Market Commentary Monday, July 27, 2020

July 27, 2020

EXECUTIVE SUMMARY

Week in Review – Weak Ending, But Value Beat Growth
Returns Race – Very ST and LT in Favor of Value; Today Looks Like Spring 2000
COVID-19 – Case & Death Counts Rising; Mortality Rate Descending
Econ News – Jobs Numbers Not so Great; Housing Data Improves Considerably
Gravitational Pull – Buffett on Interest Rates
Equities Attractively Valued – Earnings Yield & Money Market Fund Comparisons
Sentiment – No Love for Equities
History Lesson – Spanish Flu, Pearl Harbor, Nixon Resignation, Gulf War, 9/11, etc. and Stock Returns
Earnings Season – Small Sample Size, but Q2 Numbers Beating the Street
Stock News – Updates on INTC, IBM, MSFT, T, MAN, BIIB, WHR, ONB, CMA, COF, SYF, KEY & LMT

Market Review

It was a lousy ending to the week, with the big plunge on Friday in **Intel** (INTC – $50.59) not helping matters, but Value stocks managed to outperform Growth for the second straight week, despite one of the biggest daily gaps in history in the other direction on Monday. Incredibly, even with the first day of the week seeing the Russell 3000 Growth index soar 2.34% versus a 0.66% drop for the Russell 3000 Value index, for the full five days, the former dipped 0.75% while the latter advanced a modest 0.20%.

Obviously, the returns race has been decidedly one-sided in recent years,…

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VALUE SHOWING SIGNS OF LIFE

While two+ weeks does not a trend make, it is nice to see a decent absolute and relative rebound in undervalued stocks, especially as there is plenty of runway remaining for a return to historical norms.

Total Returns Matrix

Since 7.9.20	Year to Date	1-Year	3-Year	5-Year	7-Year	10-Year	15-Year	20-Year	Name
1.47	5.29	6.80	12.79	22.08	20.34	32.02	73.52	152.78	Bloomberg Barclays Global-Aggregate Bond
0.52	7.40	9.91	17.58	24.46	32.70	46.52	94.36	173.56	Bloomberg Barclays US Aggregate Bond
3.02	-6.00	-0.53	32.06	70.32	101.78	225.92	264.16	301.67	Dow Jones Industrial Average
4.52	-9.06	-3.23	13.47	33.07	56.12	133.70	150.49	187.80	New York Stock Exchange Composite
1.94	-1.10	4.08	24.94	43.18	86.94	221.44	242.17	198.33	Russell 2000 Growth
8.28	**-22.20**	**-16.42**	**-11.71**	**12.38**	**24.79**	**102.49**	**99.15**	**333.27**	**Russell 2000 Value**
4.94	-11.36	-5.76	6.37	28.47	54.86	158.86	165.65	273.85	Russell 2000
-1.01	12.96	22.05	65.75	106.69	181.62	359.73	383.31	200.27	Russell 3000 Growth
5.64	**-13.39**	**-7.51**	**7.70**	**30.40**	**57.03**	**158.74**	**147.18**	**253.38**	**Russell 3000 Value**
2.15	0.22	7.68	35.67	66.73	113.74	250.88	253.00	239.35	Russell 3000
2.06	0.62	8.62	38.15	71.27	120.15	259.01	256.47	225.25	S&P 500
-0.15	11.96	18.82	60.07	100.64	173.87	348.96	367.40	227.11	S&P 500 Growth
5.45	**-12.19**	**-3.35**	**15.28**	**39.96**	**68.43**	**173.83**	**157.67**	**204.15**	**S&P 500 Value**
1.51	6.87	11.77	42.32	71.46	137.14	327.23	370.34	283.04	S&P 500 Pure Growth
9.42	**-27.39**	**-23.12**	**-11.72**	**7.34**	**35.57**	**149.17**	**151.81**	**443.82**	**S&P 500 Pure Value**
8.79	-14.12	-6.47	13.51	37.71	67.03	147.14	247.61	463.17	Berkshire Hathaway B

…but despite plenty of ups and downs for stocks along the way, Value has outperformed over the long term by a wide margin,…

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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%	975	27	3.4	3/23/2020	7/22/2020
17.5%	66.4%	569	39	2.4	3/23/2020	7/22/2020
15.0%	66.2%	554	45	2.1	3/23/2020	7/22/2020
12.5%	44.1%	333	72	1.3	3/23/2020	7/22/2020
10.0%	34.8%	243	98	0.9	3/23/2020	7/22/2020
7.5%	23.6%	148	156	0.6	3/23/2020	7/22/2020
5.0%	14.7%	72	304	0.3	6/11/2020	7/22/2020

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 07.22.20. 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	9.5%	21.5%
Dividend Paying Stocks	10.4%	18.1%
Non-Dividend Paying Stocks	8.9%	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%	4.3%
Treasury Bills	3.3%	0.9%
Inflation	2.9%	1.8%

From 06.30.27 through 05.31.20. 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

…and the current relationship between the two Russell 3000 indexes was last at today's level in early 2000, a fantastic entry point for inexpensively priced stocks that saw massive outperformance for the Russell 3000 Value index over the ensuing six years.

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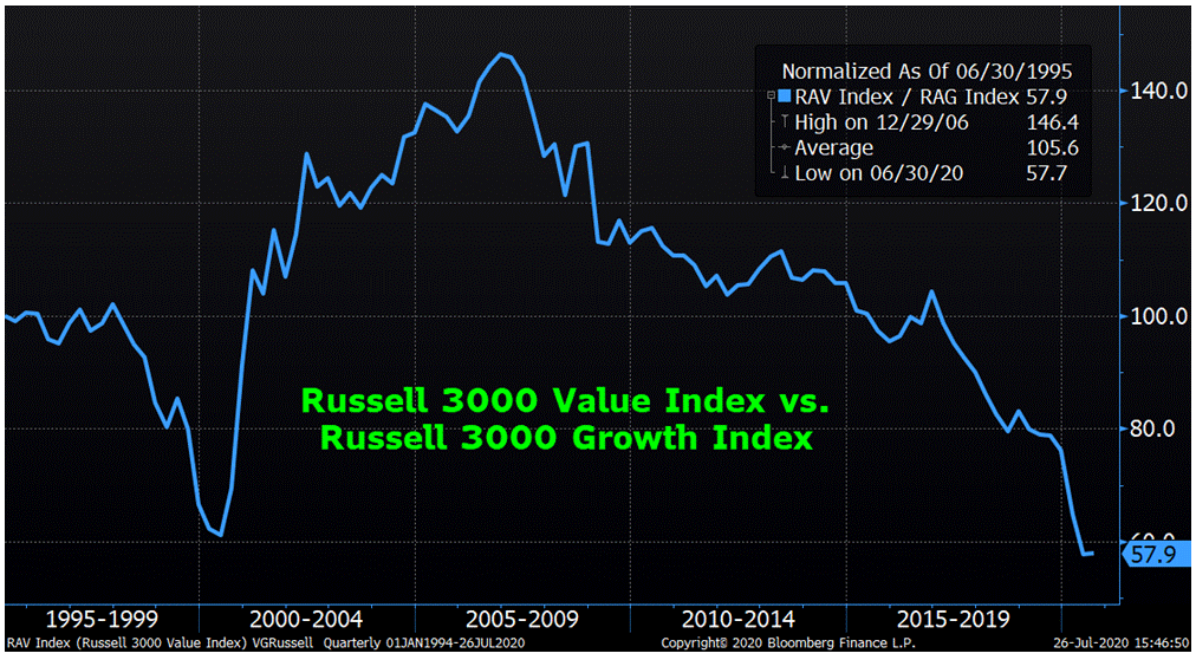
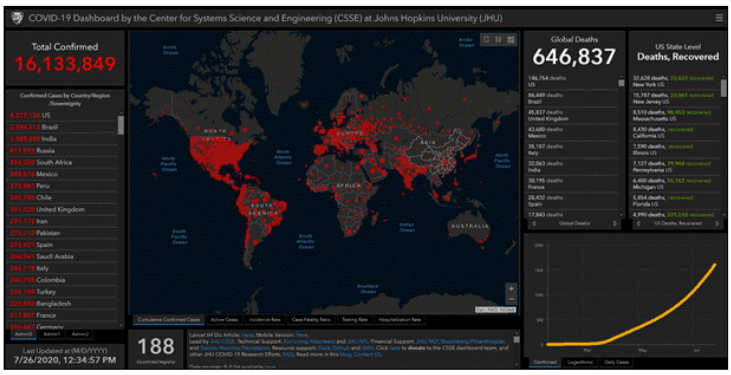
R3K VALUE "BUY" SIGNAL A LA MARCH 2000

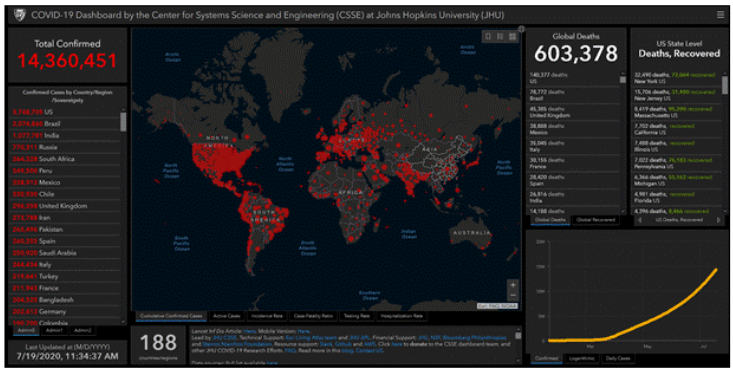
Stocks with inexpensive financial metrics have been crushed in the wake of COVID-19, but the R3K Value index is near March 2000 relative levels.



To be sure, the near-term direction of equities in general and Value and Growth in particular is anyone's guess, as developments on the health front will remain the main catalyst driving stock prices.

COVID-19 GLOBAL SPREAD





https://www.arcgis.com/apps/opsdashboard/index.html#/bda759474ofd4029942346 7b48e9ecf6

With access to testing markedly higher, there was a jump of nearly 1.8 million in global COVID-19 confirmed cases in the latest week. Case counts have risen as economies have reopened, social distancing has waned and mask wearing has been inconsistent, and the U.S. is now up to more than 146,000 fatalities. With deaths lagging cases, we would expect to see a big jump in the former, but the global mortality increase over the last seven days equaled 7.2%, up from 6.6% the week prior, but below the respective 7.3% and 8.0% increases that were seen four and five weeks ago.

The COVID-19 case and death counts continue to climb and, despite significant progress on the vaccine and therapeutic front, the virus news is like to get worse before it gets better, especially in the United States. Of course, there is still significant debate about the severity of the pandemic, with data out last week suggesting that the actual mortality rate is on the order of 0.68%.

COVID-19 FATALITY RATE: RESEARCH SUGGESTS 0.68%

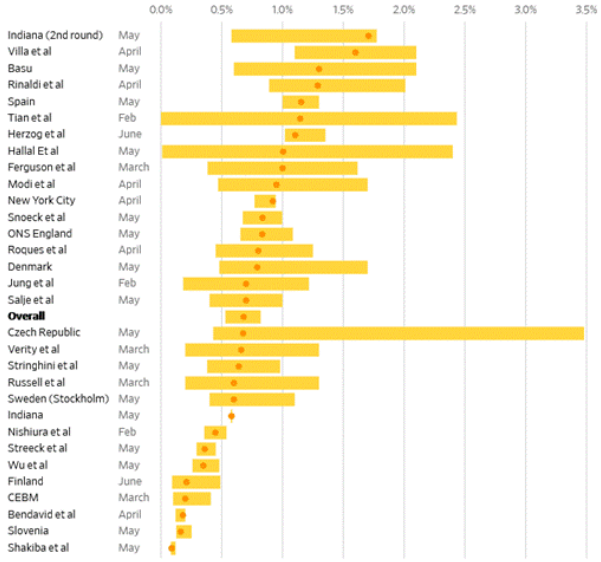
THE WALL STREET JOURNAL.

Covid-19 Fatality: Analyzing the Evidence

A comparison of 26 studies that estimate the disease's infection fatality rate* found varying results but pinpointed an overall rate of around 6.8 deaths per 1,000 infections.

Infection fatality rate by study

95% confidence interval



*The infection fatality rate measures deaths out of total estimated infections as opposed to confirmed cases

Note: Studies not identified by author names were led by governments or local authorities.

Source: Gideon Meyerowitz-Katz, Lea Merone

WSJ.com, July 21, 2020

Six months into the pandemic, researchers are homing in on an answer to one of the basic questions about the virus: How deadly is it?

Researchers, initially analyzing data from outbreaks on cruise ships and more recently from surveys of thousands of people in virus hot spots, have now conducted dozens of studies to calculate the infection fatality rate of Covid-19.

That research—examining deaths out of the total number of infections, which includes unreported cases—suggests that Covid-19 kills from around 0.3% to 1.5% of people infected. Most studies put the rate between 0.5% and 1.0%, meaning that for every 1,000 people who get infected, from five to 10 would die on average.

The estimates suggest the new coronavirus is deadlier than the seasonal flu, though not as lethal as Ebola and other infectious diseases that have emerged in recent years. The coronavirus is killing more people than the deadlier diseases, however, in part because it is more infectious.

"It's not just what the infection-fatality rate is. It's also how contagious the disease is, and Covid is very contagious," said Eric Toner, an emergency medicine physician and senior scholar at Johns Hopkins Center for Health Security, who studies health-care preparedness for epidemics and infectious diseases. "It's the combination of the fatality rate and the infectiousness that makes this such a dangerous disease."

An analysis of 26 different studies estimating the infection-fatality rate in different parts of the globe found an aggregate estimate of about 0.68%, with a range of 0.53% to 0.82%, according to a report posted in July on the preprint server medRxiv, which hasn't yet been reviewed by other researchers.

An infection-fatality rate of roughly 0.6% is six times greater than the 0.1% estimate for seasonal influenza, which is based on CDC data. Though researchers point out the estimates are calculated in different ways and the flu estimate doesn't take asymptomatic cases into account.

Certainly, 68 deaths out of 10,000 infections is nothing to cheer about, but it is far better than death rates of more than 3% bandied about a few months back, while overall domestic mortality statistics presently show that 1.60 million lives were lost from all causes over the first six months of 2020, compared to 1.45 million over the same period last year.

National Center for Health Statistics First 26-Weeks-of-the Year Overall U.S. Mortality Statistics

Year	Total Deaths	Year-over-Year Change	Versus 7-Year Average
2014	1,324,841		92%
2015	1,392,174	5.1%	97%
2016	1,381,620	-0.8%	96%
2017	1,436,219	4.0%	100%
2018	1,463,519	1.9%	102%
2019	1,451,640	-0.8%	101%
2020	1,598,597	10.1%	111%

Source: National Center for Health Statistics (NCHS)

The 219,864 American fatalities from COVID-19 through 11.2.20 that is now expected by the Institute for Health Metrics and Evaluation is hard to fathom, but that mortality count would be #3 on the annual rankings for cause of death in the U.S., while some may be surprised that the overall death rate so far in 2020 from all causes is 10.1% above that of 2019.

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

No doubt, the increase in the death toll in 2020 is almost entirely attributable to COVID-19 and pressure is mounting on hard-hit cities and states to reinstate stay-at-home orders. Clearly, such an order would put a huge dent in the fledgling economic recovery, as even in our home county of Orange, where case counts have spiked, restaurants and shops were busy this past weekend, albeit with tables set up on outdoor patios and parking lots and stores limiting the number of shoppers.

Time will tell how long and strong the current economic rebound will be, but economic numbers generally have been trending better, even as there are tons of people still out of work,…

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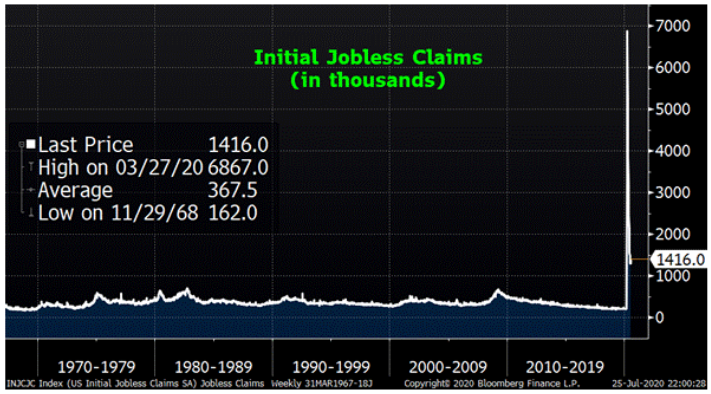
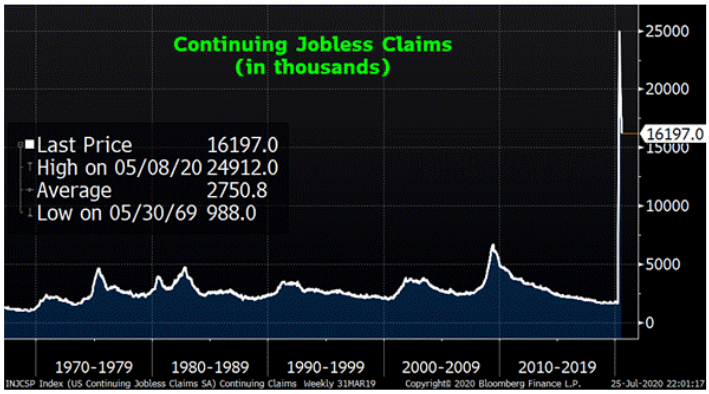
UGLY LABOR STATISTICS





The latest figures on first-time claims for jobless benefits saw an increase to a seasonally adjusted 1.42 million, roughly in line with estimates, but the Great Lockdown readings remain more than double anything seen in the 50+ year history of the measure. The sum of those still receiving unemployment assistance remained very elevated at 16.2 million in the latest numbers, but that tally was down 1.1 million from the week prior.

…yet folks have had enough confidence to be busy home shopping, taking advantage of historically low mortgage interest rates,…

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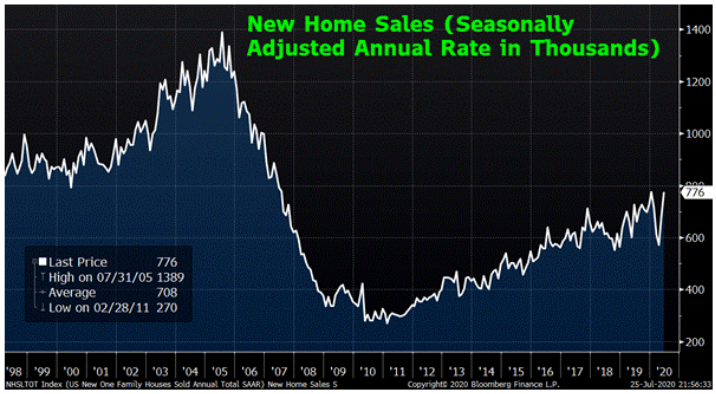
STRONG HOUSING BOUNCEBACK CONTINUES



Sales of new homes soared during June, jumping 13.8% to a seasonally adjusted annual rate of 776,000, the strongest showing since July 2007. No doubt, microscopic mortgage rates are greatly helping the housing market, as even with the impact of COVID-19 and the Great Lockdown, sales of existing homes rebounded by a whopping 21% in June to a seasonally adjusted annual pace of 4.72 million, though that tally is still below average.

…with the expectation, at least according to one important forward-looking gauge, that the next six months will continue to see improvement, albeit off a horrendously dismal base.

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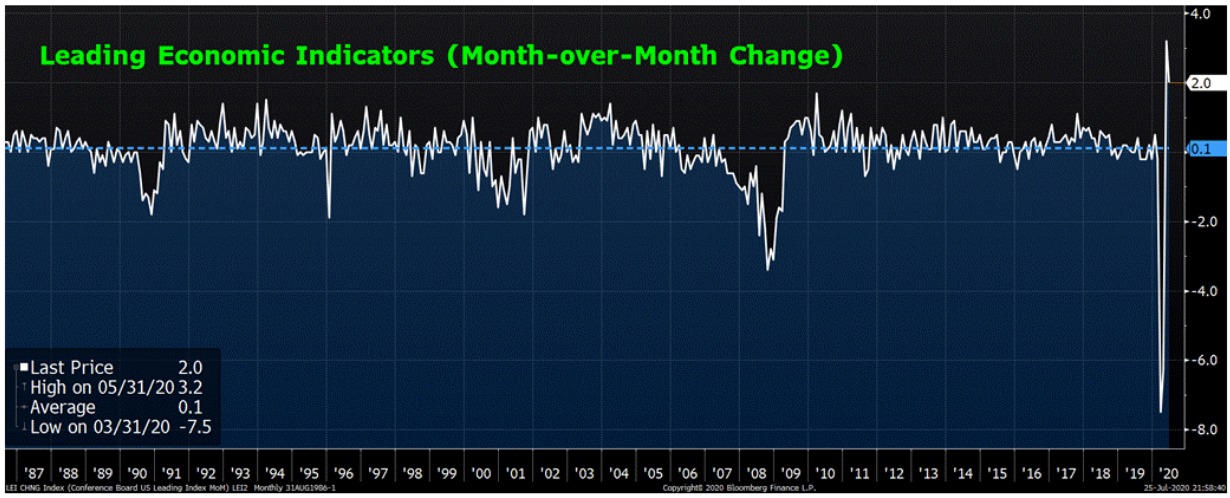
LEI WELL INTO POSITIVE TERRITORY…FOR THE TIME BEING

The forward-looking Leading Economic Index increased by 2.0% on a month-over-month basis in June, down from a record 3.2% jump in May. The Conference Board credited "the incremental reopening of the economy, with labor market conditions and stock prices in particular contributing positively," but warned, "Broader financial conditions and the consumers' outlook on business conditions still point to a weak economic outlook."



We do believe that we are realistic in our views on the economy as we hardly are of the mind that happy days are here again, but we continue to think that stock prices for many companies have discounted a tremendous amount of bad news and that they should be significantly higher, even with the COVID-19 risks.

The primary reason for this assertion is the extraordinarily favorable interest rate environment and the expectation that rates will remain extremely low for as far as the eye can see. We remember comments from Warren Buffett on the interest rate subject…along with reaction to one of those supposed billionaire market experts suggesting that equities were in trouble…on April 29, 2016, when the Dow closed at 17774 and a worrisome Presidential Election was six months away.

Responding to billionaire investor Carl Icahn's doom and gloom, the Oracle of Omaha on *CNBC Television* said he didn't put too much stock in Icahn's market 'reckoning' warning and turned the discussion to rates. "Interest rates act on asset values like gravity works on physical matter," Mr. Buffett said. "If you had zero interest rates and you knew you were going to have them forever, stocks should sell at, you know, 100 times earnings or 200 times earnings."

He continued, “When interest rates were 15 percent with [Paul] Volcker, you know, it was an enormous gravitational pull on all assets, not just stocks. If you can get 15 percent, it makes the choices way different than if you get zero.”

We are not implying that stocks should or will trade for 100 or 200 times earnings, as we don’t think interest rates will stay near zero forever, but with a 0.6% 10-year Treasury rate, one can justify much higher equity valuations. Historically, Treasuries have provided higher yields than stocks (both dividend and earnings) as there is not a grand expectation for capital appreciation. True, there is not an expectation of great depreciation either, but the chart below shows the relationship between the 10-Year Treasury (red line), the Dividend Yield on the S&P 500 (green line) and the Earnings Yield (inverse of the P/E ratio or the percentage of price represented by earnings) on the S&P 500 (blue line).

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INTEREST RATES VERY SUPPORTIVE OF STOCKS

The so-called Fed Model suggests that the yield on 10-Year Treasuries should be similar to the S&P 500 Earnings Yield, which is the inverse of the P/E ratio. If the 10-Year is greater than the S&P Earnings Yield, a market is overvalued and if the reverse is true, as it is today, a market is undervalued. Though some argue that the Fed Model is no longer an effective tool, we like today’s rich relative earnings yield (4.24% vs. 0.59% 10-Year) and generous S&P 500 dividend yield of 1.88%.

Ignoring the fact that the red line often has been above the other two, for simple equilibrium, so to speak, to be restored, the Treasury yield would need to rise considerably or the Dividend Yield and Earnings Yield would need to drop significantly. By this, we mean that in order for the S&P 500 Dividend Yield to equal the current 0.6% or so yield on the 10-Year Treasury, stocks would have to more than triple in price, all else being equal…and in order for the Earnings Yield to get

to 0.6%, the P/E ratio on the S&P 500 would have to rise from the current 23.6 to 166, a 7-fold increase in price, assuming earnings held constant.

Obviously, stocks are not going to triple or septuple anytime soon (though history shows that such events are more than reasonable in the fullness of time), but if the S&P 500 doubled in price, the Dividend Yield would be 0.94% and the Earnings Yield would be 2.12%, meaning the green and blue lines would still be above the red one, assuming interest rates stayed low…and we might argue that even if such an advance were to occur, stocks would still be cheap!

We can debate how long rates will stay low, but the Federal Reserve's projection for the Federal Funds rate is presently 0.1% through 2022 and 2.5% for the long-term. Now if the 10-Year Treasury went to 2.5%, a lot of bond investors will be crying in their soup, and we would argue earnings and dividends for Corporate America would be significantly higher than where they are today, given that it will very likely take a strong economy to move rates higher. However, assuming no change in earnings (which is not realistic under an improved economic scenario), a fair valuation for stocks based on the Earnings Yield might match the 10-Year's 2.5% long-term yield projection, which would equate to about a 70% advance in the S&P 500 from where we currently reside.

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FED: BIG REBOUND IN '21 AND LOW INTEREST RATES

The Fed's latest projections call for a severe recession (6.5% plunge in real GDP) this year, but a significant recovery in 2021 and 2022, while the Fed Funds rate will likely remain near zero all three years.

Table 1. Economic projections of Federal Reserve Board members and Federal Reserve Bank presidents, under their individual assumptions of projected appropriate monetary policy, June 2020

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

Percent

Variable	Median[1]				Central Tendency[2]				Range[3]			
	2020	2021	2022	Longer run	2020	2021	2022	Longer run	2020	2021	2022	Longer run
Change in real GDP	-6.5	5.0	3.5	1.8	-7.6–-5.5	4.5–6.0	3.0–4.5	1.7–2.0	-10.0–-4.2	-1.0–7.0	2.0–6.0	1.6–2.2
December projection	2.0	1.9	1.8	1.9	2.0–2.2	1.8–2.0	1.8–2.0	1.8–2.0	1.8–2.3	1.7–2.2	1.5–2.2	1.7–2.2
Unemployment rate	9.3	6.5	5.5	4.1	9.0–10.0	5.9–7.5	4.8–6.1	4.0–4.3	7.0–14.0	4.5–12.0	4.0–8.0	3.5–4.7
December projection	3.5	3.6	3.7	4.1	3.5–3.7	3.5–3.9	3.5–4.0	3.9–4.3	3.3–3.8	3.3–4.0	3.3–4.1	3.5–4.5
PCE inflation	0.8	1.6	1.7	2.0	0.6–1.0	1.4–1.7	1.6–1.8	2.0	0.5–1.2	1.1–2.0	1.4–2.2	2.0
December projection	1.9	2.0	2.0	2.0	1.8–1.9	2.0–2.1	2.0–2.2	2.0	1.7–2.1	1.8–2.3	1.8–2.2	2.0
Core PCE inflation[4]	1.0	1.5	1.7		0.9–1.1	1.4–1.7	1.6–1.8		0.7–1.3	1.2–2.0	1.2–2.2	
December projection	1.9	2.0	2.0		1.9–2.0	2.0–2.1	2.0–2.2		1.7–2.1	1.8–2.3	1.8–2.2	
Memo: Projected appropriate policy path												
Federal funds rate	0.1	0.1	0.1	2.5	0.1	0.1	0.1	2.3–2.5	0.1	0.1	0.1–1.1	2.0–3.0
December projection	1.6	1.9	2.1	2.5	1.6–1.9	1.6–2.1	1.9–2.6	2.4–2.8	1.6–1.9	1.6–2.4	1.6–2.9	2.0–3.3

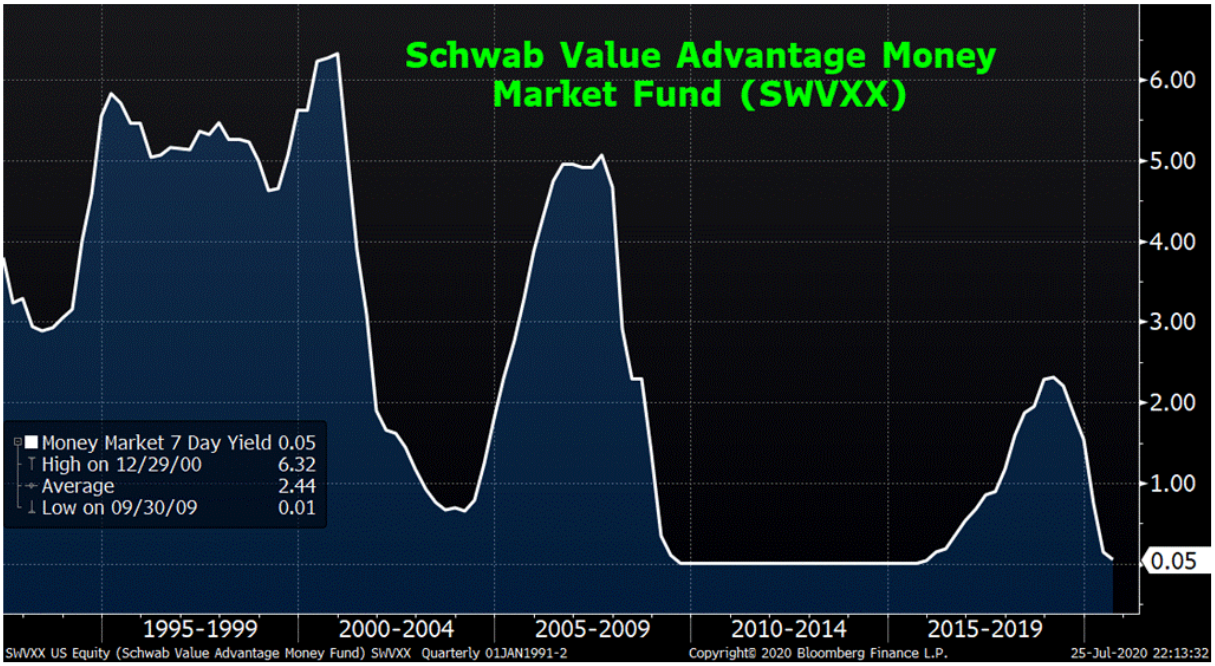
Source: Federal Reserve, June 10, 2020

True, we respect that many think the Earnings Yield is not of great value, yet P/E ratios are universally viewed as super important. However, we think there can be little debate, as Mr. Buffett articulated, that there is a big difference in how one would look at the investment choices available when money held in the mattress, i.e. money market funds, is offering returns of zero. After all, one could get 200 basis points not so long ago on "cash" and 500 to 600 basis points at previous equity market highs.

THE PRUDENT SPECULATOR

MONEY MARKET FUND YIELDS OVER TIME

The yield on the Schwab Value Advantage Prime Money Market Fund has cratered to 0.05% today, which sharply contrasts to the respective 5.00%+ and 6.00%+ at prior market peaks in 2000 and 2007.



Not surprisingly, with yields on competing investments so dismal, we think that stocks remain the place to be for those who share our long-term time horizon, yet we find it fascinating (and very reassuring from a contrarian perspective) that optimism toward equities seems to be in very short supply.

SENTIMENT: NO ENTHUSIASM FOR STOCKS

Pessimism among individual investors continues to be unusually high, climbing to more than 16 points above normal in the latest AAII Sentiment Survey. Bullish sentiment is nearly 12 percentage points below normal.

We remain perplexed that many supposed market experts continue to argue that investors are piling into stocks, given that the latest data on mutual and exchange traded fund flows from ICI shows a massive exodus from U.S. stocks and a continued infatuation with bonds.

AAII Investor Sentiment Survey

Since 1987, AAII members have been answering the same simple question each week. The results are compiled into the AAII Investor Sentiment Survey, which offers insight into the mood of individual investors.

Survey Results for Week Ending 7/22/2020

Data represents what direction members feel the stock market will be in next 6 months.

Note: Numbers may not add up to 100% because of rounding.

The AAII Investor Sentiment Survey has become a widely followed measure of the mood of individual investors. The weekly survey results are published in financial publications including Barron's and Bloomberg and are widely followed by market strategists, investment newsletter writers and other financial professionals.

Combined Estimated Long-Term Fund Flows and ETF Net Issuance

Millions of dollars

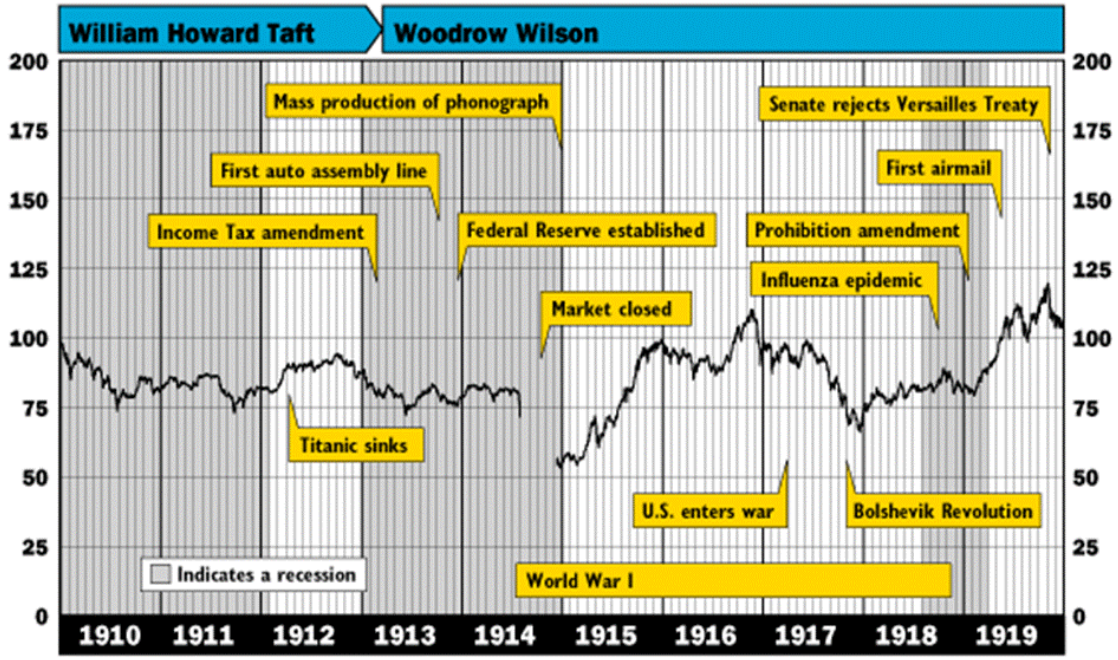
Week Ended	7/15/2020	7/8/2020	7/1/2020	6/24/2020	6/17/2020
Total Equity	-18,772	-9,310	-22,863	-17,244	-9,276
Domestic	-16,781	-6,050	-14,309	-12,762	-5,940
World	-1,991	-3,259	-8,554	-4,482	-3,337
Hybrid	-1,732	-293	-1,841	-1,382	-1,980
Total Bond	14,523	23,235	18,739	25,090	18,964
Taxable	12,780	21,391	16,438	22,216	16,021
Municipal	1,743	1,844	2,300	2,874	2,942
Commodities	1,035	1,575	1,036	2,469	313
Total	-4,947	15,207	-4,929	8,933	8,020

Source: Investment Company Institute

Yes, we realize that COVID-19 continues to be a major headwind, but stocks rallied in 1918-1919 in the face of a far-worse health threat,…

PANDEMIC PRECEDENT: SPANISH FLU

It was 100 years ago and life obviously is different today, but stocks managed to gain ground during the 1918-1919 Spanish Flu Pandemic, despite 50 million deaths worldwide, with 675,000 of those in the U.S.



…while equities have overcome numerous disconcerting events throughout history.

THE PRUDENT SPECULATOR

LOTS OF FRIGTENING EVENTS

Event	Reaction Dates		S&P Start Value	S&P End Value	Event Gain/Loss	12 Months Later	36 Months Later	60 Months Later	Event End thru Present
Pearl Harbor	12/6/1941	12/10/1941	9.32	8.68	-7%	8%	51%	76%	36946%
Truman Upset Victory	11/2/1948	11/10/1948	16.70	15.00	-10%	8%	52%	62%	21338%
Korean War	6/23/1950	7/13/1950	19.14	16.69	-13%	32%	45%	153%	19167%
Eisenhower Heart Attack	9/23/1955	9/26/1955	45.63	42.61	-7%	8%	17%	25%	7447%
Suez Canal Crisis	10/30/1956	10/31/1956	46.37	45.58	-2%	-10%	26%	51%	6955%
Sputnik	10/3/1957	10/22/1957	43.14	38.98	-10%	31%	37%	41%	8149%
Cuban Missile Crisis	8/23/1962	10/23/1962	59.70	53.49	-10%	36%	72%	78%	5912%
JFK Assassination	11/21/1963	11/22/1963	71.62	69.61	-3%	24%	14%	53%	4519%
MLK Assassination	4/3/1968	4/5/1968	93.47	93.29	0%	8%	8%	16%	3347%
Kent State Shootings	5/4/1970	5/14/1970	79.00	75.44	-5%	35%	40%	22%	4163%
Arab Oil Embargo	10/18/1973	12/5/1973	110.01	92.16	-16%	-28%	12%	6%	3389%
Nixon Resigns	8/9/1974	8/29/1974	80.86	69.99	-13%	24%	38%	56%	4494%
U.S.S.R. in Afghanistan	12/24/1979	1/3/1980	107.66	105.22	-2%	30%	31%	56%	2956%
Hunt Silver Crisis	2/13/1980	3/27/1980	118.44	98.22	-17%	37%	55%	83%	3174%
Falkland Islands War	4/1/1982	5/7/1982	113.79	119.47	5%	39%	51%	147%	2592%
U.S. Invades Grenada	10/24/1983	11/7/1983	165.99	161.91	-2%	4%	52%	69%	1886%
U.S. Bombs Libya	4/15/1986	4/21/1986	237.73	244.74	3%	20%	27%	57%	1214%
Crash of '87	10/2/1987	10/19/1987	328.07	224.84	-31%	23%	39%	85%	1330%
Gulf War Ultimatum	12/24/1990	1/16/1991	329.90	316.17	-4%	32%	50%	92%	917%
Gorbachev Coup	8/16/1991	8/19/1991	385.58	376.47	-2%	11%	23%	77%	754%
ERM U.K. Currency Crisis	9/14/1992	10/16/1992	425.27	411.73	-3%	14%	42%	132%	681%
World Trade Center Bombing	2/26/1993	2/27/1993	443.38	443.38	0%	5%	46%	137%	625%
Russia Mexico Orange County	10/11/1994	12/20/1994	465.79	457.10	-2%	33%	107%	210%	603%
Oklahoma City Bombing	4/19/1995	4/20/1995	504.92	505.29	0%	28%	122%	184%	536%
Asian Stock Market Crisis	10/7/1997	10/27/1997	983.12	876.99	-11%	21%	57%	2%	267%
Russian LTCM Crisis	8/18/1998	10/8/1998	1,101.20	959.44	-13%	39%	11%	8%	235%
Clinton Impeachment	12/19/1998	2/12/1999	1,188.03	1,230.13	4%	13%	-10%	-6%	161%
USS Cole Yemen Bombings	10/11/2000	10/18/2000	1,364.59	1,342.13	-2%	-20%	-23%	-12%	140%
September 11 Attacks	9/10/2001	9/21/2001	1,092.54	965.80	-12%	-12%	17%	36%	233%
Iraq War	3/19/2003	5/1/2003	874.02	916.30	5%	21%	42%	54%	251%
Madrid Terrorist Attacks	3/10/2004	3/24/2004	1,123.89	1,091.33	-3%	7%	32%	-26%	195%
London Train Bombing	7/6/2005	7/7/2005	1,194.94	1,197.87	0%	6%	5%	-11%	168%
2008 Market Crash	9/15/2008	3/9/2009	1,192.70	676.53	-43%	69%	103%	178%	375%
Price Changes Only - Does Not Include Dividends				**Averages:**	**-7%**	**18%**	**39%**	**66%**	**4398%**

As of 7.24.20. Source: Kovitz Investment Group using Bloomberg and Ned Davis Research Events & Reaction Dates

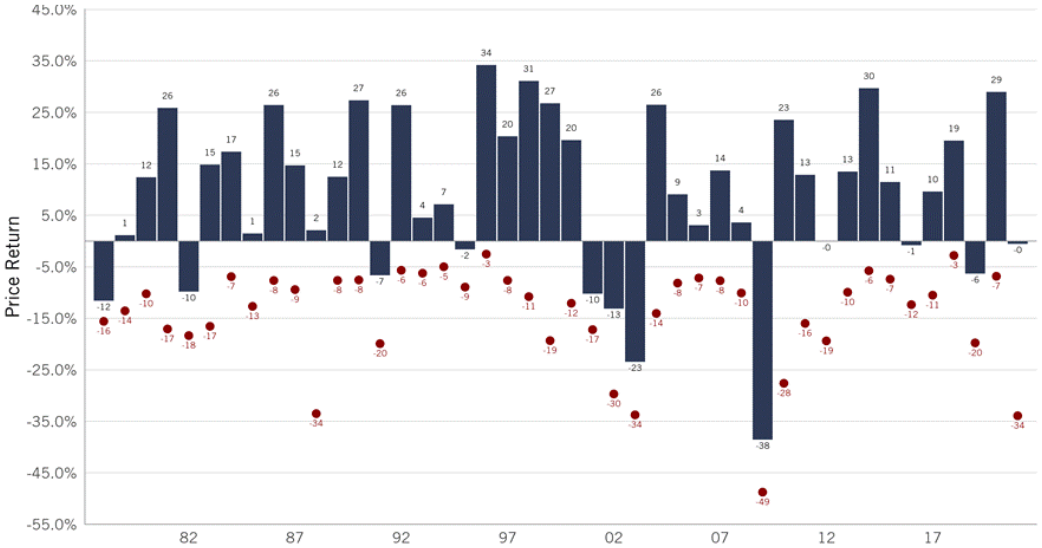
Time will tell how the COVID-19 Pandemic and Great Lockdown are remembered in terms of equity market disruption and ultimate recovery, but history is filled with plenty of disconcerting events. Happily, those who have stayed the course, sticking with their long-term investment plans, have nearly always been rewarded in the fullness of time.

With U.S. and Chinese tensions also again rising, we must remain braced for significant equity market volatility,…

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 07.24.20. 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.

…but we continue to believe that the odds today overwhelmingly favor stocks for those who can look out years as opposed to days, weeks or months.

THE PRUDENT SPECULATOR

THE LONGER THE HOLD, THE LOWER THE RISK

While fixed income investments generally boast lower volatility than equities, it is nice to see the historical odds of Value Stocks and Dividend Payers outperforming the current 0.6% yield on the 10-year U.S. Treasury increase markedly as the level of patience rises.

PATIENCE IS VIRTUOUS

VALUE STOCKS

	Count >0.6%	Count <=0.6%	Percent >0.6%
1 Month	698	417	62.6%
3 Months	743	370	66.8%
6 Months	779	331	70.2%
1 Year	803	301	72.7%
2 Year	909	183	83.2%
3 Year	942	138	87.2%
5 Year	941	115	89.1%
7 Year	993	39	96.2%
10 Year	961	35	96.5%
15 Year	933	3	99.7%
20 Year	876	0	100.0%

DIVIDEND PAYERS

	Count >0.6%	Count <=0.6%	Percent >0.6%
1 Month	701	414	62.9%
3 Months	764	349	68.6%
6 Months	793	317	71.4%
1 Year	823	281	74.5%
2 Year	917	175	84.0%
3 Year	912	168	84.4%
5 Year	957	99	90.6%
7 Year	983	49	95.3%
10 Year	957	39	96.1%
15 Year	935	1	99.9%
20 Year	876	0	100.0%

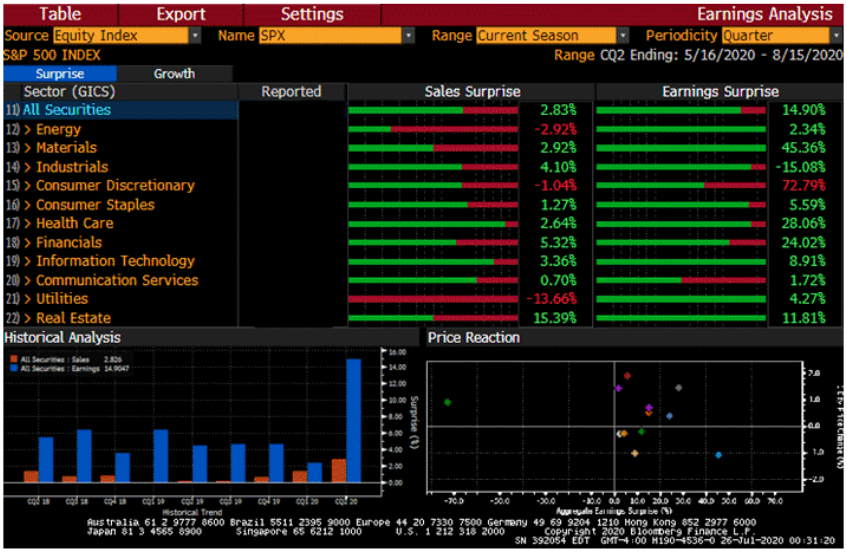
From 07.31.27 through 05.31.20. Value stocks represented by 50% small value and 50% large value returns rebalanced monthly. Dividend payers represented by 30% top of dividend payers, 40% of middle dividend payers, and 30% bottom of dividend payers rebalanced monthly. SOURCE: Kovitz using data from Professors Eugene F. Fama and Kenneth R. French

Stock Updates

Second quarter earnings reporting season picked up steam last week. We are just two weeks in, but thus far the numbers have been very good relative to subdued expectations. With 127 members of the S&P 500 having announced results, 85.5% have topped analyst projections, much better than the usual 70% or so that beat Wall Street forecasts.

EPS LIKELY TO PLUNGE IN 2020 BUT REBOUND SHARPLY IN 2021

The Q2 reporting season is young, but analysts thus far have been a little too pessimistic in their top- and bottom-line estimates. Of course, full-year 2020 COVID-19-impacted EPS likely will be miserable, but a significant rebound is projected next year.



S&P 500 Earnings Per Share

Quarter Ended	Bottom Up Operating EPS 3 Month	Bottom Up Operating EPS 12 Month
ESTIMATES		
12/31/2021	$44.76	$161.46
9/30/2021	$41.79	$152.58
6/30/2021	$38.23	$142.05
3/31/2021	$36.68	$126.41
12/31/2020	$35.88	$109.23
9/30/2020	$31.26	$112.53
6/30/2020	$22.59	$121.08
ACTUAL		
3/31/2020	$19.50	$138.63
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 7.23.20

Management team outlooks have been very subdued and forward guidance ranges have been broad if they are provided at all, but Jason Clark, Chris Quigley and Zach Tart look at a baker's dozen of our companies that posted quarterly results 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/.

Semiconductor giant **Intel** reported earnings per share of $1.23, versus the $1.12 estimate, in fiscal Q2 2020. INTC had revenue of $19.7 billion, versus the $18.5 billion estimate. Despite the terrific earnings, the stock fell a whopping 17% on Friday after management revealed more delays for the company's upcoming 7-nanometer chips.

CEO Bob Swan said, "We are seeing an approximate 6-month shift in our 7-nanometer-based CPU product timing relative to prior expectations. The primary driver is the yield of our 7-nanometer process, which, based on recent data, is now trending approximately 12 months behind our internal target. We have identified a defect mode in our 7-nanometer process that resulted in yield degradation. We've root caused the issue and believe there are no fundamental roadblocks. But we have also invested in contingency plans to hedge against further schedule uncertainty. We're mitigating the impact of the process delay on our product schedules by

leveraging improvements in design methodology such as die disaggregation and advanced packaging. We have learned from the challenges in our 10-nanometer transition and have a milestone-driven approach to ensure our product competitiveness is not impacted by our process technology road map."

We've seen this show before with Intel, and given the technical challenges making transistors 7-nanometers wide, we weren't shocked to hear there were more delays. However, other chipmakers have been on track with 7nm products, so it is a bit worrying that Intel is so far behind. And then Mr. Swan said (emphasis ours), "Our overarching priority is to deliver product leadership for our customers, and we are taking the right steps to produce a strong lineup of leadership products. We will continue to invest in our future process technology road map, but we will be pragmatic and objective in deploying the process technology that delivers the most predictability and performance for our customers, whether that be on our process, **external foundry process** or a combination of both."

Mr. Swan added, "Our advanced packaging technologies, combined with our disaggregated architecture, give us tremendous flexibility to use the process technology that best serves our customers. As an example, our data center GPU design, Ponte Vecchio, will now be released in late 2021 or early 2022, utilizing external and internal process technologies, combined with our world-leading packaging technologies. We now expect to see initial production shipments of our first Intel-based 7-nanometer product, a client CPU, in late '22 or early '23."

Not only is the CPU not scheduled to launch for about three years, a year behind the initial schedule, it is unprecedented that Intel is considering outsourcing its fabrication plants ("fabs"). Part of what makes the move difficult to comprehend is that Intel was the world's leader in silicon lithography manufacturing five years ago. It is hard to tell what is happening internally at Intel to cause that major strategy review. And after repeated manufacturing delays with its 10nm chips, management routinely reminded investors that the 7nm chips were on schedule and the delays would be made up. With the production schedule sliding, there seems to be no made up time for Intel, just lost time.

Of course, investors were far from excited about the news on Friday and sell-side analysts quickly revised their ratings, whacking target prices and changing recommendations. Indeed, last quarter we wrote, "Intel had significant trouble getting its 10-nanometer chips to production, but the company expects to make some big launches in the middle of this year. Long-serving as a disappointment for analysts, the notebook segment finally grew, a meaningful 14% year-over-year, as PC volumes surged amid widespread shelter-in-place orders." What we did not account for was a delay in the next generation of chips. While this is all gloomy news for Intel, we think that the company has the balance sheet and talent to fix this mess. It is definitely not the end of the world if Intel outsources some manufacturing, as companies we own like **Broadcom** (AVGO – $305.79) and **Qualcomm** (QCOM – $88.89) do just fine without owning a single plant. It is mainly a huge change in strategy for which no investors or analysts were ready. While we are going to be carefully watching Intel's new strategy evolve in the upcoming quarters, we continue to favor the company's diversified revenue stream, low levels of debt, forward P/E ratio below 12 and 2.6% dividend. That said, our Target Price has been trimmed to $70.

Global provider of computer solutions and advanced technologies leader **Int'l Business Machines** (IBM – $125.79) posted earnings per share of $2.18, versus the $2.12 estimate, in fiscal Q2 2020. IBM had sales of $18.1 billion, versus the $17.6 billion estimate. While shares gained sharply in early trading on Tuesday, they retreated to finish the day and the week roughly flat.

New CEO Arvind Krishna commented, "From a market perspective, while the current environment poses certain short-term challenges, it also presents long-term opportunities that IBM will seize as our clients accelerate their shift to hybrid cloud and AI. The essential work that we do in terms of running our clients' mission-critical processes continues. More profoundly, we see that the digital transformation of businesses is accelerating. Our second quarter results demonstrate this with an increase of over 10 points in our cloud revenue growth over last quarter. The trend we see in the market is clear. Clients want to modernize apps, move more workloads to the cloud and automate IT tasks. They want to infuse AI into their workflows and secure their IT infrastructure to fend off growing cybersecurity threats. As a result, we are seeing an increased opportunity of large transformational projects. These are projects where IBM has a unique value proposition, but they are also projects that take time to shape and therefore to close."

Mr. Krishna continued, "Hybrid cloud is a dominant force driving change in our industry, but it's far from universal adoption. Only 20% of the workloads have moved to the cloud. The other 80% are mission-critical workloads that are far more difficult to move. There's a massive opportunity in front of us to capture these workloads. When I say hybrid cloud, I am talking about an interoperable IT environment across on-premise, private and publicly operated cloud environments, in most cases, from multiple vendors. Why do we believe this is the future rather than a pit stop along the way? Clients find that choosing a hybrid cloud approach is 2.5x more valuable than relying on public cloud alone. This considers factors such as innovation, development time and portfolio optimization. The platform starts with Linux, which is the de facto operating system standard. We have a tremendous advantage with Red Hat Linux, which is the market share leader. Linux, along with Containers and Kubernetes, provides the architectural foundation of our platform, and OpenShift is our core product that captures all this and more. IBM has a vast software and middleware portfolio, which has now been containerized and runs on OpenShift and Red Hat Linux. The family of Cloud Paks we introduced in the second half of last year allows our middleware to run in a cloud-native environment and bridge our clients from the past to the future. This means clients can now deploy our software anywhere OpenShift runs. It is infrastructure-agnostic across not just public and private clouds but also our mainframes and power system platforms."

Mr. Krishna concluded, "As you know, with the current events in the United States, there has been a renewed focus to do more. As IBM's CEO, I'm fully committed to ensuring that IBM will continue to lead in this area. But this is also about skills and creating opportunity. Since 2011, IBM has helped to develop and expand a new public education model called P-TECH. P-TECH provides high school students from underserved backgrounds with the skills and credentials they need for competitive jobs in STEM. To that end, we recently made a commitment to hire 1,000 interns who come from P-TECH. To put this in context, we hire between 5,000 and 10,000

interns at IBM each year, so this represents more than 10% of our intern base. I'm always happy to expand later on this and other topics relating to our ESG efforts."

CEO Jim Kavanaugh added, "The current environment presents some near-term challenges for our clients, but it also provides some longer-term opportunities for us. We have a business profile and business model that provides some stability in the current environment. We have also recently taken a number of actions that strengthen our operating model for today and for the future. We built a robust hybrid cloud platform based on what we firmly believe is the winning architecture. This technology-centric platform, together with our deep industry expertise and ecosystem partners, will enable us to accelerate clients' digital transformations and move more of our clients' mission-critical workloads to the cloud. As we enter the second half, we have a compelling set of offerings and a strong pipeline across software, services and systems… And for Red Hat, we anniversaried the acquisition in early July. We're wrapping on a large part but not all of the impact of the deferred revenue adjustment and transaction charges. We also wrap on the divestitures completed in the second quarter of last year. And the savings from our structural actions will start to yield in the second half, providing better cost competitiveness and margin performance, especially in GTS. Finally, we remain confident that we have ample free cash flow and liquidity to invest in our business and return value to shareholders through dividends."

We believe that the Red Hat acquisition is likely to help IBM find its footing and regain some of the value it has lost as competitors, including names we presently have in our portfolios like Oracle (ORCL – $55.65), have swooped in on the company's cloud business. The company still offers a big and recently increased dividend and the yield is now a hefty 5.2%, while IBM has been a big buyer of its own shares since 1995 (though repurchase plans are on hold as it pays down debt from the Red Hat acquisition). And, we believe there can be some earnings multiple expansion if Big Blue can string together a few quarters of solid growth. While IBM's execution has frustrated us, the company's new management team, solid free cash flow and a sub-11 times forward P/E ratio provide plenty of support that better days are to come. Our Target Price for IBM is $182.

Computing giant **Microsoft** (MSFT – $201.30) earned $1.46 per share in fiscal Q4 2020 (vs. $1.36 est.). MSFT had sales of $38.0 billion (vs. $36.5 billion est.). Shares fell 4.3% following the announcement but were nearly flat for the week.

Microsoft CEO Satya Nadella commented, "We delivered record results this fiscal year powered by our commercial cloud, which surpassed $50 billion in revenue for the first time, up 36% year-over-year. The last 5 months have made it very clear that digital tech intensity is key to business resilience. Organizations that build their own digital capability will recover faster and emerge from this crisis stronger. We are seeing businesses accelerate the digitization of every part of their operations from manufacturing to sales and customer service to reimagine how they meet customer needs from curbside pickup and contactless shopping in retail to telemedicine in health care."

Quarterly Business Highlights

Productivity and Business Processes	• Office Commercial products and cloud services revenue increased 5% (up 7% CC) driven by Office 365 Commercial revenue growth of 19% (up 22% CC) • Office Consumer products and cloud services revenue increased 6% (up 7% CC) with continued growth in Office 365 Consumer subscribers to 42.7 million • LinkedIn revenue increased 10% (up 11% CC) • Dynamics products and cloud services revenue increased 13% (up 15% CC) driven by Dynamics 365 revenue growth of 38% (up 40% CC)
Intelligent Cloud	• Server products and cloud services revenue increased 19% (up 21% CC) driven by Azure revenue growth of 47% (up 50% CC) • Enterprise Services revenue was relatively unchanged (up 2% CC)
More Personal Computing	• Windows OEM revenue increased 7% • Windows Commercial products and cloud services revenue increased 9% (up 11% CC) • Xbox content and services revenue increased 65% (up 68% CC) • Surface revenue increased 28% (up 30% CC) • Search advertising revenue excluding traffic acquisition costs decreased 18% (down 17% CC)

Includes non-GAAP constant currency ("CC") growth. See Appendix for reconciliation of GAAP and non-GAAP measures. Growth rates in GAAP and CC are equivalent unless otherwise noted.

7

Mr. Nadella concluded, "We are expanding our opportunity and investing across the full modern technology stack. Over the next decade, technology spending as a percentage of GDP is projected to double, and we are well positioned to participate in that growth by innovating and defining the key technologies that empower every person and every organization on the planet to build more of their own tech intensity."

CFO Amy Hood offered the outlook, "We expect COGS of $10.75 billion to $10.95 billion and operating expense of $10.7 billion to $10.8 billion with continued investment against our significant long-term ambition. Other income and expense should be negative $50 million as interest expense is expected to more than offset interest income. And finally, we expect our Q1 tax rate to be approximately 16%, lower than our expected full year rate, given the volume of equity vests in our first quarter. We are committed to our customers' success in these challenging times and to managing the company for long-term growth and profitability. We will continue to expand our cloud infrastructure to support the growing customer usage and demand across our differentiated cloud offerings. And given our strong execution and growing competitive advantage in high-growth areas, we remain committed to investing against the long-term opportunity ahead of us."

MSFT returned $8.9 billion to shareholders via dividends and share repurchases in fiscal Q4, a 16% increase year-over-year. For the full fiscal year, Microsoft returned $35 billion to shareholders. Including dividends, shares have gained nearly 30% since the end of 2019, a giant move higher considering the economic environment, performance of the average stock and the growth in market capitalization. While we thought a portion of Microsoft's revenue would be temporary and due to COVID-related acceleration of IT spending for a remote workforce, we are thinking that a larger portion could be permanent as the pandemic drags on or accelerates, depending on the region. The stock sports a 3.0% free cash flow yield and a 1.0% dividend yield, to go along with significant growth potential, though the shares remain a little pricey with a forward P/E ratio of 31. We have previously trimmed the quantity of Microsoft in our managed accounts and we are presently comfortable with the current weights despite the not-so-cheap valuation. Analysts still expect the company's EPS growth rate to be at least 12% for each of the next three fiscal years, with earnings growing from $3.88 in 2018 to an estimated $8.24 in fiscal 2022, Our Target Price has been boosted again, this time to $221.

Integrated telecom services firm **AT&T** (T – $29.57) earned $0.83 per share in fiscal Q2 2020 (vs. $0.79 est.). T had sales of $41.0 billion, versus the $40.9 billion estimate. Shares fell 0.9% following the announcement.

CEO John Stankey commented on the results, "We're planning and operating under the assumption that significant accommodations for COVID will be the business norm well into next year. The unfortunate reality simply sharpens our focus and strengthens our resolve on the business transformation path we chartered and the investment focus we've adopted. As a company, our purpose is to create connection. We create connection with each other, with what people and businesses need to thrive every day and with stories and experiences that matter. That purpose leads us to our market focus. First, as a broadband provider, our high-speed fiber and wireless broadband networks connect the people and businesses that form the foundation for how we live and work. Second, as a software-based entertainment provider, we deliver compelling entertainment experiences through HBO Max and AT&T TV, giving us the opportunity to establish meaningful relationships with the majority of U.S. households. And third, the fantastic stories we tell and share in our platforms drive direct customer engagement and insights and create emotional attachments that can drive long-lasting customer loyalty across our product set."

Mr. Stankey continued, "To grow, we know we have to be more effective and efficient in our execution. As part of our transformation initiative, we have more than 50 different work streams underway that will enhance not only how we work together, but how we deliver improved service levels and greater value for our customers, including competitive pricing that drives market momentum and targeted investment to achieve growth in those key products I mentioned. Our success relies on AT&T becoming a more agile and efficient company that's able to meet our customers' needs in the highly competitive and quickly evolving markets. Our transformation began with the new operating model we put in place at WarnerMedia last year to organize our teams around entertainment networks, live programming, content production and affiliate and advertising sales. That allowed us to work together across WarnerMedia and all of AT&T to successfully launch HBO Max."

Mr. Stankey concluded, “Our core subscription businesses proved to be resilient in the face of the economic downturn. Our Mobility and Business Wireline segments performed well, and we grew EBITDA margins in both areas. We continue to add new fiber customers, though COVID limited our ability to go into some customers’ homes for installs. Our software-based entertainment business has performed well. AT&T TV subscriber growth in its first full quarter was better than we expected, and it’s our highest-performing video product on customer satisfaction, double the level of our legacy TV services. HBO Max had a strong launch, on track to hit its targets we laid out for you last fall. We’re already seeing how HBO Max can increase our broadband adds and increase wireless ARPU. Obviously, COVID had a significant impact on our WarnerMedia segment with advertising revenues, content production and theaters all shut down. We’ll talk more about that a little later in the presentation, but I cannot imagine being at this moment, absent the moves we made last year, to reconfigure our WarnerMedia operations and refocus the business on the growing and important direct-to-consumer opportunity.”

CFO John Stephens added, “We’ve been active in the bond market. Rates are low, demand is healthy, and we used this opportunity to issue about $17 billion in long-term debt at rates significantly below our average cost of debt. This allowed us to materially reduce our near-term debt towers, making our debt obligations for the next few years very manageable.”

The company’s huge 7.0% dividend yield is not in jeopardy at this point and analysts expect earnings to grow in 2021 and 2022 following the COVID-related trough this year. While AT&T has a lot of debt weighing down its balance sheet, the weighted average coupon is 4% and average maturity is 2034, with some bonds maturing as far out as July 15, 2097. There are sure to be challenges on the horizon, including customer nonpayment revenue dings, but we like the long-term, better-than-utility-like exposure (and entertainment focus) with a big yield and a very reasonable sub-10 times P/E ratio. Our Target Price is now $41.

Staffing solutions provider **ManpowerGroup** (MAN – $72.01) released Q2 2020 financial results last week that lagged expectations ($0.18 vs. $0.22 est.). Government support throughout Europe, particularly in France (where nearly two-thirds of the private workforce had benefited from state-sponsored furloughs in the quarter), has significantly reduced recent demand for employment. Year-to-date revenue through June was $8.4 billion, a decrease of 20% from the prior year. Remarkably, the firm continues to build cash on its balance sheet ($1.4 billion at quarter end) through improved collections experience on work performed in previous periods. An unused $600 million revolving credit facility, which expires in 2023, adds to MAN’s liquidity position.

MAN CEO Jonas Prising commented, “The world continues to be impacted by COVID-19 which started as a health crisis and evolved to become a global economic and social crisis. While certain regions continue to deal with the pandemic at elevated levels, elsewhere lockdowns are easing, economies are slowly re-opening and people are returning to work. I am thankful and proud of our talented colleagues for providing the highest levels of support to our clients and candidates during this extremely challenging period. In this environment, we will continue to focus on operational excellence, including managing costs prudently to offset gross profit declines while continuing to invest in our transformation. This is how we will continue to

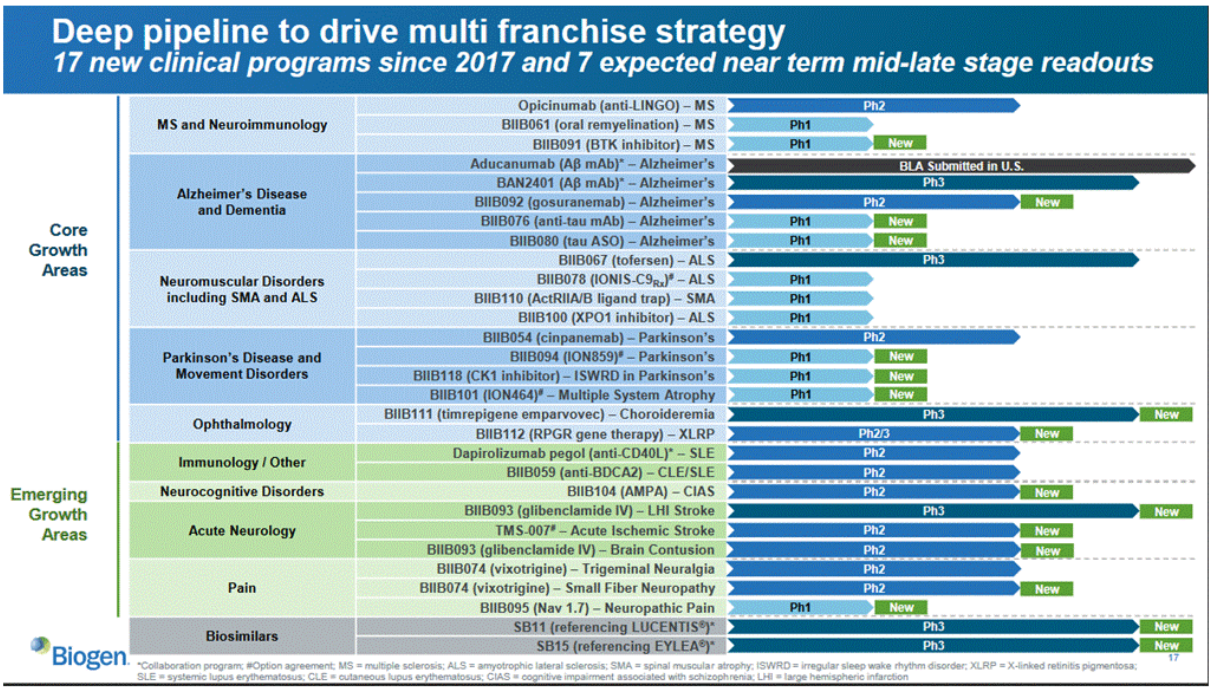
progress our key strategic initiatives and position us for further success when we emerge from these crises."

Management reinstated its Q3 guidance and expects earnings per share in the range of $0.59 to $0.67 before currency impacts. The belief stated is that major uncertainty associated with the government lockdowns has largely been lifted, although its guidance assumes no major rollbacks of reopening activities in any of the firm's largest markets.

While the near-term remains filled with operational headwinds, we appreciate management efforts to maintain solid financial footing through building cash and expense management. MAN's broad geographic footprint, wide range of offerings and shifts to recruitment outsourcing should provide a ramp as financial conditions eventually improve. MAN's dividend is paid twice a year, with the most recent declaration in May. The current dividend yield is 3.0%. Our Target Price is now $107, and we note that MAN shares doubled in price during the two years following the Global Financial Crisis.

Despite reporting better than expected top- and bottom-line results for Q2, shares of **Biogen** (BIIB – $272.33) fell more than 3% last week as investors seemed to be concerned about the lack of new details around its Alzheimer's drug filing and the announcement in an evening press release that CFO Jeff Capello was departing. While we can only speculate about the details surround the CFO's departure, we do know that Biogen will be presenting phase 3 study data for its Alzheimer drug aducanumab on Wednesday morning, July 29, at the Alzheimer's Association Virtual International Conference (the presentation will be followed by a Q&A). This event is going to tell us a lot about where Biogen is going in the short- and intermediate-term.

For Q2, BIIB reported adjusted EPS of $10.26, well above the expected $8.02 that analysts were projecting. Revenue for the period came in more than 7% above the consensus expectation of $3.43 billion. "In the second quarter, Biogen continued to deliver strong financial results. We are pleased to have completed the BLA submission for aducanumab and look forward to the prospect of launching the first therapy to reduce clinical decline in Alzheimer's disease," said CEO Michel Vounatsos. "Our progress with aducanumab exemplifies our broader strategy of building a multi-franchise portfolio based on our deep expertise in neuroscience, and we have multiple near-term value creation opportunities in other areas such as ALS, ophthalmology, lupus, stroke, and biosimilars."



Despite the lack of new info on aducanumab during the earnings call, we like that Biogen is still generating strong free cash flow which can aid in strengthening a pipeline that we already think has solid long-term potential keying on cancer and neurology disorders. That said, if aducanumab fails to gain approval, BIIB will need to fill the gap, and will most likely turn to acquisitions somewhat rapidly. The combination of the pipeline and potential adds are important because BIIB still faces looming pressure from generics in the coming years, or sooner given the court victory last month for Mylan Inc. related to Biogen's blockbuster Multiple Sclerosis drug Tecfidera, and potential competition from Novartis for its spinal muscular atrophy treatment Spinraza. No doubt, Biogen investors must be braced for volatility, and we suspect that there may be a big move this week. At this point we think the potential upside dwarfs the downside, especially with the stock trading for less than 8 times NTM adjusted earnings expectations, but we always reserve the right to change our mind favorably or unfavorably as new information is received. Our Target Price for BIIB is presently $443.

Whirlpool (WHR – $157.95) shares rose almost 11% last week on the back of a better-than-expected Q2 financial release. The appliance maker reported adjusted earnings for the period of $2.15 per share, more than doubling the consensus estimate of $1.00. Revenue also came in above expectations at $4.04 billion, versus the $3.62 billion consensus forecast. The North American business is regaining sales momentum and realized strong performance during the

period. While EMEA and Latin America continue to be a drag on company performance, management said that there was significant demand recovery across all its regions in the month of June. WHR provided 2020 sales guidance with a 7% to 12% decline now expected, versus the prior 10% to 15% drop projection.

WHR CEO Marc Bitzer commented, "Delivering a solid Q2 performance despite the far reaching impact of COVID-19 on our business is the result of the decisive actions we took throughout the quarter and ultimately demonstrates the resilience of our business model. While we recognize the uncertainty and volatility which lies ahead of us, we are proud of the way in which we managed through the most difficult quarter of this global crisis."

CFO Jim Peters added, "Our strong second-quarter results are a testament to our operational strength and the perseverance of our global team. In the quarter, we delivered solid cost takeout globally and strong cash flow improvement through disciplined working capital management. The actions we took earlier this year to sustain our margins and protect our liquidity strengthened our ability to succeed through the ongoing COVID-19 pandemic and have prepared us to withstand current economic uncertainty."

While the near-term is hazy, despite an improving U.S. housing market, we feel confident in the company's liquidity as it has continued its work to cut and contain costs. WHR has $2.5 billion in cash, another $2.5 billion it can tap if needed and debt maturities over the next four years that average less than $300 million. We are expecting margins to widen in the near-term as the company benefits from lower steel costs. We think that as things open back up and life gets back to somewhat normal. WHR will benefit in the U.S. from the home appliance replacement cycle and continued home purchasing by Millennials, while the rest of the world progresses technologically and emerging markets incorporate modern conveniences into daily living. WHR's well-covered dividend yield is currently 3.0%. Our Target Price has been hiked to $198.

Regional banking concern **Old National Bancorp** (ONB – $14.22) released Q2 2020 financial results last week that handily beat expectations (EPS of $0.33 vs. $0.24 est.). Compressed interest rates led to lower interest income year-over-year, while higher fee income and expense reduction supported the bottom line. Total loans increased by $1.3 billion, primarily due to PPP loan funding and growth in commercial real estate. Provisions for credit losses at ONB are on the low end of the banks in our coverage as reserves for future losses represent 94 basis points of total loans. The bank identified six segments that it deemed vulnerable in the current climate, ranging from Oil/Gas to Restaurants and Senior Housing. None of the loan exposure from these industries exceeds 2.3% of total loans, and the total exposure of all of these identified segments are just 7% of total loans. While payment deferral requests ticked early in the quarter, they had slowed to a trickle be quarter end.

CFO Brendon Falconer summarized the quarter and outlook for the remainder of the year, "We are pleased with our overall performance as the fundamentals of our core business were strong. Commercial production was solid. Our fee businesses continue to perform well, particularly our mortgage and capital markets lines, and we delivered on the promised expense savings we outlined in our ONB Way strategic plan…We ended the quarter with a healthy $2.7 billion commercial pipeline, but economic uncertainty may impact pull-through rates and mute loan

growth in the near term. The impact on our net interest margin to the short end of the curve is now largely behind us, but historically, low long-term rates will continue to put pressure on asset yields as our loan and investment portfolio is repriced at lower coupons."

Consistent with the technological objectives in the firm's ONB Way initiative, the firm recently announced a partnership with Infosys. CEO Jim Ryan explained, "The technology investments required for financial services are only accelerating, and we recognize the need for a strong partner to help us maximize the benefits from those increased investments. This multiyear technology partnership will fund those accelerated investments in technology infrastructure, improve our training and development opportunities and increase our innovation. We are confident that over time this partnership will significantly enhance our client experiences and provide even greater scale to grow our bank efficiently and effectively."

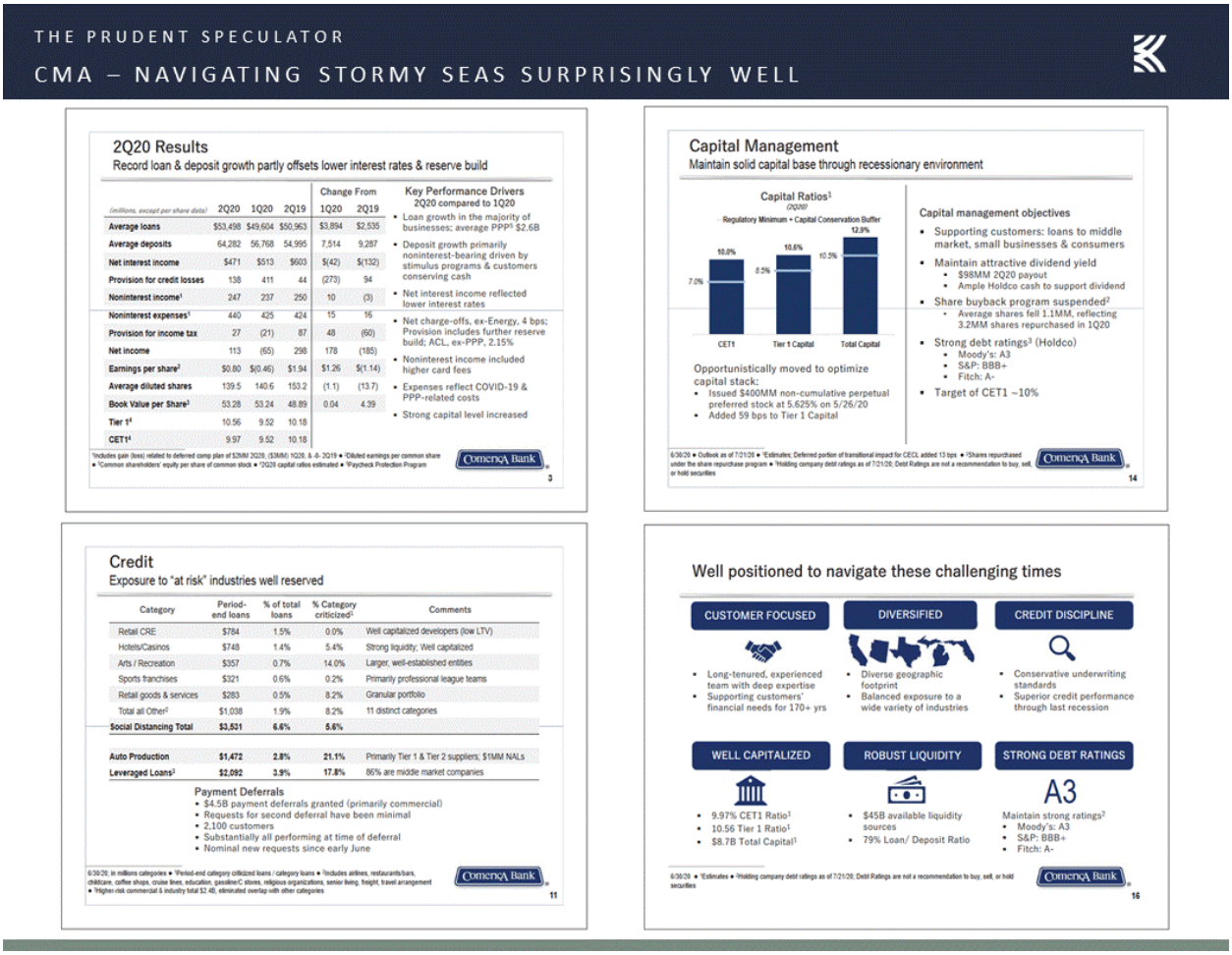
The interest rate environment remains a headwind for most banks, and for Old National in particular, given that interest income accounts for over 70% of total revenue. Still, we are encouraged by progress the bank in making under its ONB Way program to drive efficiency, shed costs and invest in technology. ONB's growing deposit base also appears to be an area of strength given the low and shrinking cost of funds. The stock rebounded 7.8% last week, yet shares still yield 3.9% and trade at 80% of book value. Our Target Price for ONB now stands at $20.

Comerica Inc. (CMA – $37.42) shares jumped more than 5% last week, supported by a solid Q2 earnings release. Adjusted EPS for the three-month period came in at $0.80, more than $260% above the consensus estimate of $0.22. While the company increased credit reserves during the quarter, many investors seemingly were expecting a greater hit, given the bank's exposure to the energy sector as well as small businesses in general, the latter a driver of why the company beat expectations by so much. During the earnings call, management said it believes that it can increase net interest income in the second half of the year, important to a lender where spread revenue accounts for more than 65% of its total.

CMA CEO Curt C. Farmer commented, "The highlight of the quarter was significant loan and deposit growth, which drove average balances to record highs and partly offset the impact of lower interest rates on net interest income. Overall, credit quality remained solid; however, with the unprecedented, rapid decline in the economy and high level of uncertainty, we prudently increased our credit reserves. Capital levels continued to be strong and we remain focused on maintaining an attractive dividend yield for our shareholders, as our book value per share grew to $53.28."

Mr. Farmer continued, "We have quickly adapted to the COVID-19 pandemic and are continuing to make adjustments as the crisis evolves. The health and safety of our employees and our customers remains our top priority. Across the bank, our colleagues have continued to ensure that our customers are well taken care of, working tirelessly to provide sound financial advice, credit expertise and payment flexibility where needed. Particularly, I am proud of the tremendous dedication our colleagues have displayed in supporting the Paycheck Protection Program. Through our long history, Comerica has successfully managed through many

challenging times. Helping our customers and communities endure stressful situations and achieve long-term success is at the heart of Comerica's relationship banking strategy."



With persistently low interest-rates, a weak energy market and Corporate America still struggling, the current environment is sort of a perfect storm hitting Comerica, but the stock price, in our view, discounts a far more dire future than what we think will occur. As contrarians, we like that CMA is unloved by most of the analysts following it, but we acknowledge that the forward sledding will be through rough terrain. That said, we think the bank will work to limit its energy exposure from here and we like the potential upside if and when long-term rates move higher. In addition, management remains committed to the dividend for now (the yield is presently 7.3%) and given the recent quarter, the company can likely maintain it at these levels through a few uglier quarters unless the Federal Reserve directs otherwise. A higher-risk, greater-reward bank in our portfolios, we continue to closely monitor CMA, even as it trades significantly below our current Target Price of $71.

Shares of **Capital One Financial** (COF – $65.06) dipped roughly 4% in after-hours trading Tuesday evening as the firm released Q2 business results. Sentiment for the credit card giant seemingly turned overnight, reversing the prior evening's decline and driving shares nearly 5% higher for the full week. The diversified financial services operation announced a slightly worse-

than-expected loss of $1.61 (vs. a 1.53 expected loss) in Q2. Provision for credit losses, lower net interest margin and loan balances were all key drivers in the period.

Consistent with most banks in our coverage universe, Capital One took a big $4.2 billion provision for credit losses, with $2.7 billion of the measure contributed to reserves for future losses which now stands at 6.69% of total loans, up from 2.71% at December 31, 2019. Net charge-offs, 30-plus day delinquent but performing loans, and nonperforming loans are all trending in the right direction, with the first two lower by almost a percentage point each. Deposits grew 13% in the quarter and were up 19% year-over-year. Total loans contracted by 4% in Q2 as average card balances shrunk by 11%, while cash more than doubled to $55.8 billion.

Capital One founder and CEO Richard Fairbank summarized the period, "Capital One's second quarter results were driven by the near-term impact of the COVID-19 pandemic. A significant allowance build and declining revenue drove negative earnings per share. Consumer credit trends were very strong. We further fortified liquidity and our CET ratio — CET1 ratio increased to 12.4%. Based on the new cumulative earnings rule that the Federal Reserve announced in the quarter, we expect to reduce our third quarter common stock dividend to $0.10 per share, subject to our Board's approval."

He continued, "Pulling way up, we're more than halfway through a year, none of us will ever forget. Capital One started the year with significant momentum. Then COVID-19 hit an inflection point in March, driving a sudden shutdown of economic activity, a sharp increase in unemployment. And along with the biggest and fastest government response since the great depression. We are well positioned by the choices we made before this downturn started. Since our founding days, we have hardwired resilience into the choices we've made on credit, capital and liquidity through good times and bad. As a result, we entered the downturn with strong and resilient credit trends, a fortified balance sheet and deep experience in successfully navigating through prior periods of stress, including the Great Recession. Our investments to transform our technology and how we work and our efforts to drive the company to digital are powering our response to the pandemic. Our technology transformation enables us to develop and scale up compelling digital customer experiences, as social distancing increases demand for digital engagement."

Uncertainty still abounds in regard to the economy and business environment in the wake of COVID-19, particularly for a higher-risk firm like Capital One. That said, we still hold the belief that a lot of the remaining downside is priced into banks and financials. And, while we hesitate to look for proof in near-term share price movements, investors' seeming willingness to look past a looming 75% COF dividend cut appears to support our position. We remain more concerned about a smaller credit card portfolio than we are about credit losses when we move to the other side of this pandemic and the economy starts to reaccelerate. However, we continue to be long-term fans, liking that COF in a more normal environment is a willing and opportunistic asset acquirer in efforts to bolster returns and diversify. Additionally, we like the firm's focus on managing risks, while improving efficiency, even as it invests to grow and transform itself as banking goes digital. While the near-term outlook remains difficult, COF trades today for less than 10 times the consensus 2021 EPS estimate. Our Target Price now resides at $114.

Consumer financial services concern **Synchrony Financial (**SYF – $23.56) released Q2 2020 financial results last week that missed expectations ($0.06 vs. $0.18 est.). Lower interest margin of 13.53% compared to last year's margin of 15.75% contributed to the miss, as well as $475 million, a 40% increase, in provisions for credit losses compared to last year. $627 million of the $1,673 million provision went to reserve for future losses, while the net charge-off rate improved 20 basis points year-over-year, excluding the Walmart portfolio sold in October 2019. Shares are down 34.5% year-to-date despite being 84% off the March 23 bottom.

Purchasing activity for the self-described deliverer of customized financing programs across key industries including retail, health, auto, travel and home, along with award-winning consumer banking products, declined 31% overall through the first half of April. But by June, volumes had picked up, driving a 3% increase over the prior year. Balances per account were 4% higher at quarter end even as tighter underwriting drove a pullback in new accounts (down 36%). Nearly 2% of average loans had been granted forbearance in the quarter, with 70% of these leaving this status by the end of June.

CEO Margeret Keane commented on the quarter, "As we navigate the day-to-day of this new environment in which we all find ourselves, we are also acutely focused on the future of our business…We also returned $128 million in capital through common stock dividends. We are pleased with the strength of our business, and we are well positioned to continue to help our cardholders and partners navigate through these challenging times. We continue to remain highly focused on digital innovation, accelerating our data analytics capability and creating frictionless customer experiences, which are key to the success of our programs and winning new partnerships."

President Brian Doubles highlighted the firm's focus on digital sales penetration, "In Retail Card, digital sales penetration was 48% in the second quarter, and digital applications were approximately 70% of our total applications, 14 percentage points higher than last quarter. The mobile channel alone grew 43% compared to the same quarter last year, excluding Walmart. Further, more than 60% of total payments made on our cardholders' accounts are done digitally. We continue to provide partners and customers with increased digital options from applying on their own devices, provisioning a new card into their digital wallet, transacting with contactless cards and making payments. We believe customers will continue to adapt to what makes them more comfortable."

Synchrony extended several programs and added new partnerships in the period and launched a new program for Verizon. The Verizon card provides wireless customers the ability to save on their monthly Verizon bills through rewards earned on everyday purchases, and offers a contactless, frictionless and digital-first experience. The firm also anticipates the launch of a new program with Venmo later in the year.

We still believe that SYF offers significant long-term upside, especially after the drubbing shares have endured, though we are undoubtedly concerned with exposure to troubled retailers. However, we are quite constructive on partnerships with PayPal, Amazon and newer programs with Venmo and Verizon, as SYF continues to improve its long-term potential to benefit from growing digital shopping. SYF will need to continue to enhance its technological capabilities as

it moves forward, but its financial footing is strong and credit quality remains OK. The company declared its regular $0.22 per share quarterly dividend and the yield is a rich 3.7%. Our Target Price is now $44.

KeyCorp (KEY – $12.25) shares jumped almost 5% last week after the regional bank announced Q2 2020 results. Adjusted EPS of $0.16 was double the consensus analyst estimate of $0.08, but a portion of that beat was driven by KEY taking a lesser loan provision than investors were predicting, however Q2 did see both spread and fee revenue come in better than expectations. Although commercial loan growth is expected to remain somewhat muted for the rest of the year and into 2021, on the earnings call, management sounded somewhat optimistic about the underlying consumer loan growth driven by its Laurel Road brand.

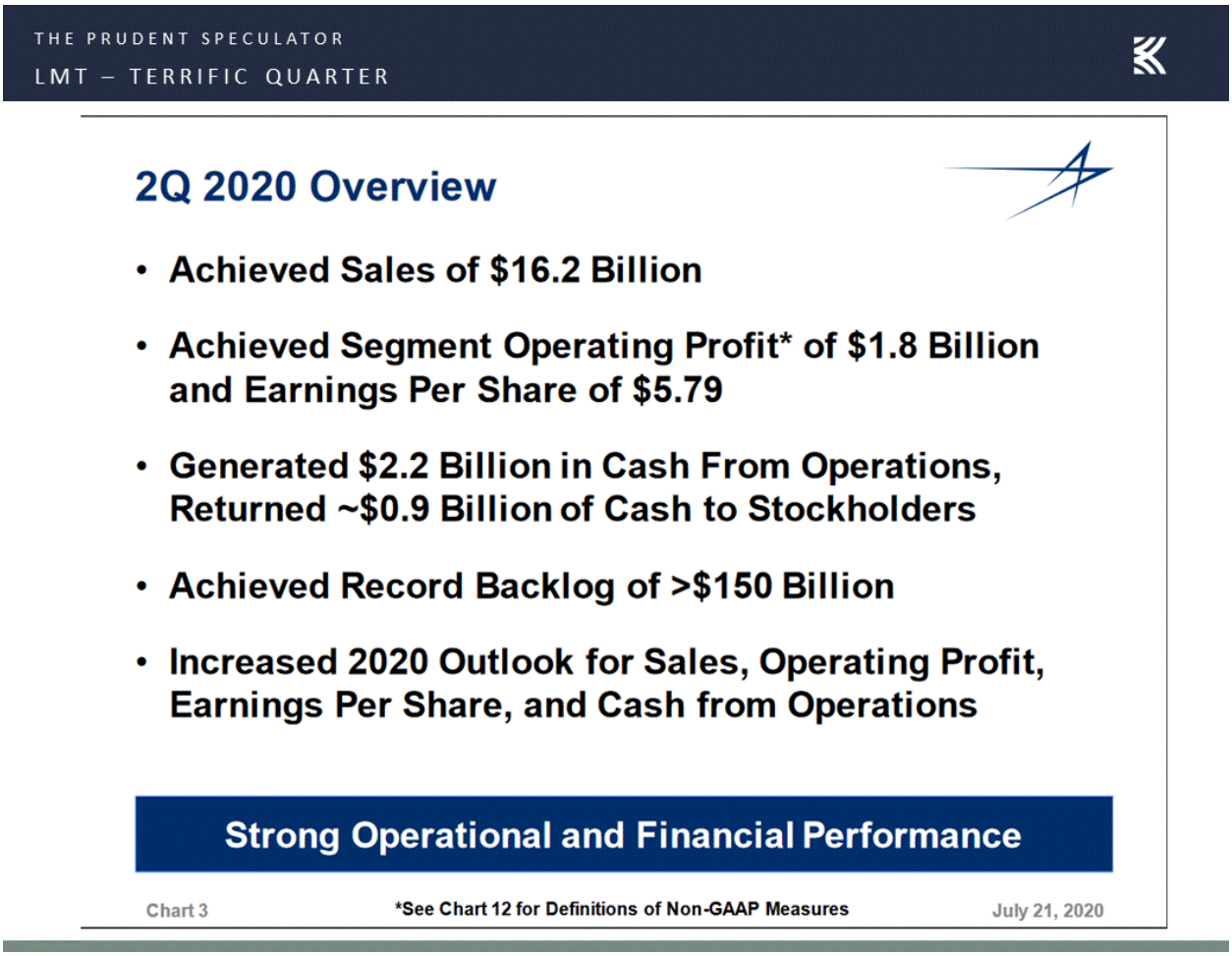
CEO Chris Gorman commented, "We are pleased with Key's second quarter results, which demonstrated the resiliency of our team and business, the strength of our balance sheet, and our strong risk management practices. Our results also reflected a significant build in our allowance for loan and lease losses, with our provision for credit losses exceeding net charge-offs by $386 million…Importantly, we generated positive operating leverage versus the year-ago quarter and a record level of pre-provision net revenue. Our results included strong balance sheet trends, with double-digit growth in both loans and deposits. Our fee businesses also benefitted from broad-based growth, driven by strength in capital markets related income, cards and payments and consumer mortgage. Expenses this quarter reflected higher production-related variable costs, expenses related to our payments business, and COVID-19 related expenses, including steps that we continue to take to ensure the health and safety of our teammates."

Mr. Gorman continued, "We have also supported our clients by offering payment deferrals, hardship support, borrower assistance programs, and forbearance options to help provide a bridge for individuals and businesses through these uncertain times. We were very active in the Paycheck Protection Program, processing more than 40,000 loans, and providing over $8 billion of funding to help our clients…We have positioned the company to perform through various operating environments and play a role in helping to revitalize our economy. Key remains well-capitalized, highly liquid, and committed to maintaining our moderate risk profile. I remain confident about the future of our company and our ability to create value for all our stakeholders."

We believe the lumps KeyCorp took in the Global Financial Crisis were the impetus for its transition to a more conservative culture, which should serve it well in the current environment. Despite pressure on net interest and fee revenue in the near-term, we like the diversified exposure in this seemingly perpetual low-rate climate. Management still appears to be supportive of the dividend, and the Q2 results seemingly allow it to sustain the current payout, at least for the near future. Shares yield a handsome 6.0% yield at current levels. Our Target Price for KEY is now $20.

Global defense contractor and security company **Lockheed Martin** (LMT – $386.21) saw its shares rise roughly 5% last week as it turned in a strong Q2 in the midst of the COVID-19 pandemic. Revenue for the three-month period came in at $16.2 billion, versus consensus estimates of $15.2 billion. Adjusted EPS was $5.79, slightly better than investor expectations of

$5.70. The Aeronautics segment continues to perform, driven by F-35 revenues. Free cash flow for the quarter came in at a robust $4.5 billion for the six months ended June, more than $1 billion higher than the same period last year. The company slightly grew its record backlog ($150 billion), which gives us continued confidence in its future revenue-generating ability, and led management to adjust its guidance for Aeronautics, Space and RMS segments, increasing the midpoint sales range by $1.125 billion.



While the risk of budget cuts on defense spending will always exist, we believe that the U.S. continues to see a great power competition with both Russia and China, and the world remains an uncertain place. CEO James D. Taiclet had the following to say regarding the federal budget, “Both the House and Senate Armed Services Committees have completed the respective markups of the fiscal year 2021 National Defense Authorization Act. Each version adheres to the Bipartisan Budget Act of 2019 spending targets and equal approximately $740 billion for national defense. Appropriation committees from each chamber are in the process of drafting the funding legislation to accompany the authorization.”

He continued, “Encouraging elements for our portfolio is the Senate version confirmed that the national defense strategy remains the road map for the Armed Services and the bill was passed with strong bipartisan support. Our portfolio was well supported in the Senate version for the

recommended increase of 16 F-35 aircraft above the President's request, additional funding for missile defense priorities, including an 8 THAAD battery, and increased funding for the Homeland Defense Radar Hawaii program. Congress will continue with the authorization and appropriation phases. We look forward to the finalization of the process in supporting our warfighters' needs."

The COVID-19 pandemic also adds uncertainty, especially given the amount of money the government has shelled out to counteract the widespread economic shutdown. That said, the production ramp of the F-35 program, international sales, and additional contract wins in hypersonics and classified content continue to drive robust cash flow. Lockheed is still incrementally repurchasing shares, and we wouldn't be surprised at another hike to the dividend (the yield is 2.4%) later in the year. Our Target Price for LMT has been elevated to $496.