Market Commentary Monday, October 12, 2020

October 12, 2020

EXECUTIVE SUMMARY

Newsletter Trades – Bought 8 Stocks for Four Portfolios on 10.06.20
Week in Review – Best Five Days Since July
Fool's Errand – Trying to Explain Short-Term Market Gyrations
Myth Busting #1 – Historical Evidence Shows Stocks Like Democrats in DC
Myth Busting #2 – Data Show Dividend Payers Prefer Higher Dividend Tax Regimes
Dividend Payers vs. Fixed Income – No Contest…for Those with a Long-Term Time Horizon
Econ Update – Decent Stats and Fed Remains Friendly
Sentiment – Still Little Love for U.S. Stocks
Stock News – Updates on DE, ETN, CMI, WHR, QCOM, AYI, BASFY, AMGN & IBM

Market Review

A little housekeeping…as discussed in the October edition of *The Prudent Speculator*, we bought the following for our newsletter portfolios on Tuesday, October 6.

TPS Portfolio
78 **Lockheed Martin** (LMT – $385.93) at $383.33
222 **Cardinal Health** (CAH – $48.03) at $47.5642
54 **Synchrony Financial** (SYF- $28.84) at $28.6470

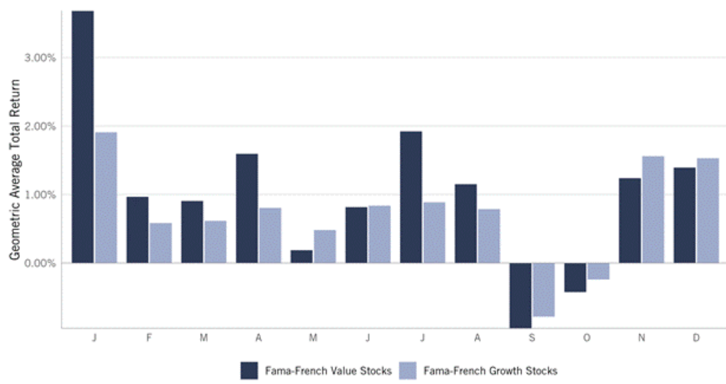
Buckingham Portfolio
145 **Micron Tech** (MU – $49.89) at $48.2644

Millennium Portfolio
203 **Morgan Stanley** (MS – $48.83) at $49.20
90 **Westrock** (WRK – $37.80) at $36.67

PruFolio
170 **JM Smucker** (SJM – $118.68) at $117.38
642 **Kimco Realty** (KIM – $11.62) at $12.11

Sometimes scary October is looking thus far like the last 20 years rather than the previous nine decades,…

While the average decline has been relatively tame over the last nine decades, and the period actually has been very positive on average over the last 20 years, October is one of only two months, September 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 October
Last 20 Years

	Russell 3000 Growth Index	S&P 500 Index	Russell 3000 Index	Russell 3000 Value Index
Average	1.33	1.31	1.16	1.01
2019	2.82	2.17	2.15	1.47
2018	-9.23	-6.84	-7.36	-5.46
2017	3.69	2.33	2.18	0.68
2016	-2.64	-1.82	-2.16	-1.68
2015	8.39	8.44	7.90	7.39
2014	2.90	2.44	2.75	2.60
2013	4.21	4.60	4.25	4.29
2012	-2.93	-1.85	-1.73	-0.55
2011	11.35	10.93	11.51	11.68
2010	4.74	3.80	3.91	3.07
2009	-1.79	-1.86	-2.57	-3.35
2008	-17.93	-16.80	-17.74	-17.54
2007	3.49	1.59	1.83	0.10
2006	3.76	3.26	3.60	3.44
2005	-1.21	-1.67	-1.87	-2.54
2004	1.63	1.53	1.64	1.65
2003	5.84	5.65	6.05	6.27
2002	8.91	8.80	7.96	6.98
2001	5.52	1.91	2.33	-0.63
2000	-4.97	-0.42	-1.42	2.28

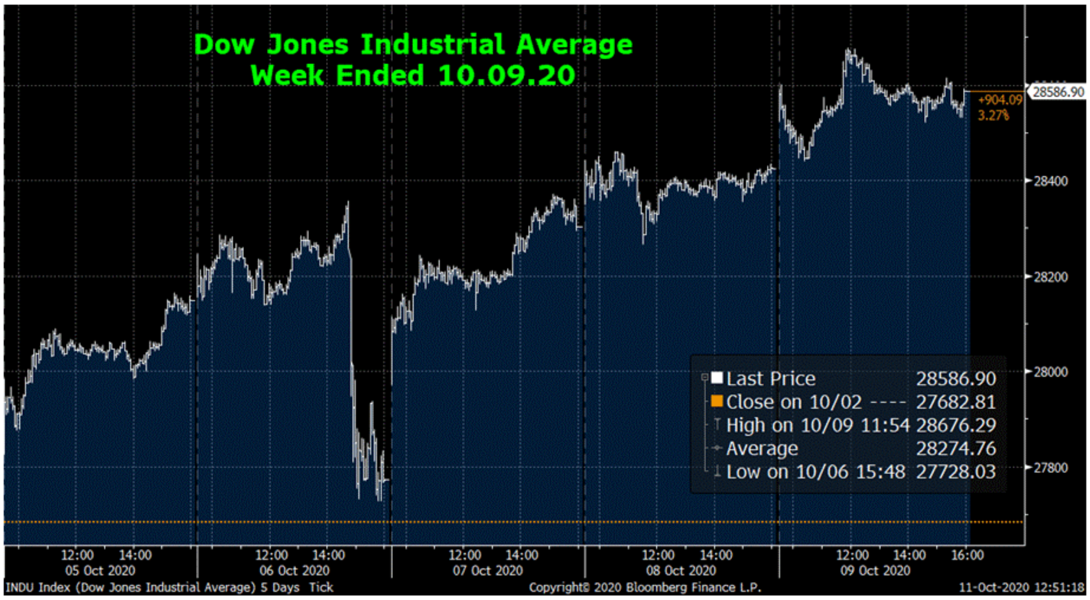
% Total Return September 30 - October 31. Source: Kovitz using data from Bloomberg.

…with the first full week of trading seeing equities post their best returns since July. While Friday was not so grand for those of us following a Value-based approach, we can't complain too much about the weekly gain of 3.92% for the Russell 3000 Value index, even as the Russell 3000 Growth index jumped 4.38%. Of course, the S&P 500 and Dow Jones Industrial Average managed total return advances of "only" 3.89% and 3.31%, respectively, so it was our kind of week as the average stock generally outperformed those two capitalization- and price-weighted indexes.

To be sure, it was hardly a straight move up, with *The New York Times* explaining in its Wednesday edition that "Markets fell [on Tuesday] as the reality sank in that the economy recovery, which is slowing, would not get another jolt anytime soon." That explanation was part of a front-page story, "As Infections Jolt West Wing, Trump Ends Talks on Aid." Skip ahead to the end of the week, and the Saturday edition of the *Times* told us, "Wall Street closed out its best week in three months on Friday as investors drew encouragement from ongoing negotiations on Capitol Hill aimed at delivering more aid to the ailing U.S. economy."

GREAT WEEK FOR THE DOW…WITH A BIG HICCUP ON TUESDAY

One might have thought news related to President Trump's COVID-19 diagnosis would be most impactful, but the twists and turns in stimulus negotiations proved far more important to the daily market moves. Indeed, the Dow Jones Industrial Average quickly shed some 600 points on Tuesday when the White House said it was ending talks until after the election, only to rebound to even higher levels when the President changed his tune somewhat and discussions with the Democrats continued.



We continue to pity those who must attempt to explain the short-term equity market gyrations as stocks move up and down for myriad reasons, with it extremely difficult to accurately attribute one day's worth of buying and selling in an asset class where holding periods are often measured in years. For example, Saturday's *Wall Street Journal* told us that despite the very volatile trading week, the big rally was because, "Investors expect volatility to recede in the weeks leading up to Nov. 3 election." The piece continued, "Polling has further consolidated around a Biden advantage in the presidential election…markets have significantly reduced the premium they assign to that date."

Incredibly, the *Journal* went on to say that the experts on Wall Street have found in their surveys and talks with investors that there has been a "flip-flop on sentiment in the event of a Biden win. Investors previously said it would be bad for stocks, but now they are predicting it would boost markets." Good to know that everyone is certain about what would be positive and negative for equities, but market history would suggest that investors in general should not fear a Democrat in the Oval Office, while those who favor Value stocks should welcome such an outcome, especially if it came with a Democratic sweep of Congress.

THE PRUDENT SPECULATOR

STOCKS AND WASHINGTON

The current polls suggest a sizable lead for the Biden/Harris ticket in the race for the White House. Of course, market history (albeit not that many data points) suggests that a Democrat in the Oval Office is good for stocks and that a complete "D" sweep would bode very well for Value.

PARTIES IN POWER & ANNUALIZED RETURNS

Conceding that there are not a lot of data points from which to draw grand conclusions, stocks seem to like the letter D better than R.

Pres Pty	Con Pty	Div Payers	Non-Div Payers	Value Stocks	Growth Stocks	Large Stocks	Small Stocks
D	R	14.8%	10.1%	15.6%	9.9%	15.0%	10.4%
D	D	14.1%	20.7%	20.6%	16.5%	12.9%	24.0%
D	S	15.3%	15.3%	14.5%	14.9%	15.6%	14.3%
R	R	-2.2%	-7.7%	-2.4%	-4.2%	-2.0%	-4.9%
R	D	9.8%	2.2%	10.7%	6.7%	9.5%	6.4%
R	S	6.7%	-3.5%	10.7%	1.9%	5.8%	5.4%
D Pres		**14.3%**	**18.0%**	**19.0%**	**14.9%**	**13.5%**	**20.3%**
R Pres		**5.1%**	**-2.3%**	**6.1%**	**2.0%**	**4.8%**	**2.3%**

Annualized Total Returns. From 12.31.28 through 12.31.18. Performance segregated by presidential and congressional party are geometric averages. Performance divided only by presidential party are also geometric averages. SOURCE: Kovitz using data from the U.S. House of Representatives, Morningstar and Professors Eugene F. Fama and Kenneth R. French

President Party	Congress Party	Start Date	End Date	Dividend Payers	Non-Div Payers	Value Stocks	Growth Stocks	Large Stocks	Small Stocks
R	R	12.31.1928	12.31.1930	-39.5%	-65.3%	-56.0%	-54.4%	-31.2%	-69.9%
R	R	12.31.1930	12.31.1932	-50.1%	-50.8%	-52.6%	-44.2%	-48.0%	-52.5%
Hoover		**12.31.1928**	**12.31.1932**	**-69.8%**	**-82.9%**	**-79.1%**	**-74.5%**	**-64.2%**	**-85.7%**
D	D	12.31.1932	12.31.1934	80.1%	60.8%	116.0%	137.5%	51.8%	201.7%
D	D	12.31.1934	12.31.1936	83.4%	153.2%	152.1%	78.6%	97.8%	131.0%
Roosevelt		**12.31.1932**	**12.31.1936**	**230.3%**	**307.2%**	**444.6%**	**324.2%**	**200.1%**	**597.0%**
D	D	12.31.1936	12.31.1938	-13.7%	-31.2%	-31.3%	-19.3%	-14.8%	-44.2%
D	D	12.31.1938	12.31.1940	3.0%	22.0%	16.1%	3.1%	10.2%	4.8%
Roosevelt		**12.31.1936**	**12.31.1940**	**-16.4%**	**-46.3%**	**-42.3%**	**-16.8%**	**-23.5%**	**-46.9%**
D	D	12.31.1940	12.31.1942	5.7%	13.5%	31.0%	-1.0%	6.4%	31.5%
D	D	12.31.1942	12.31.1944	61.5%	164.2%	143.3%	68.4%	50.8%	189.6%
Roosevelt		**12.31.1940**	**12.31.1944**	**70.7%**	**199.7%**	**218.8%**	**66.7%**	**60.4%**	**280.8%**
D	D	12.31.1944	12.31.1946	30.5%	44.3%	47.2%	31.8%	25.4%	53.4%
D	R	12.31.1946	12.31.1948	7.3%	-20.2%	8.5%	-5.0%	11.5%	-1.2%
Truman		**12.31.1944**	**12.31.1948**	**40.0%**	**15.1%**	**59.7%**	**25.2%**	**39.9%**	**51.6%**
D	D	12.31.1948	12.31.1950	59.2%	98.0%	84.7%	58.2%	56.5%	66.1%
D	D	12.31.1950	12.31.1952	38.0%	17.8%	28.9%	30.7%	46.8%	11.1%
Truman		**12.31.1948**	**12.31.1952**	**119.7%**	**133.2%**	**138.2%**	**106.8%**	**129.7%**	**84.5%**
R	R	12.31.1952	12.31.1954	51.7%	42.4%	58.2%	47.1%	51.1%	50.2%
R	D	12.31.1954	12.31.1956	36.8%	19.2%	33.7%	28.9%	40.2%	25.6%
Eisenhower		**12.31.1952**	**12.31.1956**	**107.5%**	**69.7%**	**111.6%**	**89.6%**	**111.8%**	**88.6%**
R	D	12.31.1956	12.31.1958	31.2%	30.6%	38.5%	37.5%	27.9%	40.9%
R	D	12.31.1958	12.31.1960	15.2%	0.8%	9.8%	13.8%	12.5%	12.6%
Eisenhower		**12.31.1956**	**12.31.1960**	**51.1%**	**31.6%**	**52.0%**	**56.5%**	**43.9%**	**58.6%**
D	D	12.31.1960	12.31.1962	17.7%	-8.1%	22.5%	4.3%	15.8%	16.4%
D	D	12.31.1962	12.31.1964	44.8%	15.4%	58.7%	28.0%	43.0%	52.6%
Kennedy/Johnson		**12.31.1960**	**12.31.1964**	**70.5%**	**6.0%**	**94.4%**	**33.6%**	**65.7%**	**77.6%**
D	D	12.31.1964	12.31.1966	1.6%	42.6%	20.1%	14.5%	1.1%	31.8%
D	D	12.31.1966	12.31.1968	42.9%	127.4%	103.6%	84.1%	37.7%	149.6%
Johnson		**12.31.1964**	**12.31.1968**	**45.1%**	**224.3%**	**144.6%**	**110.8%**	**39.3%**	**229.0%**
R	D	12.31.1968	12.31.1970	-7.4%	-48.9%	-13.9%	-23.9%	-4.8%	-38.1%
R	D	12.31.1970	12.31.1972	34.2%	21.4%	29.0%	38.7%	36.0%	21.7%
Nixon		**12.31.1968**	**12.31.1972**	**24.2%**	**-38.0%**	**11.1%**	**5.6%**	**29.4%**	**-24.7%**
R	D	12.31.1972	12.31.1974	-36.1%	-63.2%	-33.7%	-54.6%	-37.2%	-44.7%
R	D	12.31.1974	12.31.1976	81.0%	127.1%	139.5%	88.6%	69.9%	140.5%
Nixon/Ford		**12.31.1972**	**12.31.1976**	**15.7%**	**-16.5%**	**58.7%**	**-14.4%**	**6.6%**	**33.0%**
D	D	12.31.1976	12.31.1978	5.2%	41.7%	26.2%	17.3%	-1.1%	54.8%
D	D	12.31.1978	12.31.1980	60.3%	161.8%	56.5%	90.6%	56.8%	100.7%
Carter		**12.31.1976**	**12.31.1980**	**68.7%**	**270.9%**	**97.5%**	**123.6%**	**55.1%**	**210.6%**
R	S	12.31.1980	12.31.1982	20.4%	-4.2%	55.3%	9.7%	15.4%	45.8%
R	S	12.31.1982	12.31.1984	29.3%	-1.9%	54.1%	8.5%	30.2%	30.4%
Reagan		**12.31.1980**	**12.31.1984**	**55.6%**	**-6.1%**	**139.3%**	**19.1%**	**50.3%**	**90.0%**
R	S	12.31.1984	12.31.1986	57.9%	26.4%	56.2%	42.2%	56.6%	33.2%
R	D	12.31.1986	12.31.1988	21.8%	8.9%	23.1%	10.2%	22.9%	11.5%
Reagan		**12.31.1984**	**12.31.1988**	**92.3%**	**37.7%**	**92.3%**	**56.8%**	**92.5%**	**48.5%**
R	D	12.31.1988	12.31.1990	24.2%	2.8%	0.3%	15.6%	27.3%	-13.6%
R	D	12.31.1990	12.31.1992	45.2%	70.3%	73.5%	56.8%	40.6%	78.4%
Bush H.		**12.31.1988**	**12.31.1992**	**80.4%**	**75.1%**	**74.1%**	**81.3%**	**79.0%**	**54.2%**
D	D	12.31.1992	12.31.1994	9.9%	17.4%	20.8%	3.1%	11.4%	24.7%
D	R	12.31.1994	12.31.1996	69.6%	56.9%	69.6%	55.4%	69.1%	58.2%
Clinton		**12.31.1992**	**12.31.1996**	**86.4%**	**84.1%**	**104.9%**	**60.3%**	**88.5%**	**97.3%**
D	R	12.31.1996	12.31.1998	65.7%	60.8%	50.5%	41.1%	71.5%	13.8%
D	R	12.31.1998	12.31.2000	16.9%	16.6%	28.4%	13.4%	10.0%	25.1%
Clinton		**12.31.1996**	**12.31.2000**	**93.7%**	**87.4%**	**93.3%**	**60.0%**	**88.7%**	**42.4%**
R	R	12.31.2000	12.31.2002	-18.7%	-45.5%	-10.5%	-32.4%	-31.4%	6.5%
R	R	12.31.2002	12.31.2004	41.7%	62.0%	75.6%	56.9%	42.7%	90.3%
Bush W.		**12.31.2000**	**12.31.2004**	**15.2%**	**-11.7%**	**57.1%**	**6.0%**	**-2.1%**	**102.6%**
R	R	12.31.2004	12.31.2006	23.0%	19.1%	37.1%	12.7%	21.5%	22.8%
R	S	12.31.2006	12.31.2008	-31.7%	-36.4%	-39.8%	-31.3%	-33.5%	-40.0%
Bush W.		**12.31.2004**	**12.31.2008**	**-16.0%**	**-24.3%**	**-17.4%**	**-22.5%**	**-19.3%**	**-26.4%**
D	D	12.31.2008	12.31.2010	41.8%	84.4%	46.9%	64.9%	45.5%	68.1%
D	S	12.31.2010	12.31.2012	17.5%	15.5%	13.1%	14.0%	18.5%	14.4%
Obama		**12.31.2008**	**12.31.2012**	**66.7%**	**112.9%**	**66.2%**	**88.0%**	**72.4%**	**92.3%**
D	S	12.31.2012	12.31.2014	50.5%	53.7%	52.2%	53.0%	50.5%	49.3%
D	R	12.31.2014	12.31.2016	12.8%	11.4%	19.8%	9.7%	13.5%	21.1%
Obama		**12.31.2012**	**12.31.2016**	**69.7%**	**71.2%**	**82.3%**	**67.8%**	**70.8%**	**80.8%**
R	R	12.31.2016	12.31.2018	12.9%	26.8%	-1.1%	22.8%	16.5%	-7.5%
Trump		**12.31.2016**	**12.31.2018**	**12.9%**	**26.8%**	**-1.1%**	**22.8%**	**16.5%**	**-7.5%**

Total Returns are not annualized. From 12.31.28 through 12.31.18. SOURCE: Kovitz using data from the U.S. House of Representatives, Morningstar and Professors Eugene F. Fama and Kenneth R. French

Obviously, we understand that the current Biden tax plan calls for significant increases in taxes, including the end to preferential treatment for dividends. All else being equal, this should be a negative for income-producing stocks, but all else is never equal. In fact, those counseling the avoidance of dividend payers are assuming that what is "promised" on the campaign trail makes its way into law and, more importantly, they are ignoring the historical performance evidence that vehemently argues to the contrary.

THE PRUDENT SPECULATOR

BUSTING THE MYTHS: HIGHER TAX RATES FAVOR…DIVIDEND PAYERS

With the Biden Tax plan supposedly returning the tax rate on dividends to the ordinary income rate, rather than the preferential "qualified" rate that has been in place since 2003, some are suggesting that investors avoid dividend paying stocks. Keeping in mind that capital gains have accounted for the lion's share of long-term returns, the table below vividly illustrates that **dividend-paying stocks have outperformed non-dividend payers when taxed at higher levels and vice-versa.**

Tax Regimes & Annualized Equity Returns

Period	Dividend Status	No Dividends	Low 30% Div Payers	Mid 40% Div Payers	High 30% Div Payers	All Div Payers
Revenue Act 1936						
1936-1939	Fully Taxable	-1.6%	4.6%	4.5%	-0.4%	3.2%
Revenue Act 1940						
1940-1953	Exempt	14.1%	9.5%	12.6%	13.7%	12.1%
Internal Revenue Code 1954						
1954-1985	Normal Income with Modest Credits	9.6%	10.6%	11.5%	14.2%	12.2%
Tax Reform Act 1986						
1986-2002	Fully Taxable	7.9%	11.6%	12.4%	13.7%	12.7%
Bush Tax Cuts 2003						
2003-2020	Qualified Dividends at Lower Rate	15.6%	10.5%	12.4%	8.9%	10.9%

Source: Kovitz using data from Professors Fama & French. IRS.gov and SureDividend.com

It is fascinating that dividend payers have had better total returns than non-dividend payers in less friendly tax regimes…and that the reverse is also true…but the favorable numbers shouldn't be surprising given the long-term returns data, not to mention the fact that dividends generally have grown over time.

THE PRUDENT SPECULATOR

THE VALUE OF DIVIDENDS

We remain perplexed that so many investors would rather risk their money in record-low-yielding fixed income instruments, when dividend payments have risen over time (i.e. they are not fixed) and dividend-payers have enjoyed superb long-term total returns.

DIVIDENDS GENERALLY RISE OVER TIME

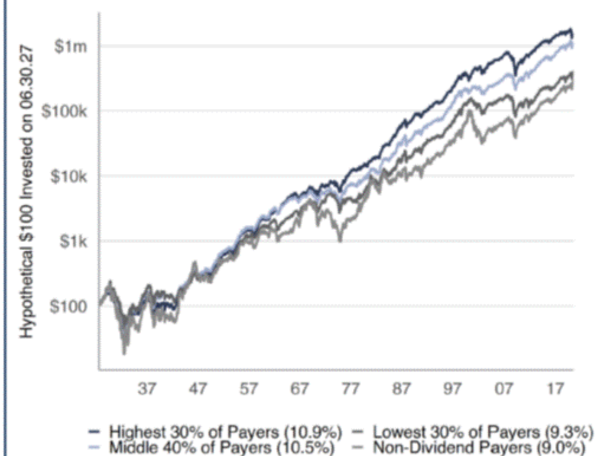
There are occasional hiccups when economic contractions occur, but the long-term trend in dividend payouts has been higher.

	S&P 500	S&P 500 Value	S&P 500 Growth	Russell 3000	R3000 Value	R3000 Growth
Index Value	**3363**	**1114**	**2334**	**1968**	**1523**	**1741**
Current Yield	**1.8%**	**2.9%**	**1.1%**	**1.7%**	**2.7%**	**0.8%**
2021 Est Div	$61.30	$32.37	$26.43	$33.64	$39.57	$15.61
2020 Est Div	$58.78	$31.56	$24.65	$32.25	$38.51	$14.61
2019 Div	$58.69	$32.36	$23.31	$33.33	$43.30	$15.91
2018 Div	$53.86	$27.22	$24.64	$31.72	$40.33	$15.91
2017 Div	$50.47	$27.93	$20.32	$28.62	$38.23	$13.85
2016 Div	$46.73	$24.19	$21.95	$26.58	$35.91	$12.98
2015 Div	$43.86	$23.93	$18.48	$24.76	$33.19	$12.37
2014 Div	$40.16	$21.94	$17.56	$22.40	$30.45	$11.18
2013 Div	$35.00	$19.47	$15.04	$19.87	$26.87	$10.03
2012 Div	$31.97	$17.38	$14.18	$18.76	$24.38	$9.87
2011 Div	$26.62	$13.89	$12.58	$14.95	$20.75	$7.20
2010 Div	$23.59	$12.28	$11.08	$13.21	$18.35	$6.46
2009 Div	$23.59	$14.25	$8.91	$13.03	$18.91	$5.97
2008 Div	$28.46	$20.34	$8.23	$15.63	$26.59	$5.58
2007 Div	$28.39	$21.20	$7.90	$15.71	$28.38	$5.25

As of 09.30.20. SOURCE: Kovitz using data from Bloomberg Finance L.P.

DIVIDEND PAYERS WIN THE RETURNS RACE

More than nine decades of historical evidence illustrate that the greater the income a stock produces the better the overall return.



From 06.30.27 through 07.31.20. Logarithmic scale. SOURCE: Kovitz using data from Professors Eugene F. Fama and Kenneth R. French

And, today, choosing income-oriented stocks should be even more intriguing, for anyone with a longer-term time horizon,…

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 0.77% yield on the 10-year U.S. Treasury increase markedly as the level of patience rises.

PATIENCE IS VIRTUOUS

VALUE STOCKS

	Count >0.77%	Count <=0.77%	Percent >0.77%
1 Month	700	418	62.6%
3 Months	746	370	66.8%
6 Months	777	336	69.8%
1 Year	796	311	71.9%
2 Year	905	190	82.6%
3 Year	940	143	86.8%
5 Year	937	122	88.5%
7 Year	994	41	96.0%
10 Year	964	35	96.5%
15 Year	935	4	99.6%
20 Year	879	0	100.0%

DIVIDEND PAYERS

	Count >0.77%	Count <=0.77%	Percent >0.77%
1 Month	702	416	62.8%
3 Months	766	350	68.6%
6 Months	792	321	71.2%
1 Year	825	282	74.5%
2 Year	919	176	83.9%
3 Year	914	169	84.4%
5 Year	955	104	90.2%
7 Year	984	51	95.1%
10 Year	960	39	96.1%
15 Year	936	3	99.7%
20 Year	879	0	100.0%

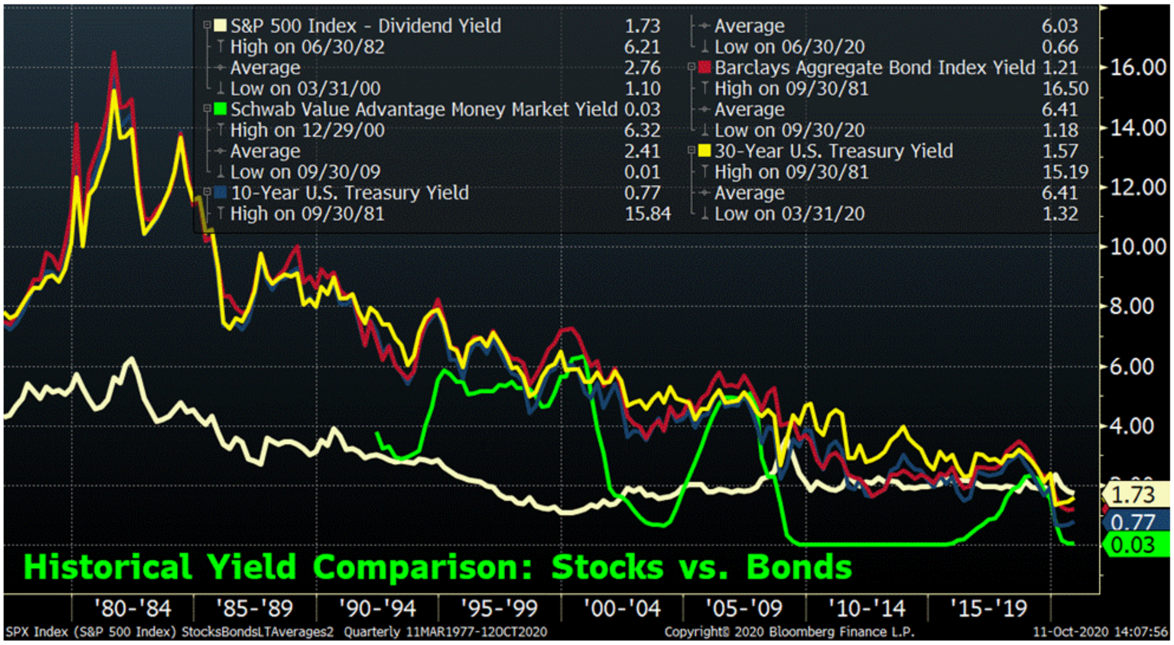
From 07.31.27 through 08.31.20. Value stocks represented by 50% small value and 50% large value returns rebalanced monthly. Dividend payers represented by 30% top of dividend payers, 40% of middle dividend payers, and 30% bottom of dividend payers rebalanced monthly. SOURCE: Kovitz using data from Professors Eugene F. Fama and Kenneth R. French

…given the microscopic yields available on other investment options.

THE PRUDENT SPECULATOR

EQUITY VS. FIXED INCOME YIELDS

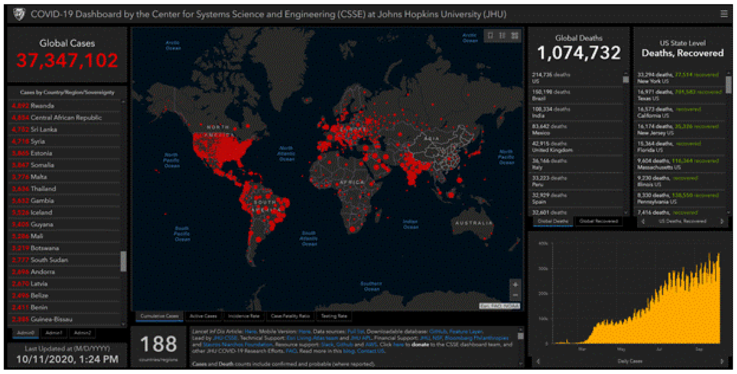
Though stocks are not necessarily a substitute for cash, government or corporate bonds, the payout on the S&P 500 (1.73%) is extraordinarily generous versus the income provided by fixed income, especially given the recent plunge in rates. Incredibly, **equities yield more than the Barclays Aggregate Bond Index and more than 50 times the yield of a "generous" Money Market Fund**!

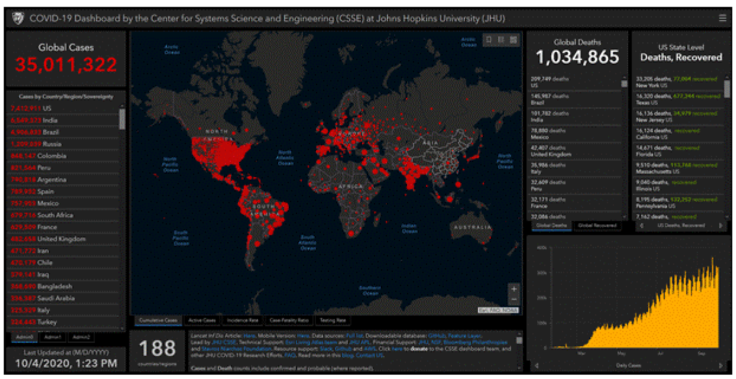


True, there is plenty of uncertainty these days, including the upcoming election, while the coronavirus battle remains a long-playing wildcard,…

THE PRUDENT SPECULATOR

COVID-19 GLOBAL SPREAD





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

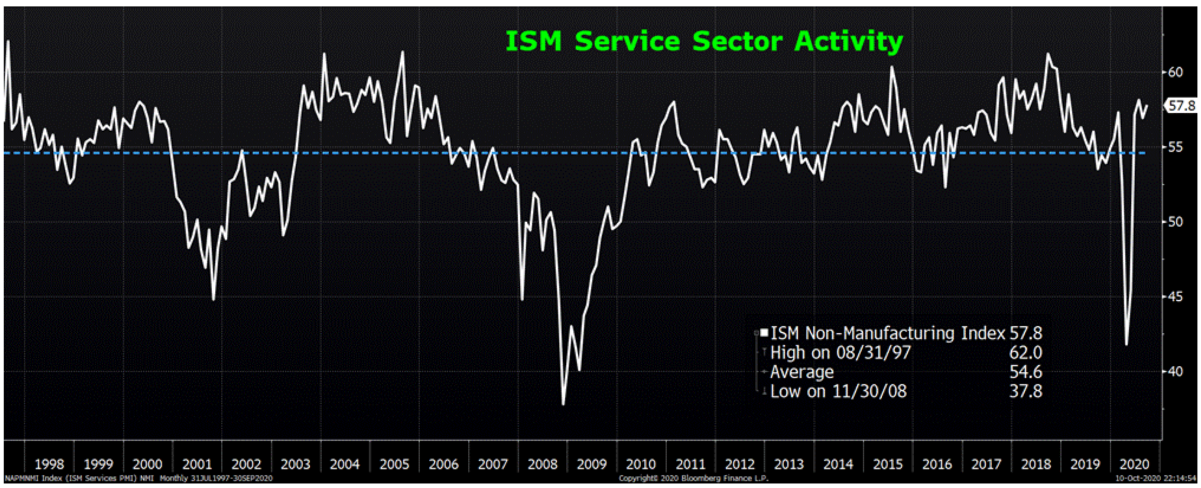
With access to testing remaining high, there was another jump of more than 2.3 million in global COVID-19 confirmed cases in the latest week. Case counts have surged as economies have reopened, social distancing has waned and mask wearing has been inconsistent, and the U.S. is now up to nearly 215,000 fatalities. While deaths obviously lag cases, and Europe, the United Kingdom and the U.S. have seen new spikes in those diagnosed with the virus, the increase in the weekly fatality count has remained relatively constant in the 40,000 range. No doubt, the approaching flu season will represent another health risk.

…but the U.S. economy has held up better than most were thinking back in the Spring, with the latest read on the health of the important service sector coming in much better than expected,…

THE PRUDENT SPECULATOR

ISM NON-MANUFACTURING REBOUNDS: 3.2% ANNUALIZED GDP GROWTH

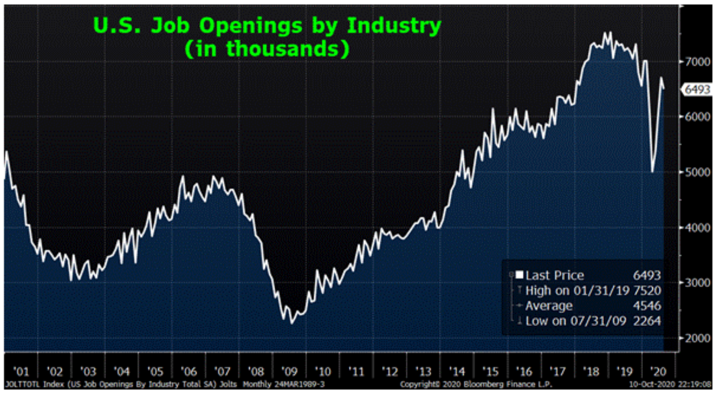
The latest read on the health of the service sector rose to a better-than-expected 57.8 in September, up from 56.9 in August. The tally was well above average and suggests a growing non-manufacturing economy, with the Institute for Supply Management stating, "The past relationship between the Services PMI and the overall economy...corresponds to a 3.2% increase in real gross domestic product (GDP) on an annualized basis."

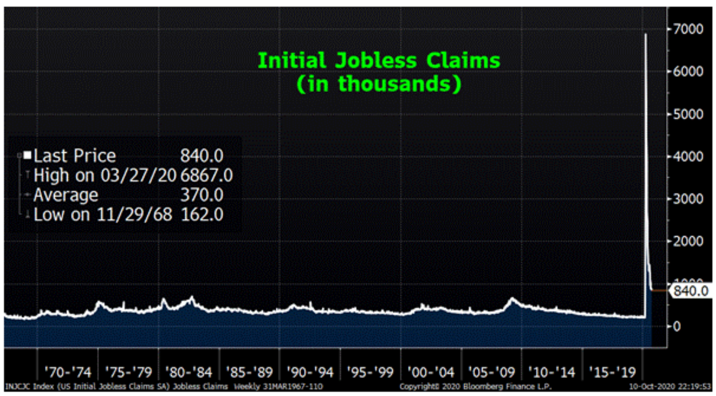


…and even the ugly jobs numbers trending in a better direction.

THE PRUDENT SPECULATOR

DISMAL (BUT IMPROVING) EMPLOYMENT NUMBERS





A hefty 5.9 million people were rehired or found new jobs during August and there were 6.5 million job openings during the month, but the labor picture hardly can be called good, even as the numbers today are significantly better than many had projected a few months back. Looking at more current data, first-time filings for unemployment benefits continue to be massive, with a whopping 840,000 claims in the latest week.

And, Jerome H. Powell and his colleagues at the Federal Reserve continue to do all they can to bolster the economy,…

FED CHAIR JEROME H. POWELL SPEECH TO NABE: 10.06.20

The Road Ahead

I will now turn to the outlook. The recovery has progressed more quickly than generally expected. The most recent projections by FOMC (Federal Open Market Committee) participants at our September meeting show the recovery continuing at a solid pace. The median participant saw unemployment declining to 4 percent and inflation reaching 2 percent by the end of 2023. Of course, the economy may perform better or worse than expected. The outlook remains highly uncertain, in part because it depends on controlling the spread and effects of the virus. There is a risk that the rapid initial gains from reopening may transition to a longer than expected slog back to full recovery as some segments struggle with the pandemic's continued fallout. The pace of economic improvement has moderated since the outsize gains of May and June, as is evident in employment, income, and spending data. The increase in permanent job loss, as well as recent layoffs, are also notable.

We should continue do what we can to manage downside risks to the outlook. One such risk is that COVID-19 cases might again rise to levels that more significantly limit economic activity, not to mention the tragic effects on lives and well-being. Managing this risk as the expansion continues will require following medical experts' guidance, including using masks and social-distancing measures.

A second risk is that a prolonged slowing in the pace of improvement over time could trigger typical recessionary dynamics, as weakness feeds on weakness. A long period of unnecessarily slow progress could continue to exacerbate existing disparities in our economy. That would be tragic, especially in light of our country's progress on these issues in the years leading up to the pandemic.

The expansion is still far from complete. At this early stage, I would argue that the risks of policy intervention are still asymmetric. Too little support would lead to a weak recovery, creating unnecessary hardship for households and businesses. Over time, household insolvencies and business bankruptcies would rise, harming the productive capacity of the economy, and holding back wage growth. By contrast, the risks of overdoing it seem, for now, to be smaller. Even if policy actions ultimately prove to be greater than needed, they will not go to waste. The recovery will be stronger and move faster if monetary policy and fiscal policy continue to work side by side to provide support to the economy until it is clearly out of the woods.

…even as the latest FOMC projections call for a healthy rebound in GDP in 2021.

FED: BIG REBOUND IN '21 AND NEAR-ZERO INTEREST RATES THROUGH '23

The Fed's latest projections call for a much less severe recession (3.7% plunge in real GDP) this year, and a significant recovery of 4.0% GDP growth in 2021 and a decent 3.0% expansion in 2022, while the Fed Funds rate will likely remain near zero through 2023.

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

Percent

Variable	Median[1]					Central Tendency[2]					Range[3]				
	2020	2021	2022	2023	Longer run	2020	2021	2022	2023	Longer run	2020	2021	2022	2023	Longer run
Change in real GDP	-3.7	4.0	3.0	2.5	1.9	-4.0–-3.0	3.6–4.7	2.5–3.3	2.4–3.0	1.7–2.0	-5.5–1.0	0.0–5.5	2.0–4.5	2.0–4.0	1.6–2.2
June projection	-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
Unemployment rate	7.6	5.5	4.6	4.0	4.1	7.0–8.0	5.0–6.2	4.0–5.0	3.5–4.4	3.9–4.3	6.5–8.0	4.0–8.0	3.5–7.5	3.5–6.0	3.5–4.7
June projection	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
PCE inflation	1.2	1.7	1.8	2.0	2.0	1.1–1.3	1.6–1.9	1.7–1.9	1.9–2.0	2.0	1.0–1.5	1.3–2.4	1.5–2.2	1.7–2.1	2.0
June projection	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
Core PCE inflation[4]	1.5	1.7	1.8	2.0		1.3–1.5	1.6–1.8	1.7–1.9	1.9–2.0		1.2–1.6	1.5–2.4	1.6–2.2	1.7–2.1	
June projection	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		
Memo: Projected appropriate policy path															
Federal funds rate	0.1	0.1	0.1	0.1	2.5	0.1	0.1	0.1	0.1–0.4	2.3–2.5	0.1	0.1	0.1–0.6	0.1–1.4	2.0–3.0
June projection	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

Source: Federal Reserve, September 16, 2020

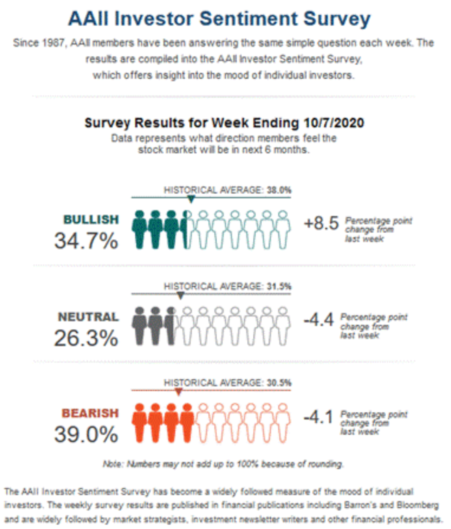
So, we remain optimistic about the long-term prospects of our broadly diversified portfolio of what we believe to be undervalued stocks, and we are happy from a contrarian perspective that we don't have a lot of company in our view,…

THE PRUDENT SPECULATOR

SENTIMENT: NOT A LOT OF ENTHUSIASM FOR U.S. STOCKS

Folks on Main Street became much more Bullish last week AFTER a sizable bounce that followed the September selloff. 'Twas ever thus, as the only problem with market timing is getting the timing right…and as contrarians, we are happy that optimism remains below normal.

Illustrating that mutual and exchange-traded fund investors are terrible market timers, folks tiptoed into equities the week ended 9.16.20 just in time for a sizable equity market selloff. They then fled stocks in the week ended 9.23.20, missing out on a big rebound in stocks.



Combined Estimated Long-Term Fund Flows and ETF Net Issuance

Millions of dollars

Week Ended	9/30/2020	9/23/2020	9/16/2020	9/9/2020	9/2/2020
Total Equity	-11,847	-19,267	7,864	-8,519	-28,307
Domestic	-908	-17,278	9,184	-8,785	-18,048
World	-10,939	-1,989	-1,320	266	-10,260
Hybrid	-2,092	-1,711	-1,111	-929	-1,163
Total Bond	4,357	5,036	15,460	13,419	24,543
Taxable	3,391	3,572	13,474	11,631	23,201
Municipal	966	1,464	1,986	1,788	1,342
Commodities	187	1,355	-334	142	718
Total	-9,396	-14,586	21,879	4,113	-4,209

Source: Investment Company Institute

…even as we expect the near-term, unlike the *Wall Street Journal's* latest take, to be volatile and most likely dependent on news coming out of Capitol Hill on the stimulus talks.

Stock Updates

Jason Clark, Chris Quigley and Zach Tart look at nine of our companies that had developments of sufficient importance to merit a Target Price review. Keep in mind that all stocks are rated as a "Buy" until such time as they are a "Sell." 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*.

Shares of **Deere & Co.** (DE – $234.81) continued to plow ahead since we trimmed our holding at the end of August. While we continue to keep a close eye on Deere and its place in our portfolios, we have made the decision to again increase our Target Price as investors are seemingly pay more attention to stocks in the Industrials sector.

Further, last week, analysts covering Deere continued to increase their estimates for the upcoming quarter and full-year fiscal 2020 and 2021. The consensus estimate for Q4 has been raised to $1.24 per share, up from the previous consensus of $1.19. The 2020 estimate has been boosted to $7.50 per share, up from the previous consensus forecast of $7.46, and the full year 2021 estimate has been lifted to $10.27 per share, up from $10.22.

We acknowledge that continuing to hold an overweight position of Deere does not come without its short-term risks following the very strong run up. As we have been writing, the near term for agriculture continues to be complicated by the three Ps (pandemic, politics and production), particularly as issues around global trade and continued government support remain unresolved. However, longer term, we view the replacement cycle and precision ag as highly supportive with technology advancements continuing to bolster pricing. Further, we think demand will continue to increase as worldwide arable land and population growth should force farmers to be more productive and should continue to drive the need for more efficient farming.

We also like that Deere has the diversifier of its construction products, and think the company will benefit from continued emerging market urbanization, while it could realize top- and bottom-line gains from a U.S. infrastructure spend if one occurs post election. With earnings estimates climbing after the excellent recent quarterly profit report, our Target Price on our remaining DE is now $242.

Note, also, that while every company is fighting for its spot in our portfolios and stocks in the Industrials sector could be sources of cash should a new idea come along, we are not yet ready to part with any more of our ownership in **Eaton Corp PLC** (ETN – $107.53), where we have raised our Target Price to $112, or **Cummins** (CMI – $223.32) where our Target Price now stands at $231.

Whirlpool (WHR – $201.40) shares summitted a new 52-week high last week with another 4% run over the last 5 trading days. The move results in a 35% advance year-to-date as the appliance maker has been a major beneficiary of the homebuilding boom this year. Even with the massive rally, a very reasonable multiple of 13 times next-12-month earnings and a very favorable environment for nearly all things home building/remodeling, given low interest rates and more time spent at home for many, leaves us wanting to hold onto our shares a while longer. The last few quarters have seen a transition away from the firm's less profitable EMEA operations in favor of more profitable business in North America. We await the release of Q3 results later this month. Shares yield 2.4% and our Target Price has been boosted to $218.

Shares of **Qualcomm** (QCOM – $124.87) brushed up against our published Target Price last week, thanks to competitor moves including AMD's rumored $30 billion acquisition of Xilinx and a big piece in *The Wall Street Journal* discussing CEO Steve Mollenkopf's 5G ambitions. Mr. Mollenkopf told the *Journal*, "If you look at the U.S. and China, [the rollout of 5G] is very good. In the U.S., the average consumer isn't seeing it all the time now, but their phones have already made the decision to do it and it's coming. With the combination of Sprint and T-Mobile, you're going to have three well-capitalized companies [along with AT&T and Verizon] who really now understand the future of the internet is wireless. There are parts of Europe that are going a little bit slower than we expected, but on the whole it's good. China's rollout has really accelerated since COVID. I don't know whether it was conscious, but it definitely seems to be that way." Mr. Mollenkopf also said that he was excited that Qualcomm holds the technology necessary for big industrial companies to use 5G in ways that can transform industries.

We have inched up our Target Price to $131, given that QCOM does not have excessive weights in our broadly diversified portfolios and we appreciate the company's strong balance sheet. We are also pleased to see the long-time master litigator moving past many of its patent disputes and towards the future. Despite shares residing at all-time highs, the company sports a forward P/E ratio around 22, with the figure falling to 19 in 2021 and 17 in 2022. QCOM shares still yield a very generous 2.1%.

Manufacturer and distributor of lighting systems **Acuity Brands** (AYI – $99.62) released fiscal Q4 results last week that handily beat analyst expectations. Despite the beat, shares sank 12% over Thursday and Friday as CEO Neil Ashe expressed a cautious outlook and expected weakness in nonresidential building activity. We note that year-over-year revenue and earnings declines slowed markedly compared to Q3 as business activity picked up over the reporting period. Management attributed the 5% revenue decline in Q4 to equal parts volume declines and product price/mix (4% each), offset by a 3% benefit from acquisitions. The firm repurchased between 1% to 2% of its outstanding shares in the quarter for around $102 per share.

Mr. Ashe commented, "During the quarter, we made the decision to be aggressive in the marketplace. Thanks to a myriad of actions across the company, we were able to make strategic investments in price while also maintaining our gross profit margins. As the market has changed, our business is flexing to where we see opportunity. This quarter, we grew sales through the retail channel and in infrastructure and industrial markets. While we were able to grow in those areas, many of the end markets we serve continue to be negatively impacted by the impacts of COVID. There is no better illustration of this than the geographic inconsistency that we saw across the country."

The breadth of economic uncertainty sweeping our nation has undoubtedly impacted project spending on Acuity's products and services. But opportunities exist in certain areas (i.e. building controls through retrofits and renovation) to compensate for weakness in others (i.e. new build construction). Acuity President Richard Reece explained, "I believe in this post-COVID era, we are going to see real opportunity for renovations, whether it's in office space, whether it's how we shop, whether it's how restaurants and hospitality need to arrange and manage their buildings. We've got the terminal side or UV opportunity that may be out there. So, there's clearly opportunity in the traditional renovation we've had, but I think evolving into a broader renovation than just energy savings. How can we make the space safer? How can we address the opportunities, the controls and so forth bring in?"

We really like Acuity's conservative financial posture, with a balance sheet that boasts more cash than debt and flexible operating structure where generally two-thirds of costs are variable. In addition to opportunities to distribute far UVC capable lighting, Acuity's opportunities in Internet of Things appear promising as its indoor location services data platform provides navigation, way-finding, asset tracking, occupant behavior data and asset analytics using a connected lighting platform, a real plus as businesses are busy reconfiguring space for hygiene and social distancing purposes. After the recent swoon, shares trade at 12.7 times 2021 expected EPS, and yield 0.5%. Our Target Price has been trimmed to $173.

Shares of **BASF SE** (BASFY – $16.22) gained 6% last week as the German chemical maker reported preliminary figures for Q3 2020. BASF expects EBIT (earnings before interest and tax) excluding special items to be 581 million euros (690 million USD at current spot rates). For the full-year 2020, BASF expects sales between 57 billion euros and 59 billion euros ($67 billion to $70 billion) and EBIT between 3.0 and 3.3 euros per share ($3.55 to $3.90).

The company said via press release, "The Surface Technologies, Materials, Industrial Solutions and Chemicals segments exceeded average analyst estimates for EBIT before special items in the third quarter of 2020. EBIT before special items was on a level with analyst estimates in the Agricultural Solutions segment, but fell short of analyst estimates in the Nutrition & Care segment… The year-on-year decrease in the BASF Group's EBIT before special items was primarily due to the continued weak earnings contributions from the upstream Chemicals and Materials segments due to ongoing high pressure on margins. The Nutrition & Care, Agricultural Solutions and Industrial Solutions segments and Other also recorded lower earnings compared with the prior-year quarter. EBIT before special items in the Surface Technologies segment was almost on a level with the prior-year period."

While the company offered an improved Q4 outlook, it is hardly firing on all cylinders thanks to the pandemic and weak global industrial activity numbers. We continue to hold our BASF shares and think the valuation is cheap for 2021 (16 times estimated earnings) and 2022 (13 times estimated earnings), however the usual caveat applies that every stock in our portfolios is fighting for its position and should an opportunity with a better expected return profile present itself, BASF's execution challenges (not all management's fault) may put it on the chopping block. Our Target Price remains $21.

Biotechnology concern **Amgen** ($236.70) announced top-line results last week from GALACTIC-HF, a phase 3 trial of omecamtiv mecarbil in patients with heart failure with reduced ejection fraction. The trial found that the treatment met its primary endpoint, which measured the time to death or first heart failure event, by demonstrating a statistically significant effect to reduce cardiovascular death or heart failure compared to placebo. However, no reduction in the secondary endpoint of cardiovascular death was observed. Shares sank nearly 9% over Thursday and Friday trading on the news.

"The outcomes observed in GALACTIC-HF further the understanding of treating heart failure, a devastating disease in which half of heart failure patients will die within five years of initial hospitalization," said David M. Reese, M.D. executive vice president of Research and Development at Amgen. "At Amgen, we remain committed to developing and delivering transformative medicines that improve the lives of patients with cardiovascular disease."

The news is certainly disappointing, as competition is expected to eat into existing biologic revenues in the coming years and the COVID-19 pandemic has added near-term headwinds to research and marketing of new drugs. But we do think the selling was overdone, and like that Amgen has shifted the conversation from legacy products to focus on growth products. Strong free-cash-flow generation has enabled the firm to add value through opportunistic shares repurchases, while solid financial footing and 2.7% dividend yield are also a plus. Our Target Price for AMGN has been pared to $283.

Shares of **IBM** (IBM – $127.79) gained 6% last week thanks in large part due to news that the technology giant plans to spin out its infrastructure business. In an open letter to his IBM team, CEO Arvind Krishna wrote, "Two things are becoming increasingly clear. First, we're seeing a tremendous increase in client demand for our capabilities and expertise. Second, we're noticing that client buying needs for application and infrastructure services are diverging. Because of this, we have decided that the managed infrastructure services business of our GTS segment will become an independent company, which we're initially referring to as 'NewCo.' We expect the new company to be created sometime toward the end of 2021. IBM will sharpen its focus on its open hybrid cloud platform and AI capabilities. And the new company will focus on delivering managed infrastructure services."

In our view, the shakeup was long overdue. For decades, IBM has been slow or unwilling to innovate. Management worked hard to stay stuck in neutral, firing or pushing out executives that wanted IBM to focus, a practice that was especially prevalent under CEO Louis Gerstner in the early 1990's. While Mr. Gerstner's early work was largely positive, IBM's big bet on OS/2 nearly broke the firm. Even though it was clear that Windows 95 was crushing OS/2, management compounded the problem when it went out and bought Lotus Development, thinking that adding an office suite to a sinking ship would magically right it. Gerstner was replaced by Sam Palmisano in 2002, who grew IBM to the largest IT company in the world by 2009 and made acquisitions, such as PWC Consulting, that should have put IBM as the leader in cloud computing. That didn't happen because IBM refused to invest in databases and double-digit growth became unsustainable, requiring profitability to be shored up by cost-cutting measures.

Unfortunately, while Larry Ellison of **Oracle** (ORCL – $61.15) and Jeff Bezos of Amazon (AWS) were rapidly investing in cloud computing, Mr. Palmisano was busy doing nothing, justifying the inaction by stating, "Enterprise will have its own unique model. You can't do what we're doing in a cloud." Mr. Palmisano's view could not have been more wrong. And when Ginni Rometty took over in 2012, the revenue decline continued. Ms. Rometty's IBM continued the tradition of refusing to make meaningful investments in the cloud business (until a last-ditch effort to acquire Red Hat last year), instead focusing on share buybacks to prop up earnings per share.

While we long have believed and continue to think that IBM shares are significantly undervalued, we were not unhappy to see Ms. Rometty depart earlier this year, but it was unclear to us that Mr. Krishna would be able to reverse decades of overpromising and systematic underinvestment. It is still too early to tell if Mr. Krishna's plan is going to be a success, but the concrete steps to move away from the all-in-one model and towards a specialization (read: market leader) model should be applauded. Mr. Krishna's letter seems to fully recognize the same future IBM's competitors do, "Today, hybrid cloud and AI are swiftly becoming the locus of commerce, transactions, and over time, of computing itself. This shift is driven by the changing needs of our clients, who find that choosing an open hybrid cloud approach is 2.5 times more valuable than relying on public cloud alone. We also know that there's tremendous value in focus. Our intent is to concentrate our energy on the things that matter the most to our clients so we can move them the furthest. As a more focused company, IBM will innovate and move faster, and invest more strategically in the future of our business. That is why, as part of this major change, IBM will accelerate actions to simplify and optimize our operating model for speed and growth."

Even though IBM has a long way to go before any level of success can be declared, we are thrilled that the company appears to be headed in the direction of a hybrid cloud and AI solutions. Both markets, we think, have plenty of upside potential given their relative newness, plus IBM can rely on Red Hat's expertise (Red Hat's CEO Jim Whitehurst took over as IBM's President in April). It is likely to be a bumpy road as IBM transforms, but we think that the company may actually start to reward us more handsomely (the dividend yield is currently 5.1%) for its position in our broadly diversified portfolios. Thinking that the sum of the parts is worth more than the whole, our Target Price for all of IBM is now $184.