Market Commentary Monday, August 31, 2020

August 30, 2020

EXECUTIVE SUMMARY

TPS 647 – September Newsletter Coming Wednesday Evening / Thursday Morning
Newsletter Trades – AAPL & CCL Sells
Apple – Raised our Target Price Again on the Balance of our Holdings
Dow Jones Industrial Average – Constituency Changes
Market of Stocks – A Handful of Names Fueling the Rally
Sentiment – Still Little Love for Equities
COVID-19 – Abbott Lab's 5-Minute Test Approved by FDA
Econ News – Data are Mixed, but Big Q3 Rebound in the Cards
FOMC Policy Shift – Fed Will Now Let Inflation Run Hotter to Support the Economy
Interest Rates – Low Rates Support Equities
Inflation – Historical Equity Return Numbers
Patience – The Longer One Holds, the Lower the Chance of Loss Over the Last Nine Decades
Stock News – Updates on MDT, SJM & JWN

Market Review

Note that work is underway on the September edition of *The Prudent Speculator*. This month, we will have at least two brand-new recommendations, while we offer our regular quarterly *Earnings Scorecard* feature. If all goes according to plan, *TPS 647* will be emailed late Wednesday evening September 2 or early Thursday morning September 3. In the interim, we will be positing updated Target Prices to theprudentspeculator.com soon after the calendar turns.

Also, a little housekeeping before this week's missive. As discussed in our *Sales Alert* on Friday, August 21, we waited our usual two days to transact and sold the following in our newsletter portfolios on Tuesday, August 25:

TPS Portfolio
42 **Apple** (AAPL – $499.23) at $494.9401
622 **Carnival Corp** (CCL – $17.21) at $15.56

Buckingham Portfolio
10 AAPL at $494.9401

We will use those prices for the sales in our hypothetical portfolios: 18 Apple and 177 Carnival in Millennium Portfolio and 36 Apple in PruFolio.

And speaking of Apple, shares of the consumer electronics titan again eclipsed our published Target Price last week, as the tech behemoth briefly rose above $505 per share. While there was nothing in the way of significant news to argue for a substantial valuation increase, we are holding the balance of our position for a revised pre-split Target Price of $518. We trimmed shares of Apple a week ago this past Friday and **Microsoft** (MSFT – $228.91) on Friday, and in our view, having meaningfully reduced our exposure to the two giants (ranked #1 and #2 in weight for the S&P 500 and Russell 3000), we are comfortable maintaining the remainder of our stakes.

Of course, the positions are still large in our broadly diversified portfolios, so as new undervalued ideas present themselves, we may peel off more shares as a source of funds for purchases. Happily, Apple and Microsoft have been stellar performers this year, the two best in the Dow Jones Industrial Average (DJIA), and we aren't the only ones taking a little money off the table on AAPL. With the two-trillion-in-market-capitalization stock undergoing a 4-for-1 split, the good folks at Dow Jones decided to make three changes to the venerable DJIA, booting Raytheon, **Exxon Mobil** (XOM – $40.69) and **Pfizer** (PFE – $37.91). We certainly have no quibble with one of the replacement stocks, long-held biotech giant **Amgen** (AMGN – $253.12), though the other two names, Honeywell Int'l and Salesforce.com are not stocks that we presently favor.

THE PRUDENT SPECULATOR

DOW JONES INDUSTRIAL AVERAGE – MAJOR SHAKEUP

DOW JONES INDUSTRIAL AVERAGE

Name	Symbol	YTD Total Return	8.28.20 Price	Index Weight - Price %	Market Cap ($Millions)	Index Weight - Cap %	P/E Ratio	NTM P/E Ratio	Price to Sales Ratio	Price to Book Value	Free Cash Flow Yield	Dividend Yield
							22.4	21.2	2.1	4.3	1.0	2.28
Apple	AAPL	62.2	$499.23	11.9%	2,134,525	23.0%	38.0	33.5	8.0	29.6	4.6	0.64
UnitedHealth Group	UNH	7.5	$314.37	7.5%	298,757	3.2%	17.7	17.7	1.2	4.7	7.2	1.43
Home Depot	HD	30.2	$286.29	6.9%	308,178	3.3%	26.2	24.5	2.6	nmf	6.2	2.00
Microsoft	MSFT	37.1	$228.91	5.5%	1,732,311	18.7%	39.4	34.7	12.2	14.6	2.9	0.89
Visa	VZ	-0.8	$215.71	5.2%	418,910	4.5%	40.8	37.4	18.5	13.9	3.0	0.56
McDonald's	MCD	7.6	$214.91	5.1%	159,915	1.7%	33.9	29.3	8.4	nmf	2.5	2.28
Goldman Sachs	GS	-11.1	$207.71	5.0%	74,462	0.8%	11.5	9.8	1.4	0.9	-74.6	2.41
Boeing	BA	-47.6	$175.80	4.2%	99,230	1.1%	nmf	nmf	1.5	nmf	-15.3	3.51
3M	MMM	-5.8	$165.66	4.0%	95,423	1.0%	19.1	18.8	3.0	8.8	6.5	3.53
Johnson & Johnson	JNJ	5.2	$153.64	3.7%	404,507	4.4%	27.3	17.7	5.0	6.4	4.8	2.55
Caterpillar	CAT	-4.7	$143.63	3.4%	77,777	0.8%	17.4	21.7	1.7	5.7	4.7	2.87
Walmart	WMT	11.3	$140.30	3.4%	397,323	4.3%	27.0	25.7	0.7	5.3	6.4	1.53
Proctor & Gamble	PG	11.6	$138.77	3.3%	345,485	3.7%	27.1	25.5	4.9	7.5	4.7	2.21
Walt Disney	DIS	-11.4	$135.54	3.2%	244,929	2.6%	nmf	52.4	3.5	2.8	1.7	0.65
Int'l Business Machines	IBM	-4.7	$125.07	3.0%	111,385	1.2%	10.1	10.6	1.5	5.4	11.9	5.20
Travelers	TRV	-16.7	$115.89	2.8%	29,342	0.3%	16.1	11.8	0.9	1.1	19.6	2.86
Nike	NKE	7.2	$112.29	2.7%	175,160	1.9%	63.1	43.5	4.7	21.7	0.9	0.87
JPMorgan Chase	JPM	-28.3	$102.77	2.5%	313,202	3.4%	13.6	13.2	2.3	1.3	21.5	3.50
American Express	AXP	-21.2	$102.54	2.5%	82,561	0.9%	21.3	18.4	1.9	3.9	0.8	1.68
Merck	MRK	-5.0	$85.65	2.1%	216,629	2.3%	15.5	14.2	4.6	7.8	4.7	2.78
Chevron	CVX	-26.7	$85.63	2.0%	159,896	1.7%	32.0	46.0	1.4	1.2	3.3	5.91
Raytheon	RTX	-29.5	$62.24	1.5%	95,081	1.0%	17.9	18.3	0.9	1.4	nmf	3.89
Verizon Comm	VZ	-0.8	$59.26	1.4%	245,221	2.6%	11.1	12.2	1.9	3.9	10.4	4.15
Intel	INTC	-16.4	$50.43	1.2%	214,479	2.3%	9.8	10.6	2.7	2.6	8.8	2.59
Coca-Cola	KO	-13.0	$49.83	1.2%	214,042	2.3%	25.6	25.1	6.2	12.2	3.7	3.25
Dow Inc.	DOW	-17.3	$46.05	1.1%	34,129	0.4%	17.9	26.4	0.9	2.7	15.8	6.08
Cisco Systems	CSCO	-9.6	$42.20	1.0%	178,181	1.9%	14.9	13.5	3.6	4.7	7.5	3.36
Exxon Mobil	XOM	-37.5	$40.69	1.0%	172,047	1.9%	50.0	42.2	0.8	1.0	-0.9	8.55
Walgreen Boots	WBA	-30.5	$38.76	0.9%	33,587	0.4%	18.9	7.5	0.2	1.6	11.4	4.75
Pfizer	PFE	1.9	$37.91	0.9%	210,661	2.3%	16.1	12.9	4.3	3.3	7.2	3.96
New Additions												
Amgen	AMGN	1.1	$253.12		148,251		20.2	15.4	6.2	13.9	7.3	2.47
Honeywell	HON	-10.1	$168.38		118,166		19.8	22.4	3.5	6.5	5.5	2.14
Salesforce.com	CRM	28.8	$271.10		246,701		nmf	73.4	12.5	6.5	2.0	nmf

As of 8.28.20. Source: Kovitz using data from Bloomberg

Of course, the Dow is a price-weighted index, so the Apple split will drop the stock from the most important constituent to #18 or #19, about in line with **International Business Machines** (IBM – $125.07), despite Cupertino's finest dwarfing Big Blue by 19-fold in terms of market capitalization. Such is a nuance of the Dow as those following the index will have to sell a big chunk of their post-split shares…and generally this is the reason why the benchmark is not one favored by most index investors.

That said, exclusion/inclusion in the Dow is a big deal, and the new stocks received a hefty boost in trading last week, while the exiled stocks fared far worse following the announcement after trading had ended on Monday, August 24. Incredibly, give that each dollar gain or loss in a DJIA stock as of last week accounted for a 6.86-point move in the index, if the three exits had been made the day that the Dow folks made their decision (and ignoring the adjustments to every other stock that would have had to have been made), the Dow would have closed Friday higher than it actually did by some 625 points. That is not a misprint RTX, PFE and XOM cost the Dow some 14 combined points, but the big gains in Amgen, Honeywell and Salesforce would have added a whopping 611 points to the index.

Needless to say, it is a market of stocks and not simply a stock market, as a look at a capitalization-weighted index like the Russell 3000 will attest. The aforementioned Apple and Microsoft, along with big moves up in stocks like Amazon, Tesla, Facebook, Nvidia and PayPal Holdings account for all of the year-to-date 9.53% total return. Meanwhile, the average return for Russell 3000 members stands at -0.9%, while Small Caps and Value stocks have seen their ranks post a 7.5% drop on average thus far in 2020.

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MARKET OF STOCKS – MONUMENTAL DISPERSION OF RETURNS

The Russell 3000 index is at a record high, but the rally has been driven by a handful of mega-cap Growth stocks. The average member of the R3K is still in the red for the year and the average return for inexpensive stocks (i.e. the smallest 1997 and the 2269 Value stocks) stands at -7.5%.

Market of Stocks - Russell 3000									
R3K Members	% of Market Cap	Average YTD Total Return	Median Price to Earnings	Median NTM P/E	Median Price to Sales	Median Price to Book Value	Median Free Cash Flow Yield	Average Dividend Yield	Number of Holdings
All 2997	100.0	**-0.9**	20.0	18.5	2.0	2.2	4.0	2.13	2997
Largest 10	24.4	**32.3**	37.8	27.7	6.8	7.6	3.2	0.69	10
Top 11-20	8.3	**73.1**	59.2	46.9	8.0	13.6	2.7	1.23	10
Top 21-30	6.1	**9.0**	16.6	15.3	2.8	4.3	6.8	2.52	10
Top 31-40	4.9	**3.4**	33.0	29.6	3.8	6.4	3.2	3.18	10
Top 41-50	4.0	**12.4**	32.7	23.3	6.1	7.4	4.4	2.18	10
Largest 50	47.7	**26.1**	33.6	26.3	5.1	6.6	3.7	1.96	50
Next 950	47.5	**11.6**	24.4	21.4	3.0	3.7	4.2	1.86	950
Bottom 1997	4.8	**-7.5**	16.6	16.1	1.6	1.8	4.0	2.26	1997
Market of Stocks - Russell 3000 Value									
All Value	100.0	**-7.5**	17.7	16.5	1.6	1.6	5.6	2.49	2269
Largest 10 Value	16.1	**-8.4**	14.8	13.4	2.2	2.5	9.0	2.90	10
Market of Stocks - Russell 3000 Growth									
All Growth	100.0	**6.0**	29.4	24.5	3.7	4.9	2.4	1.08	1509
Largest 10 Growth	43.8	**88.1**	40.1	36.0	11.7	18.9	2.9	0.26	10

From 12.31.19 - 8.28.20. Source: Kovitz using data from Bloomberg.

No doubt, we continue to like the valuation metrics and dividend yields associated with stocks on the Value side of the ledger, especially with the major market averages now trading at all-time highs. We also favor Value, given that investors remain concerned in what they are saying about the near-term prospects for stocks, not to mention what they are doing with their equity mutual and exchange-traded funds,…

SENTIMENT: NO ENTHUSIASM FOR STOCKS

Pessimism among individual investors continues to be high, remaining more than 9 points above normal in the latest AAII Sentiment Survey. Bullish sentiment inched up in the latest week yet is still 5.9 percentage points below normal.

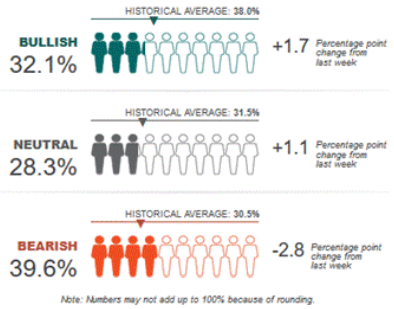
We remain perplexed that many supposed market experts continue to argue that investors are piling into stocks, given that the latest data on mutual and exchange traded fund flows from ICI shows a massive exodus from U.S. stocks and a continued infatuation with bonds.

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 8/26/2020

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

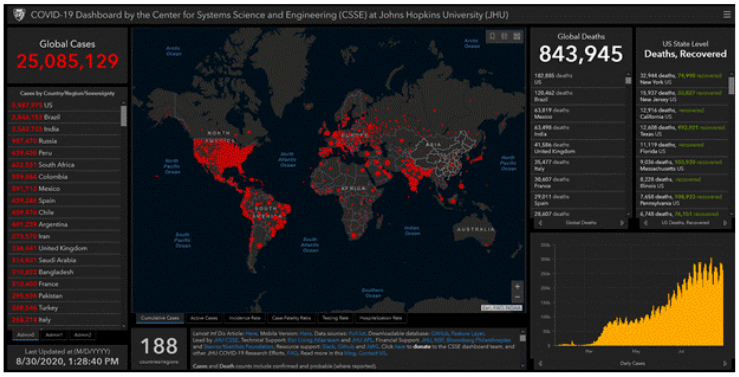
Millions of dollars

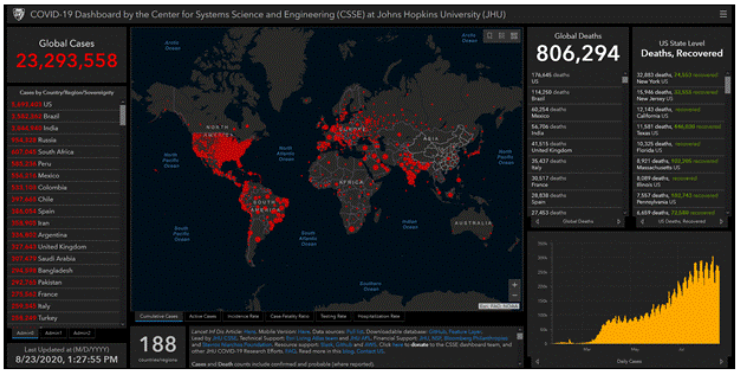
Week Ended	8/19/2020	8/12/2020	8/5/2020	7/29/2020	7/22/2020
Total Equity	-15,105	-3,256	-20,319	-14,372	-11,396
Domestic	-15,776	-5,495	-18,757	-10,864	-7,889
World	672	2,239	-1,562	-3,508	-3,507
Hybrid	-300	-577	-275	-925	-641
Total Bond	17,809	20,153	27,334	18,496	23,077
Taxable	14,886	16,607	23,924	15,616	19,472
Municipal	2,924	3,545	3,410	2,879	3,605
Commodities	370	-97	2,600	3,388	2,229
Total	2,775	16,222	9,340	6,586	13,269

Source: Investment Company Institute

…while we continue to believe that improving news on the health front will be a catalyst for inexpensive companies to regain Wall Street affection.

COVID-19 GLOBAL SPREAD





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

With access to testing remaining high, there was another jump of nearly 1.8 million in global COVID-19 confirmed cases in the latest week. Case counts have surged as economies have reopened, social distancing has waned and mask wearing has been inconsistent, and the U.S. is now up to more than 182,000 fatalities. While deaths obviously lag cases, the news has been better on the global mortality rate, as in the latest week the increase in fatalities totaled 4.7%, up from a 4.3% climb the week prior, but down from jumps of 6.1%, 6.1% and 6.2%, respectively, for the three weeks before the last two.

For example, while a couple of days trading never a trend makes, the Russell 3000 Value index did manage to outperform the Russell 3000 Growth index by a score of 149 basis points to 42 basis points over the final two days of last week, following good news from **Abbott Labs** (ABT – $110.79), out after the close of trading on Wednesday in regard to the approval of a quick COVID-19 test.

Abbott announced that the U.S. Food and Drug Administration (FDA) has issued Emergency Use Authorization (EUA) for its BinaxNOW™ COVID-19 Ag Card rapid antigen test for detection of COVID-19 infection. In conjunction with the test, the firm has made a free and optional mobile app called NAVICA available for Apple and Android digital wallets to allow people to store, access and display their results as needed similar to a digital airplane boarding pass. Abbott has said that it will offer the 15-minute test for $5 and plans to produce 50 million tests a month, while the company quickly won a $760 million contract from the U.S. government. “We intentionally designed the BinaxNOW test and NAVICA app so we could offer a comprehensive testing solution to help Americans feel more confident about their health and lives,” said ABT CEO Robert B. Ford. “BinaxNOW and the NAVICA app give us an affordable, easy-to-use, scalable test, and a complementary digital health tool to help us have a bit more normalcy in our daily lives.”

Abbott shares are up 8.2% in the past 5 trading days and 28% year-to-date, as the company has benefitted as a leader in testing and diagnostics throughout the pandemic. That said, it will take some time for a $5 test to really move the needle, and on the surface the valuation isn't exactly cheap, trading north of 28 times earnings expected over the next 12 months. However, we remain content to hold our ABT stake for the time being. We like that Abbott also boasts a diversified base of highly competitive products, ranging from nutritionals (i.e. Pedialyte® and Similac®) to diagnostics (which includes the second version of the immensely popular glucose monitoring system, the Freestyle Libre 2®), and produces about 40% of its sales from faster-growing emerging markets. We continue to keep a close eye on the stock, however, even as we've bumped our Target Price up to $117.

Obviously, progress on testing is only part of the ongoing COVID-19 battle, but it also was good to hear Dr. Anthony Fauci, director of the National Institute of Allergy and Infectious Diseases, speak somewhat optimistically on the timeline for a vaccine: "The way the pace of the enrollment is going on and the level of the infections that are going on in the United States, it is likely that we'll get an answer by the end of the year." He went on to say, "I would say a safe bet is at least knowing that you have a safe and effective vaccine by November, December," though cautioned, "I would not be satisfied until a vaccine was proven to be safe and effective, before it was actually approved for general use."

To be sure, there is a herculean effort being made in the fight against COVID-19, and we think we will eventually have an effective vaccine, but we understand that it will be a long time before life ever returns to normal. As such, we respect that the near-term outlook for the health of the U.S. economy remains in question, with mixed numbers out last week,…

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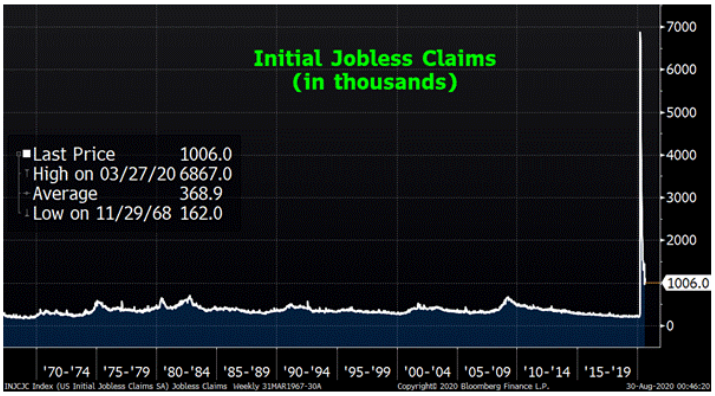
MIXED ECONOMIC NUMBERS



The headline number for durable goods orders in July topped estimates with a gain of 11.2%, one of the best monthly upturns on record dating back to 1990. Excluding volatile transportation orders, durable goods orders also rose a solid 2.4%. That said, first-time filings for unemployment benefits continue to be massive, with 1.01 million claims in the latest week, bringing the total for the last 23 weeks to more than 58 million.

…even as estimates for Q3 GDP growth continue to rise,…

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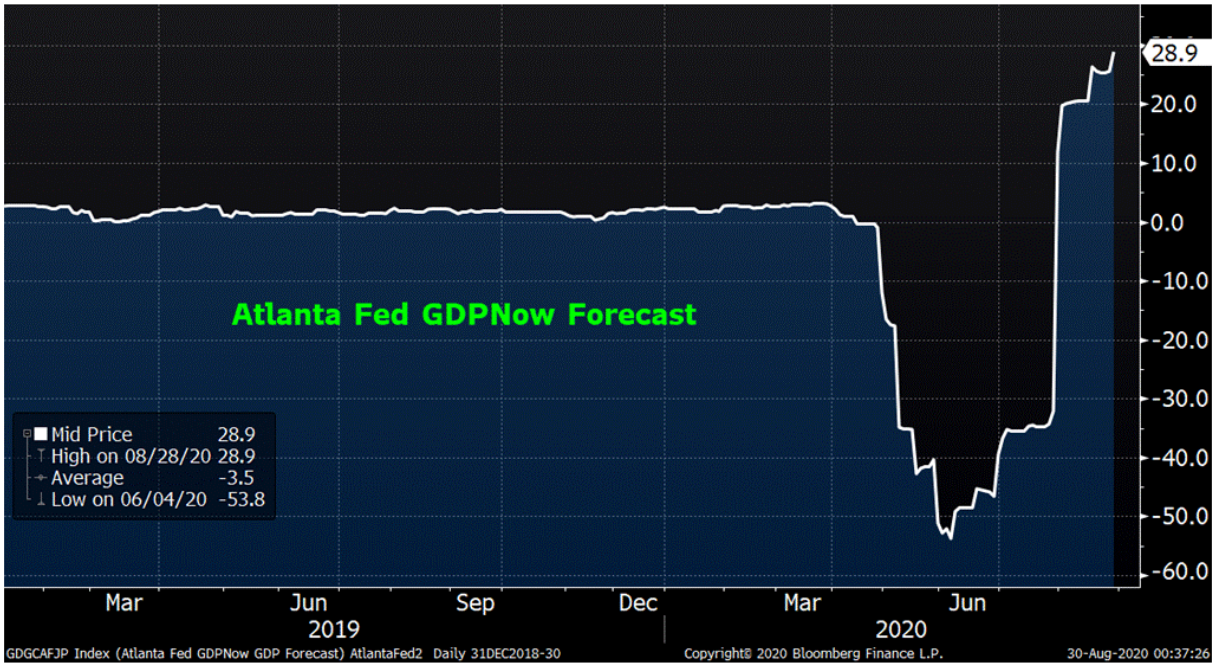
SIGNIFICANT BOUNCE IN U.S. GDP EXPECTED IN Q3

While a rebound is almost a mathematical certainty, given the magnitude of the massive Q2 economic contraction, the Atlanta Fed is now projecting a 28.9% increase in GDP in Q3 on an annualized basis.



…and consumer spending remains elevated,…

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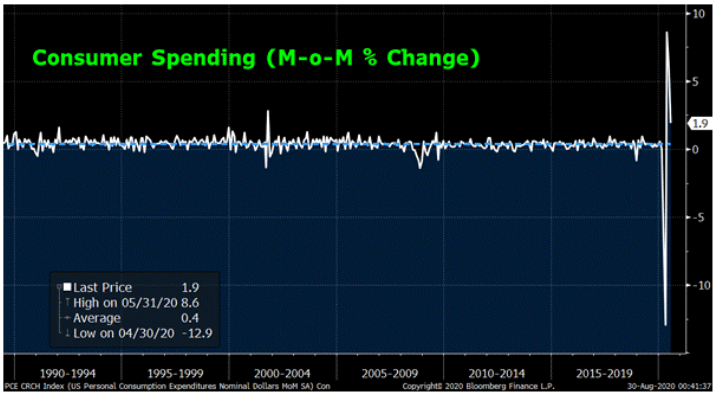
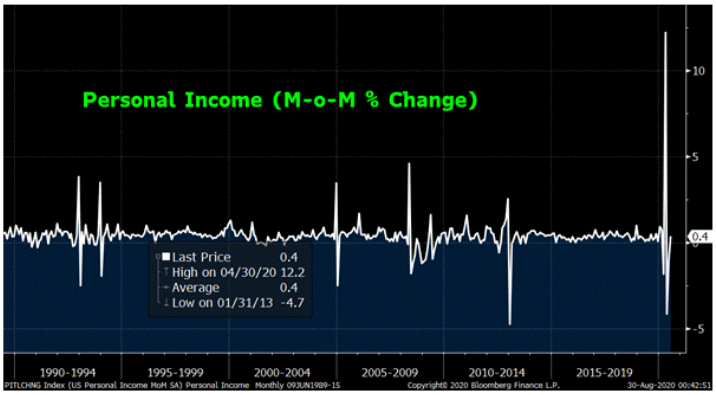
CONSUMERS SPENDING AGAIN BUT THE SAVINGS RATE REMAINS HIGH



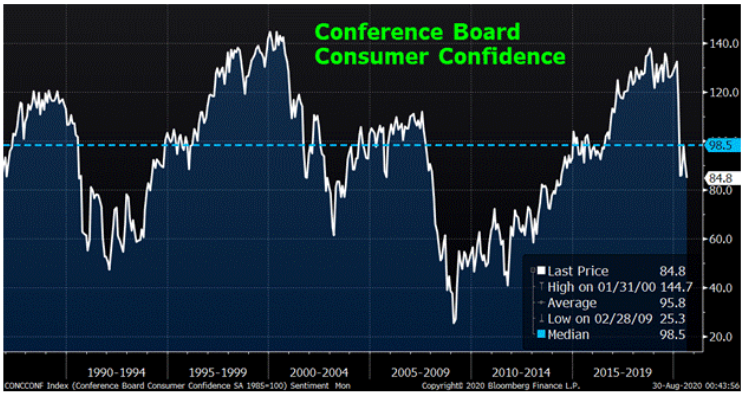


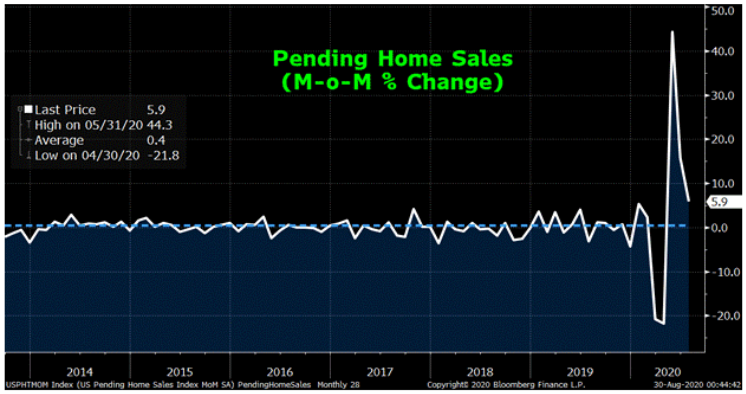
With more businesses reopened, consumer spending continued its bounce back in July, rising a robust 1.9%. True, the tally was down considerably from the 6.2% jump in June, but the increase topped expectations calling for a 1.5% gain. Personal income climbed by 0.4% in July, no doubt impacted by the winding down of government stimulus, but the savings rate remained at a very robust 17.8%, near the highest rate in modern times.

…despite some consumer pessimism about the future, but not enough to slow down the housing market from continuing to boom.

THE PRUDENT SPECULATOR

AMERICANS NOT CONFIDENT BUT STILL BUYING HOMES





Consumer confidence skidded to 84.8 in August, down from a revised 91.7 in July, to the lowest level since the pandemic began. Also, the future expectations (next six months) component of the Conference Board's index fell to a COVID-19 low, but consumers have been confident enough to continue to buy houses, with an index of pending home sales rising for the third consecutive month, this time by 5.9% in July.

Certainly, housing sales and the economy are being bolstered by extraordinarily low interest rates, with the Federal Reserve last week telling us that it will let inflation run hotter over the longer run to support the labor market,…

THE PRUDENT SPECULATOR

FOMC STATEMENT ON LONGER-RUN GOALS AND MONETARY POLICY STRATEGY

"The economy is always evolving, and the FOMC's strategy for achieving its goals must adapt to meet the new challenges that arise," said Federal Reserve Chair Jerome H. Powell. "Our revised statement reflects our appreciation for the benefits of a strong labor market, particularly for many in low- and moderate-income communities, and that a robust job market can be sustained without causing an unwelcome increase in inflation."

Among the more significant changes to the framework document are:

• On maximum employment, the FOMC emphasized that maximum employment is a broad-based and inclusive goal and reports that its policy decision will be informed by its "assessments of the *shortfalls* of employment from its maximum level." The original document referred to "*deviations* from its maximum level."

• On price stability, the FOMC adjusted its strategy for achieving its longer-run inflation goal of 2 percent by noting that it "seeks to achieve inflation that averages 2 percent over time." To this end, the revised statement states that "following periods when inflation has been running persistently below 2 percent, appropriate monetary policy will likely aim to achieve inflation moderately above 2 percent for some time."

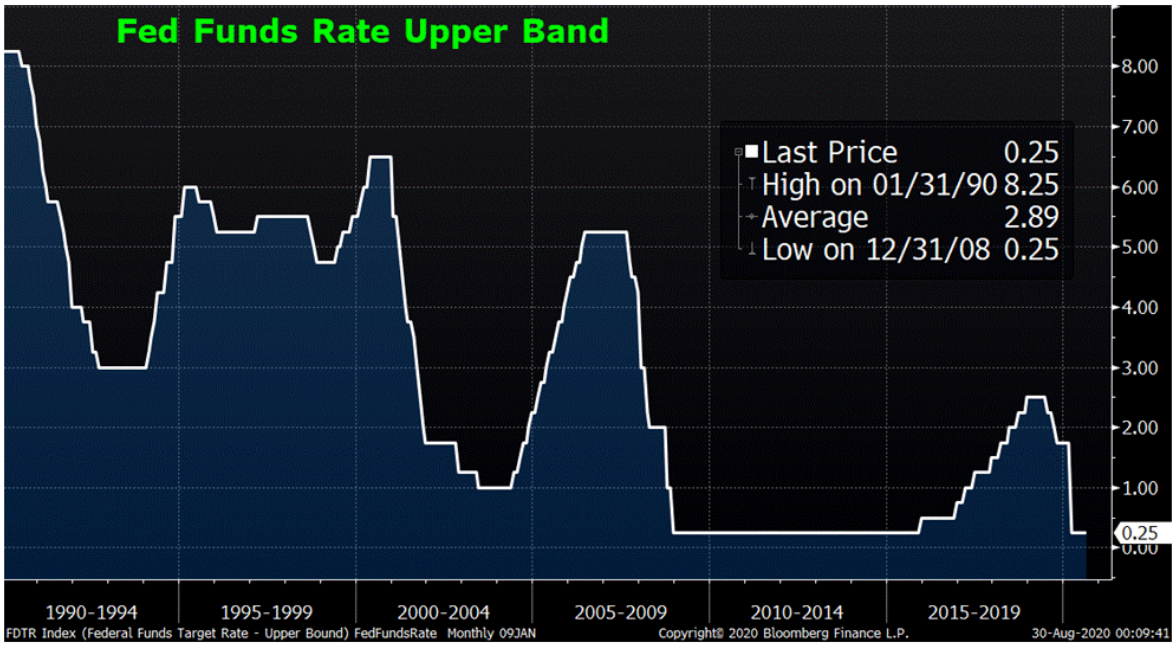
• The updates to the strategy statement explicitly acknowledge the challenges for monetary policy posed by a persistently low interest rate environment. Here in the United States and around the world, monetary policy interest rates are more likely to be constrained by their effective lower-bound than in the past.

August 27, 2020

…which means that the Fed Funds rate is unlikely to budge from its current 0.0% to 0.25% range for the foreseeable future.

FED FUNDS RATE EXPECTED TO REMAIN NEAR ZERO FOR QUITE SOME TIME

Jerome H. Powell made it quite clear on August 27, 2020, that the Federal Reserve is likely to keep interest rates lower for longer to support the economy, even if it means that inflation overshoots its 2.0% target for a period of time.

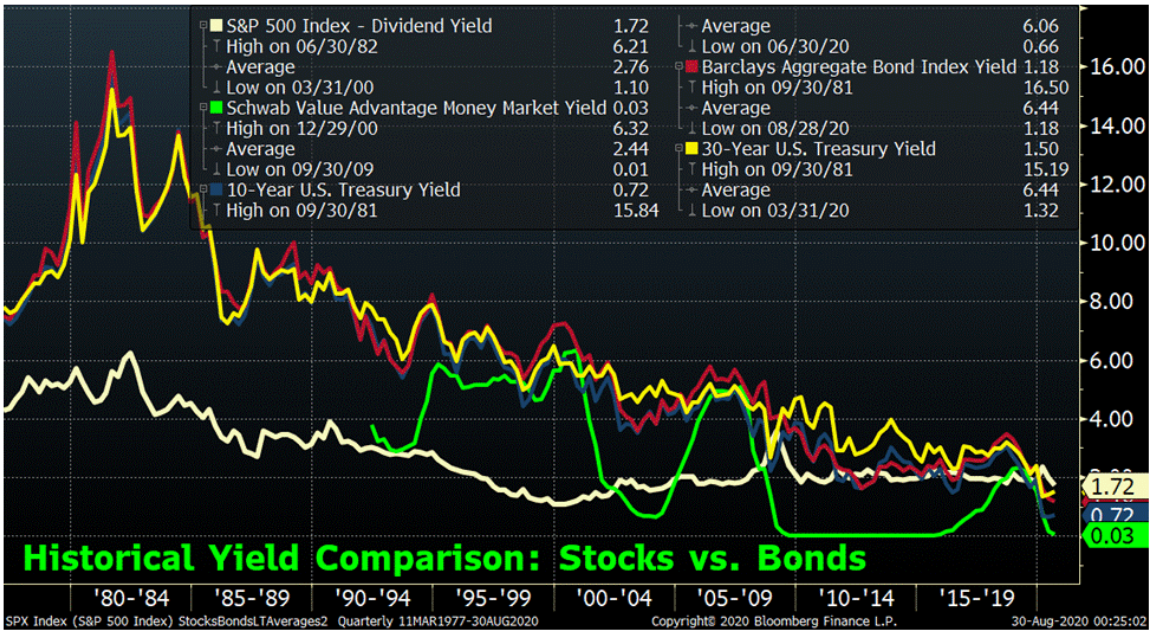


Just as they are for housing, we continue to believe that low interest rates provide strong support for equity prices, especially when one considers how generous yields are today on dividend paying stocks, relative to other income producing investments.

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 (1.72%) is extraordinarily generous versus the income provided by fixed income, especially given the recent plunge in rates. Incredibly, **equities yield more than the Barclays Aggregate Bond Index and more than 50 times a "generous" Money Market Fund!**



Further, the yield being provided on earnings is also very attractive when one considers that stock prices could double and still be inexpensive relative to the current government bond yield,…

THE PRUDENT SPECULATOR

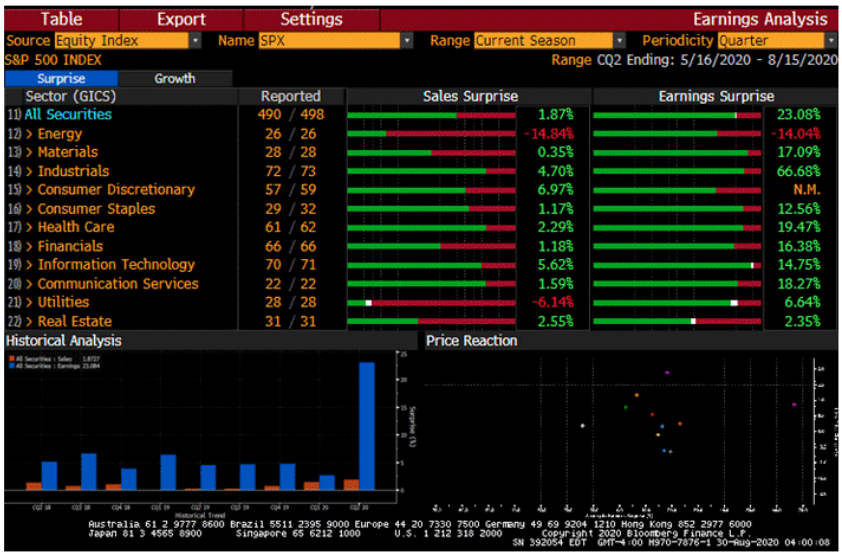
INTEREST RATES VERY SUPPORTIVE OF STOCKS

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 many dismiss the Fed Model, we like today's rich (and temporarily depressed) relative earnings yield (3.66% vs. 0.72% 10-Year) and generous S&P 500 dividend yield of 1.72%.

…especially as corporate profits showed remarkable resiliency in the second quarter and the consensus forecast calls for significant EPS growth in 2021.

EPS LIKELY TO PLUNGE IN 2020 BUT REBOUND SHARPLY IN 2021

Q2 reporting season was very good, relative to analyst projections that had 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	$45.04	$163.91
9/30/2021	$42.22	$154.35
6/30/2021	$39.79	$143.99
3/31/2021	$36.86	$130.83
12/31/2020	$35.48	$113.47
9/30/2020	$31.86	$117.17
6/30/2020	$26.63	$125.12
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

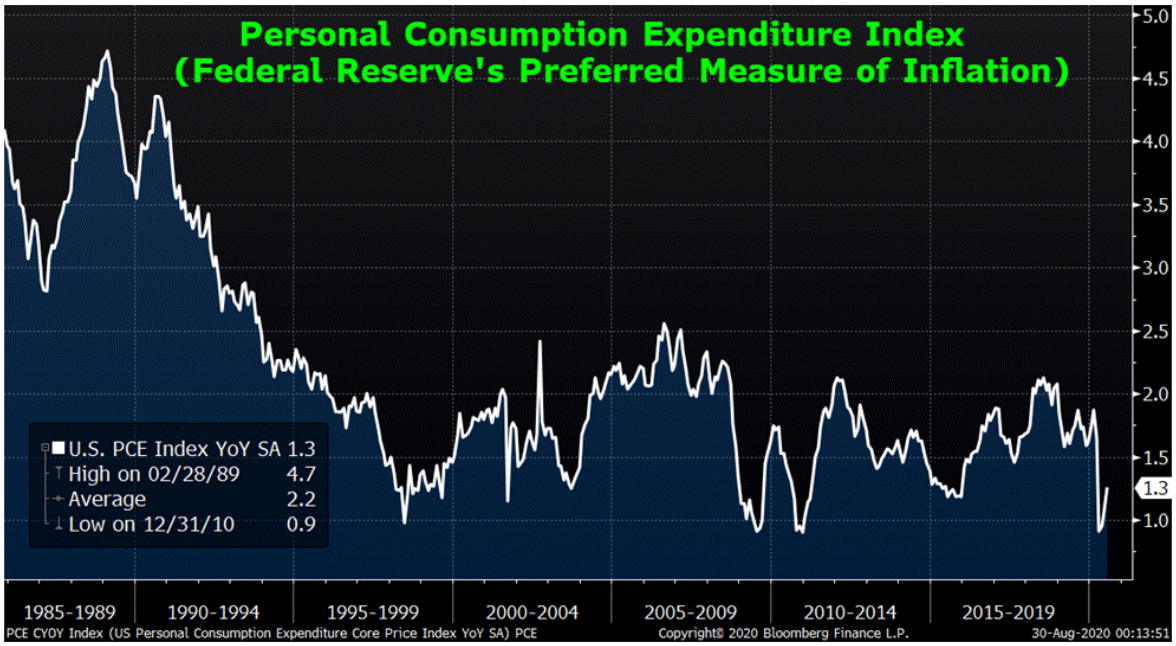
Source: Standard & Poor's. As of 8.20.20

Though we remain optimistic in our long-term outlook for our broadly diversified portfolios, we suspect that many will soon start to worry about the potential impact of rising inflation, given the major FOMC policy shift,…

THE PRUDENT SPECULATOR

INFLATION WORRIES LESSEN FURTHER WITH FED POLICY SHIFT

The Federal Reserve's preferred gauge of inflation, the Personal Consumption Expenditure (PCE), continues to reside well below its 2.0% target, and Jerome H. Powell & Co. have just given themselves a runway to let the economy run hotter before hiking interest rates.



…so we figure it a good time to reprise our debunking of the "Inflation is Bad for Stocks" myth.

Why an Unpleasant Inflation Surprise Could Be Coming

If inflation turns up, economists have long assumed it would do so slowly, giving the Fed plenty of time to respond. But Michael Feroli of J.P. Morgan notes this assumption is built on models in which the world behaves in a predictable, linear way. In fact, he says, the world isn't linear and inflation can change suddenly for unexpected reasons: it "is sluggish and slow-moving, until it isn't."

A case in point: in 1966, inflation, which had run below 2% for nearly a decade, suddenly accelerated to over 3%. Some of the circumstances echo the present: unemployment had slid to 4%, taxes had been cut and federal spending for the Vietnam War and Lyndon Johnson's "Great Society" programs was surging. Deutsche Bank economists note the budget deficit jumped by more than 2% of gross domestic product between 1965 and 1968, similar to what they project between 2016 and 2019. Except in recessions, stimulus of this size "is unprecedented outside of these two episodes," they said.

The effect of an overheating economy was then compounded by policy errors. Fed chairmen William McChesney Martin Jr. and Arthur Burns were too optimistic about how low unemployment could go without pushing prices higher, and succumbed to pressure from Johnson and then Richard Nixon to keep interest rates low. **From 1966 to 1981, inflation and interest rates climbed to double digits, decimating stock and bond values.**

Wall Street Journal, February 28, 2018

In yet another example of fear over facts, *The Wall Street Journal* warned of dire consequences should we have another inflation and interest rate scare like 1965-1981. If past is prologue, as Value investors, we hope they are right.

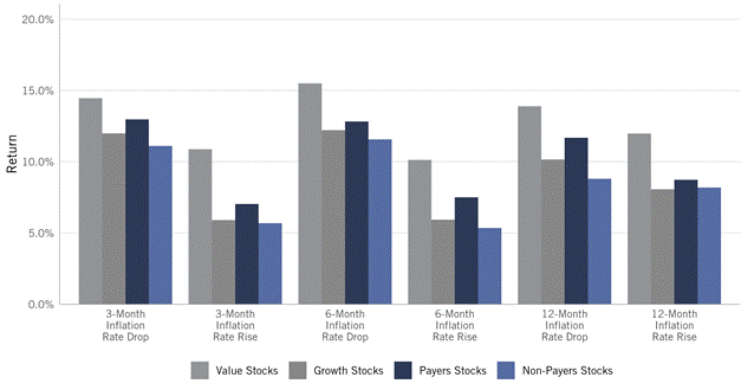
Annualized Returns December 1965 - December 1981	
Inflation	7.0%
IA SBBI US 1 Yr Treasury TR	7.1%
IA SBBI US 30 Day TBill TR	6.8%
IA SBBI US LT Govt Bonds TR	2.5%
IA SBBI US IT Govt Bonds TR	5.8%
IA SBBI US LT Corp Bonds TR	2.9%
FF Growth Stocks TR	7.4%
S&P 500 TR	6.0%
Dow Jones Industrials TR	3.9%
FF Value Stocks TR	13.4%

Source: Morningstar

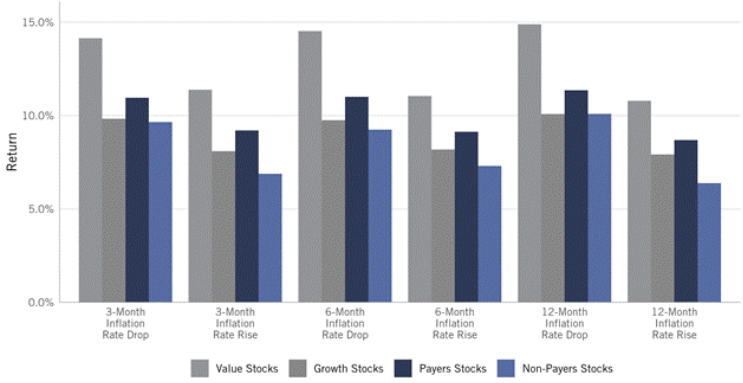
Anything is possible, obviously, but we like what nine-plus decades of market history have to say about changes in inflation and returns, especially for those of us who favor inexpensively priced stocks often of dividend-paying companies!

THE PRUDENT SPECULATOR

INFLATION Δ AND VALUE/GROWTH & DIV/NO DIVS RETURNS



From 12.31.27 through 03.31.20. Concurrent annualized 12-month returns. SOURCE: Kovitz using data from Bloomberg Finance L.P. and Professors Eugene F. Fama and Kenneth R. French



From 12.31.27 through 03.31.20. Subsequent annualized 12-month returns. SOURCE: Kovitz using data from Bloomberg Finance L.P. and Professors Eugene F. Fama and Kenneth R. French

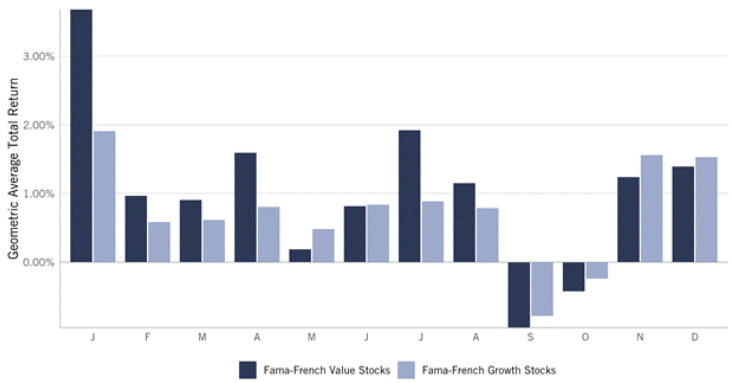
Many have incorrectly warned that rising inflation rates will prove fatal for equities, but nine decades of returns data show that stocks in general have performed admirably on average, both concurrent with and subsequent to increases (as well as decreases) in the inflation rate over 3-, 6-, and 12-month time spans, with Value Stocks and Dividend Payers leading the charge.

True, the equity markets have come a long way very quickly, so we must always be braced for downside volatility, and we concede that the calendar is about to turn to seasonally scary September,…

THE PRUDENT SPECULATOR

SCARY SEPTEMBER NOT BAD THE LAST 15 YEARS

While the average decline has been relatively tame over the last nine decades, and the period actually has been positive on average over the last 15 years, September is one of only two months, October the other, where returns on stocks have been negative dating back to 1927.



From 12.31.27 through 12.31.19. Geometric average. 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. SOURCE: Kovitz using data from Professors Eugene F. Fama and Kenneth R. French

Scary September Last 15 Years

	Russell 3000 Growth Index	S&P 500 Index	Russell 3000 Index	Russell 3000 Value Index
Average	0.52	0.68	0.61	0.71
2019	-0.04	1.87	1.76	3.67
2018	0.33	0.57	0.17	0.00
2017	1.62	2.06	2.44	3.26
2016	0.45	0.02	0.16	-0.13
2015	-2.78	-2.47	-2.91	-3.05
2014	-1.75	-1.40	-2.08	-2.43
2013	4.66	3.14	3.72	2.76
2012	2.04	2.58	2.63	3.20
2011	-7.70	-7.03	-7.76	-7.83
2010	10.92	8.92	9.44	7.99
2009	4.43	3.73	4.19	3.95
2008	-11.57	-8.91	-9.41	-7.13
2007	4.08	3.74	3.64	3.19
2006	2.57	2.57	2.24	1.90
2005	0.49	0.81	0.87	1.26

% Total Return August 31 - September 30. Source: Kovitz using data from Bloomberg.

…but we still think that those who share our belief that time in the market beats market timing will continue to be rewarded.

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 0.72% yield on the 10-year U.S. Treasury increase markedly as the level of patience rises.

PATIENCE IS VIRTUOUS

VALUE STOCKS

	Count >0.72%	Count <=0.72%	Percent >0.72%
1 Month	699	417	62.6%
3 Months	744	370	66.8%
6 Months	777	334	69.9%
1 Year	801	304	72.5%
2 Year	906	187	82.9%
3 Year	939	142	86.9%
5 Year	940	117	88.9%
7 Year	993	40	96.1%
10 Year	962	35	96.5%
15 Year	933	4	99.6%
20 Year	877	0	100.0%

DIVIDEND PAYERS

	Count >0.72%	Count <=0.72%	Percent >0.72%
1 Month	701	415	62.8%
3 Months	764	350	68.6%
6 Months	793	318	71.4%
1 Year	824	281	74.6%
2 Year	917	176	83.9%
3 Year	912	169	84.4%
5 Year	954	103	90.3%
7 Year	983	50	95.2%
10 Year	958	39	96.1%
15 Year	935	2	99.8%
20 Year	877	0	100.0%

From 07.31.27 through 06.30.20. 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 has come to a close. The numbers were very good relative to subdued expectations. With 490 members of the S&P 500 having announced results, per data from Bloomberg, 84.4% have topped analyst projections, much better than the usual 70% or so that beat Wall Street forecasts.

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 three 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" and a listing of all current recommendations is available for download via the following link: https://theprudentspeculator.com/dashboard/ We also offer the reminder that any sales we make for our newsletter strategies are announced via our *Sales Alerts*.

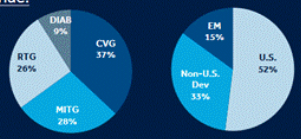
Medtronic PLC (MDT – $107.86) released fiscal Q1 financial results that beat analyst estimates on both top and bottom lines. Shares opened trading 5% higher the morning of the announcement and rose 9% by week's end. The medical device maker reported adjusted EPS of $0.62 (vs. $0.22 est.) and revenue of $6.5 billion (vs. $5.5 billion est), although both figures were below those of

the prior year. Year-over-year declines were a result of reduced elective surgical volumes, although management states the recovery (7.0% and 8.5% sequential earnings and revenue growth, respectively) from the depths of the pandemic in April has been faster than expected. Medtronic experienced low-to-mid teen revenue declines in its Cardiac & Vascular, Minimally Invasive, and Restorative Therapies businesses, and a 5% decline in Diabetes. Management continues to avoid providing formal annual or quarterly financial guidance given the uncertainty on near-term financial results caused by the COVID-19 pandemic.

MDT
Q1 FY21 HIGHLIGHTS

TAKING SHARE IN A NUMBER OF KEY BUSINESSES; PROCEDURE RECOVERY FASTER THAN EXPECTED

Revenue:



	Revenue $M[1]	As Rep Y/Y %	CCC[3] Y/Y%	Organic[4] Y/Y %
CVG	2,433	(12.8)	(11.4)	(High-Teens)
MITG	1,801	(14.2)	(12.5)	(High-Teens)
RTG	1,712	(14.9)	(14.8)	(Low-20s)
Diabetes	562	(5.1)	(3.2)	(HSD)
Total	**$6,507**	**(13.2%)**	**(11.8%)**	**~(17%)**
U.S.	3,351	(14.5)	(14.7)	(Low-20s)
Non-U.S. Dev	2,175	(8.5)	(6.9)	(LDD)
EM	981	(18.1)	(12.5)	(High-Teens)
Total	**$6,507**	**(13.2%)**	**(11.8%)**	**~(17%)**

Other Financial Highlights:

	Diluted EPS	As Rep Y/Y%	CC[2] Y/Y%
GAAP	$0.36	(43.8%)	NC
Non-GAAP	$0.62	(50.8%)	(47.6%)

Cash Flow from Ops	$278M
Free Cash Flow[5]	$(56)M

- **REVENUE:** Declined approximately 17% excluding the benefit of an additional selling week, which we estimate added approximately $360-390M. As planned, reduction in bulk purchases had an impact similar to the extra week
- Product launches kicking in; C2Q results point to share gains in several markets
  - **CVG:** Declined high-teens; disruptive Micra™ technology and new High-Power platform Cobalt™ and Crome™ driving significant implant share gains in High and Low Power in second calendar quarter; regaining share in TAVR
  - **MITG:** Declined high-teens; continued strong demand for ventilators drove LSD RGR growth
  - **RTG:** Declined low-20s; multiple product launches across portfolio, increased strength in Spine
  - **Diabetes:** Declined HSD; delays in new pump patient starts and continued competitive pressure, partially offset by global growth in CGM
  - **Geographies:** Encouraging signs of recovery across key geographies; sequential improvement in the U.S. and China
- **EPS:** Non-GAAP EPS $0.62 declined 50.8%, including an estimated benefit of $0.06-0.10 from the extra week
- **CAPITAL ALLOCATION:** Increased cadence of tuck-in acquisitions
  - 3 major acquisitions announced CY2020 to date: Digital Surgery, Medicrea, and Companion Medical; combined present value total consideration ~$1B

1 Data has been intentionally rounded to the nearest million and, therefore, may not sum.
2 Figures represent comparison to Q1 FY20 on a constant currency basis.
3 Figures represent comparison to Q1 FY20 after adjusting for significant acquisitions or divestitures and currency.
4 Figures represent comparison to Q1 FY20 after adjusting for significant acquisitions or divestitures, currency, and extra selling week.
5 Operating cash flows less property, plant, and equipment additions.

Q1 FY21 Earnings Results | August 25, 2020 | 4

Medtronic

CEO Geoffrey Martha commented, “We’re playing offense and finding a new gear at Medtronic. We are driving toward faster and broader topline growth, not just as we emerge from the pandemic, but sustainable growth over the long-term…We’ve been operating with a high sense of urgency, and we’re going to carry this forward. I’ve discussed in the past how our organization needs to simplify and become less bureaucratic. In the coming weeks, you’re going to hear more about the actions we’re taking to become a more nimble and a more competitive organization, empowering our business units while also allowing them to take advantage of Medtronic’s global scale. I’m really excited about this direction. And I’m convinced that by empowering our general managers, we can become more competitive, we can accelerate our innovation, we can serve our customers better and we’re going to unlock a lot of value for our shareholders.”

While the operating environment is still far from ideal, we are encouraged that procedure volumes are trending back in the right direction. We like the company's diverse portfolio, as it seems to continuously offer up new products to keep the growth engine going as older products mature. And we point out that Medtronic's solid financial position is supporting increases in research & development spending (9.5% in the current quarter over Q4) despite recent revenue declines. One example of this spending is a partnership with Blackstone Life Sciences to invest $337 million aimed at advancing new, innovative products designed to reduce the burden of diabetes management. With domestic demographic trends in its favor, its products and pipeline, including treatments for atrial fibrillation, aortic stenosis and various neurological disorders, are a major asset. Shares yield 2.2%, and our Target Price has been adjusted upward to $123.

JM Smucker (SJM – $119.65), a maker of food and beverage products including its namesake jelly, posted earnings per share of $2.37, versus the $1.68 estimate, in fiscal Q1 2021. SJM had sales of $1.97 billion (vs. $1.81 billion est.). Shares gained 7% following the announcement, resulting in a YTD gain approaching 20% including dividends. While the prior quarter was lumpy due to a run on groceries amid COVID-19 shutdowns, fiscal Q1 was much better for Smucker. The company benefited from growing at-home consumption of coffee and consumer foods due to depleted household stockpiles of food, while the international retail business improved as some economies began to open up again.

CEO Mark Smucker commented, "Across our entire portfolio, we are adapting brand-building activities to attract and retain new consumers. Key metrics for consumer purchasing behavior were positive in the quarter, including household penetration growth of over 1.6 million households versus the prior year, a nearly 150 basis point improvement in repeat rate and a high single-digit increase in dollars per buyer. This means more consumers are purchasing our brands, they are repeating purchases at a higher rate and they are spending more than before."

Mr. Smucker said that a priority for fiscal 2021 is an increase on financial discipline. He explained, "We are partnering with our customers to manage pricing where appropriate, such as in peanut butter, where a reduction in crop yields has resulted in increased cost. We have also optimized planned marketing spend for several brands by reallocating resources to brands with capacity for faster growth, such as Folgers, which grew 13% in the U.S. Retail Coffee segment in the quarter. A new advertising campaign for Folgers is beginning to air this week, with content relevant to the current environment focused on attracting new consumers. We firmly believe the current environment will translate into long-term structural changes in consumer behavior and continued growth opportunities. Finally, we continue to sharpen our focus on productivity and efficiency of our spend as SD&A expenses declined 6% in the quarter."

Although SJM offered the expected COVID-related uncertainty warning, the company did boost its 2021 adjusted EPS window to $8.20-$8.60 (previously $7.90-$8.30). The company also expects flat to slightly positive revenue growth and an improved margin between 37.5% and 38.0%. Mr. Smucker added, "We continue to adapt and be agile in this changing environment, focused on maintaining and growing our consumer base and growing our categories and market share…while there will always be more work to do, our strong start and continued business momentum has put us in a position to deliver our financial commitments for the fiscal year."

While additional movement restrictions still cannot be ruled out at this point, additional headwinds remain a distinct possibility for SJM as consumers find new balances between eating at home, work, school or at restaurants. We continue to appreciate the diversification SJM adds to our broadly diversified portfolios and think that management's focus on pet foods and healthier franchises will boost the long-term prospects for the company. SJM sports a forward P/E ratio near 15 and a just-increased 3.0% dividend yield, while it ranks well relative to its peers in our proprietary scoring math. Our Target Price is now $139.

The first earnings call on our latest go-round with **Nordstrom** (JWN – $15.68) could have been better. While the stock is still above where we purchased it for our managed account clients, the whack after reporting fiscal Q2 2021 earnings ate into our gains. JWN reported an adjusted loss per share of $1.62, versus an estimated loss of $1.52. Revenue was $1.78 billion, compared with $2.28 billion analysts were expecting and $3.87 billion in the same quarter a year ago. The results were no doubt disappointing, and a shortage (since rectified) of casual wear for the work-from-home throngs didn't help, though the size of the miss left us wondering a bit if management threw in the kitchen sink in the quarter, in an effort to put a lot of the operational, financial and other challenges behind them. One factor we believe dampened the quarter's results (and should help next quarter) was the postponement of Nordstrom's Anniversary Sale to August from the customary July period.

CEO Erik Nordstrom said, "From a top line perspective, we achieved our expectations and identified opportunities to drive further improvement. Our streamlined operations and inventory position gave us flexibility to bring in new and relevant product. While inventories were constrained and we left some demand unmet, our decision to be prudent with our inventory plans helped deliver better-than-expected merchandise margin, earnings and operating cash flow. We exited the quarter in an advantageous position, with inventories clean and with open to buy to capture customer demand."

Mr. Nordstrom continued, "With our financial position strengthened, we're now pivoting to prioritize market share gains and profitable sales growth. This includes building on our heritage of service to accelerate growth initiatives. We made foundational investments in our market strategy, our Nordstrom Rack brand offering and digital capabilities to scale our business. As we look ahead, our team is unified in executing our market strategy to deepen customer engagement with a focus on offering a seamless and personal experience however they choose to shop with us. In 5 of our top markets, we're providing customers with greater merchandise selection and faster delivery while increasing engagement through services. We're on track with our plans this year to scale our strategy to 10 total markets that account for over half of our business."

Mr. Nordstrom closed, "Our unique business model is a competitive advantage. We are building on the strengths of our Nordstrom and Nordstrom Rack brands seamlessly across stores and online to serve customers on their terms through a combination of convenience and connection. We expect to deepen our relationships with existing customers and attract new ones, driving market share gains and profitable growth. We have also worked for the last several years to create a more flexible organization. With the resetting of our base cost structure, we have become leaner and more efficient. When combined with the capital structure that provides a

strong foundation for reinvestment, we are well-positioned to respond quickly to a period of accelerated change in customer behavior."

While the pandemic is a massive headwind and has hugely upset the retail apple cart, we think that folks will eventually return to malls or the new smaller-format stores, while the year-to-date decline in the stock price still in excess of 60%+ discounts a ton of bad news. At the end of the quarter, Nordstrom had $1.0 billion of cash and $5.8 billion of debt, which on average matures in 2030. The company's dividend has been discontinued to conserve cash, but we believe that it will eventually be reinstated and JWN will pay down its debt. Of course, the Nordstrom family directly owns about a quarter of the stock, so there is the chance of an oft-rumored go-private transaction. Our Target Price now stands at $33.