE	8.1	62.9	837	0.15%	0.13%	0.43%	0.34%	1.81%	1.55%	4.48%	4.00%
	Ten Groupings of 1716 Data Points										
1	-54.0	-15.0	173	0.49%	0.42%	2.00%	1.75%	5.04%	4.50%	8.41%	7.26%
2	-14.9	-7.2	170	0.36%	0.33%	0.96%	0.83%	3.24%	2.90%	6.13%	5.40%
3	-7.2	-1.4	172	0.33%	0.30%	1.50%	1.40%	3.20%	2.80%	6.89%	6.25%
4	-1.3	3.0	175	0.05%	0.02%	1.04%	0.95%	2.73%	2.37%	5.95%	5.43%
5	3.0	8.0	189	0.05%	0.02%	0.61%	0.52%	2.37%	2.12%	4.62%	4.10%
6	8.1	12.0	151	0.09%	0.06%	0.40%	0.27%	1.58%	1.34%	5.08%	4.67%
7	12.0	16.4	171	0.17%	0.15%	0.55%	0.45%	2.29%	2.03%	4.93%	4.39%
8	16.4	22.0	177	0.16%	0.15%	0.67%	0.60%	1.93%	1.65%	5.68%	5.26%
9	22.0	29.2	166	0.07%	0.05%	0.25%	0.16%	1.84%	1.56%	4.14%	3.55%
10	29.2	62.9	172	0.26%	0.24%	0.26%	0.19%	1.36%	1.13%	2.60%	2.16%

From 07.31.87 through 6.25.20. Unannualized. SOURCE: Kovitz Investment Group using data from American Association of Individual Investors and Bloomberg

Stock Updates

Jason Clark, Chris Quigley and Zach Tart look at several of our companies that posted quarterly results or had other news that impacted their respective Target Prices last week. 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/.

Time again to raise our published Target Price for computing giant **Microsoft** (MSFT – $196.33), after shares set another record on Tuesday briefly climbing above $203, before the stock was caught in the late-week downdraft.

A sign of the times, Microsoft wrote in a LinkedIn (which MSFT owns) post, "As we look forward, we start a new chapter for Microsoft Store. Our team has proven success serving customers beyond any physical location. We are energized about the opportunity to innovate in how we engage with all customers, optimize our talent for greatest impact, and most importantly – help our valued customers achieve more. As part of our business plan, we announced a strategic change in our retail operations, including closing Microsoft Store physical locations. Our retail team members will continue to serve customers working from Microsoft corporate

facilities or remotely and we will continue to develop our diverse team in support of the overall company mission and objectives."

Microsoft says that its new focus will be on three areas to serve customers. Team members will work remotely or in the company's offices to support all areas previously handled by physical stores. Secondly, there will be an increased emphasis on Microsoft's digital storefronts. Lastly, campuses in London, New York City, Sydney and Redmond, WA will be redesigned to co-locate engineering, sales, support, envisioning centers, executive briefing centers and retail spaces.

Microsoft's physical stores were similar to Apple's stores and were meant to take on its rival, but we aren't convinced that they were perfect for MSFT's overall strategy, and certainly there were not hours-long lines for new Microsoft device launches. And Apple continues to be focused on hardware with easy-to-use software on top, while MSFT has shifted its business to target the cloud via Azure and subscription productivity software via Office 365. Although we think Personal Computing will always a part of Microsoft, it's likely to continue to take a back seat while the firm focuses on deploying capital into areas where it has had major success recently.

Microsoft remains a big weight in our broadly diversified portfolios, and an even bigger weight in most broad market indexes. While the valuation isn't inexpensive, it's not expensive either and we like the stability that the company's strong balance sheet and recurring revenue streams bring. Plus, the company has been buying back huge quantities of shares, and the yield stands at just over 1%. Given that we have already taken some MSFT money off the table, our Target Price is now $211.

Not to be outdone by Microsoft, **Apple** (AAPL – $353.63) also hit a record on Tuesday, surging as high as $371.38 while investors digested the company's announcements at the consumer electronic titan's annual Worldwide Developer Conference (WWDC). The keynote address was held on Monday morning with a full week of remote learning and forums for developers. Among the biggest announcements were iOS 14 for iPhone and iPadOS 14 for iPad, MacOS Big Sur and the company's long-rumored transition away from **Intel** (INTC – $57.50) chips for its Mac processors.

While the iOS, iPad and MacOS updates have been leaked or in beta testing for a while, the processor news seemed to take Intel shareholders by surprise. Analysts estimate that Intel will lose between 2% and 4% of revenue per year from the lost business, but we think the EPS impact will be less pronounced given Apple's reputation for shrewd negotiating. While ARM chips can do as much or more than Intel chips, the significant rewriting of software makes the transition no easy task. But we can't say we are surprised since Intel's 10-nanometer chips have been very delayed and there was much frustration on Apple's side related to the Intel Skylake chips in 2015. Beyond that, Apple's desire to control all parts hardware and software is only accomplishable if they actually design all of the major components in-house. We think that the dissolution of the relationship won't be a major long-term issue for either company. That said, our Target Price for INTC is now $72.

On Friday afternoon, news broke that Apple's App Store rules are being scrutinized as part of a U.S. antitrust probe related to the company's control of software within the store. Developers are

free to create Apps without interference from Apple, however there have been wide complaints that the company applies its rules inconsistently and favors its own applications when a competing app is submitted to its store. The company's 30% revenue cut is akin to "highway robbery," Chairman of the U.S. House Subcommittee on Antitrust Rep. David Cicilline told *The Verge*.

While the antitrust battle may just be heating up, we think that Apple has been generally flexible when it comes to regulation. It has managed to maintain a profitable operation in Europe, where privacy rules favor consumers more strongly than in the U.S. and lawmakers have been harsher on technology companies. Should Apple get its wings clipped in the U.S. also, we think they'll get through it just fine. We trimmed big AAPL positions in some portfolios a few weeks ago, and we continue to hold an above-average Apple position across our strategies. Our Target Price has been hiked to $378.

Illustrating the point made in our *Market Review* that it is impossible to know the future…or how investors might react even if they had the news in advance, *The Wall Street Journal* offered this headline in its review of Thursday's equity market action, "Banks Ignite Late Turnaround for Stocks."

According to the article, banks rose after the Federal Deposit Insurance Corp voted to reduce the amount of cash that must be set aside as collateral to cover potential losses on swap trades. As one analyst cited in the piece explained, "Banks have been under the regulatory thumb and that changed their profitability and trajectory. They're probably marginally more valuable following this."

Skip ahead to Friday and that positive bank sentiment went out the window…in the wake of the release of the Federal Reserve's highly anticipated stress tests for 2020 and additional sensitivity analyses that the Board conducted in light of the coronavirus event. These assessments incorporated a few changes compared to prior years, including COVID-19 scenario overlays (based on the potential for V, U and L-shaped economic recoveries) and an updated Stress Capital Buffer framework. In an effort to preserve capital in the midst of uncertainly, the Fed has exercised its ability to impose limits on dividends and formally restrict share buybacks. We say formally because most have already suspended repurchases on their own. Moreover, banks will be required to recalibrate capital needs and undergo additional stress analyses later in the year as economic conditions evolve.

All told, the industry appears able to withstand the pressure, even under the worst conditions. According to the Fed's DFAST publication, "The 33 banks subject to the supervisory stress test would experience substantial losses under the severely adverse scenario but could continue lending to businesses and households, due to the substantial buildup of capital since the financial crisis." This is particularly the case for Systemically Important money center banks like **JPMorgan Chase** (JPM – $92.59), **Bank of America** (BAC – $23.15) and **Citigroup** (C – $49.58), whose results from the stress scenarios fared better than many expected. For members of the KBW banking index overall, which includes banks like **Keycorp** (KEY – $11.76) and **Fifth Third Bancorp** (FITB – $18.76), Tier 1 and Tangible Common Equity capital ratios are more than 40% higher on average than at the end of 2007. The same holds for even higher-risk

banks like **Capital One** (COF – $61.16) and **Comerica** (CMA – $35.37), whose Tier One and Equity Capital ratios are higher than they were going into the Financial Crisis (35% and 16% for the former and 27% and 12% for the latter, respectively), even after significant increases to loan loss reserves in Q1.

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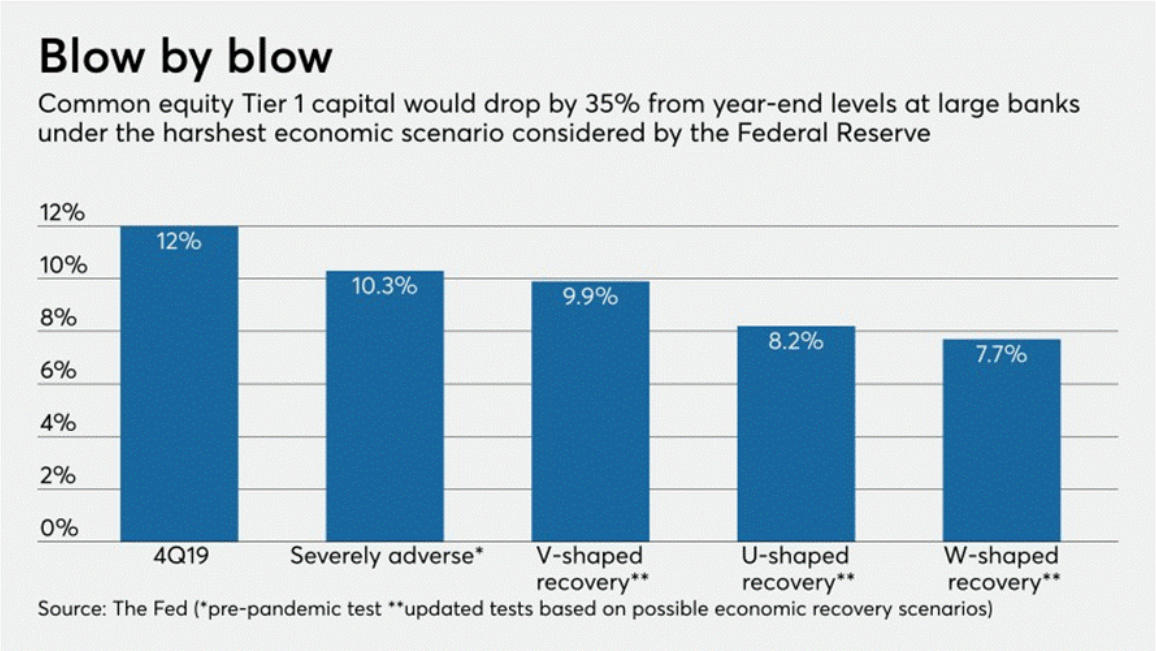
THE PRUDENT SPECULATOR

Bank's Passing the Fed's Stress Tests

As calculations from the *American Banker* show, the nation's big banks are presently equipped to persevere through the COVID-19 fallout.



With respect to prospective dividend payments, we estimate that all but those of a select handful of banks (COF and CMA possibly two that could face payout cuts) will likely remain unaffected in the near-term. Notwithstanding dissent from at least one Fed Governor, the Fed has decided to cap dividends to net income for the four preceding calendar quarters, unless otherwise specified by the Board. Of course, banks' bottom lines are subject to somewhat discretionary loan loss provision estimates, so there will be an interesting dynamic at work between "banking" excess reserves that can be used down the road during a time when investors might not dole out much punishment for the near-term earnings hit and ensuring enough net income to maintain current dividend payouts.

Judging by the market's reaction on Friday, we would not be surprised by additional volatility in the near-term, especially as the next wave of quarterly financial results are released in coming weeks. In addition, economic headlines are likely to get worse before they get better as states retract and amend reopening plans. That said, we think the 36% drop year-to-date in the KBW index has priced in a lot of bad news for long-term buyers. While rate spreads continue to

underwhelm, deposits at all commercial U.S. banks (the raw material that banks use to make money) are up almost 18% year-to-date due to measures taken by the central bank and federal government, and several of our holdings have capital market and trading operations that will also benefit from increased volatility this year.

We continue to like our bank stocks, but as we learn more about capital plans in the days and weeks ahead, while we assess Q2 results as they are reported, we will look for more opportunities to swap, consolidate and add to our holdings.