Market Commentary Monday, October 26, 2020

October 26, 2020

EXECUTIVE SUMMARY

Week in Review – Volatility but Modest Gains for Value
Q3 Earnings – 84% Beating the Street
Health – Latest COVID-19 News Not So Grand But Stocks Have Persevered Through All Viruses
Econ Update – Favorable Numbers; Clarida Says Recession Likely Has Ended
Sentiment – Still Not Much Optimism
Interest Rates – Negative Yields Around the World and a Mountain of Cash in Very-Low-Yielding U.S. Money Markets Add to the Appeal of Equities
Undervalued Dividend Payers – 25 Favored Names
Stock News – Updates on WHR, ABT, SNA, STX, IBM, LRCX, T, INTC, MAN, LMT, ONB, CMA & GBX

Market Review

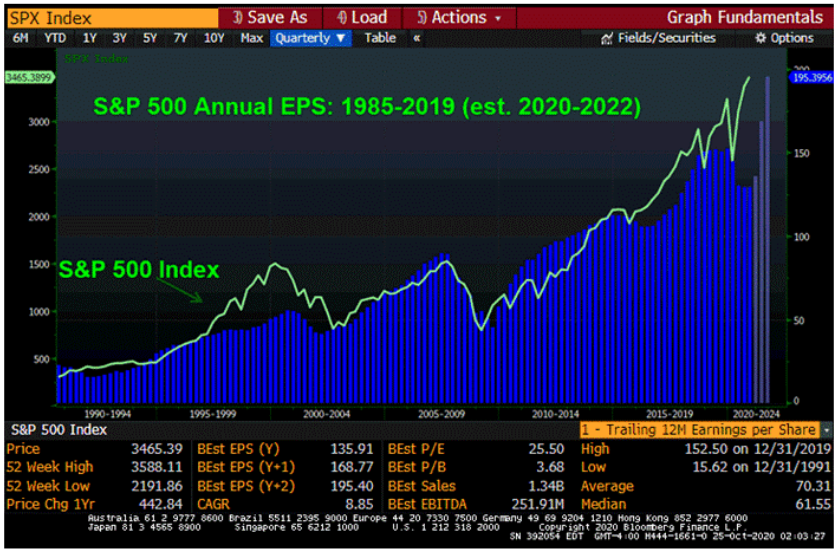
While the equity markets endured another roller-coaster ride, with the twists and turns in the stimulus negotiations in Washington driving the daily moves up and down, it was our kind of week when all was said and done. The Dow Jones Industrial Average lost 0.90% on a total return basis, while the S&P 500 dropped 0.51%, but the average stock in the S&P was higher and Value enjoyed a nice performance advantage versus Growth. Indeed, the Russell 3000 Value index gained 0.31%, compared to a 1.20% loss for the Russell 3000 Growth index, while the S&P 500 Pure Value index jumped 2.20%.

No doubt, much-better-than-expected Q3 corporate profits have provided support for the average stock. Illustrating that the analyst community had become far too pessimistic, of the 136 S&P 500 members to have announced results thus far, a whopping 114 have exceeded forecasts, with the current 84% “beat” rate far above the usual 70% or so level. Even better 73.5% of companies have poster higher-than-projected sales, which compares very favorably to the 62.3% top-line “beat” rate in the second quarter.

To be sure, we understand that earnings on a year-over-year basis are hardly stellar, given that Q3 2019 saw the S&P 500 turn in EPS of $39.81, while the current quarter for that index is now projecting only $33.41. But on a sequential basis, the numbers are very good, given respective EPS of $19.50 and $26.79 in Q1 2020 and Q2 2020. And, as we look ahead to Q4 and 2021, earnings are expected to show continued sequential improvement.

EPS PLUNGE IN 2020 BUT REBOUND IN 2021

Q2 earnings 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.



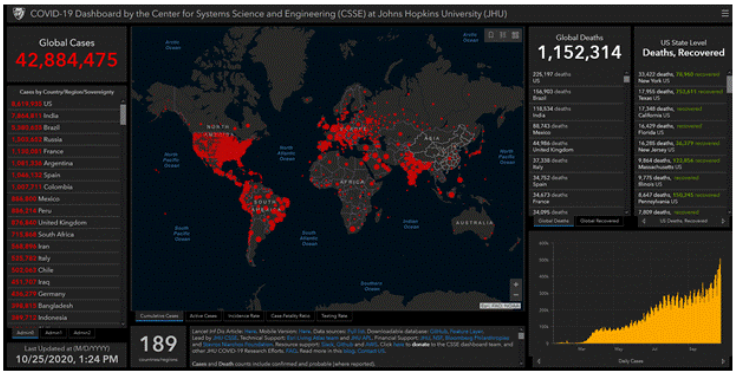
S&P 500 Earnings Per Share

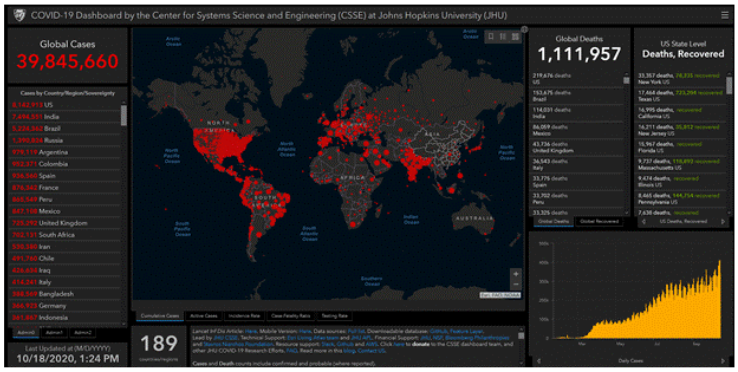
Quarter Ended	Bottom Up Operating EPS 3 Month	Bottom Up Operating EPS 12 Month
ESTIMATES		
12/31/2021	$44.69	$164.30
9/30/2021	$42.32	$155.59
6/30/2021	$40.10	$146.68
3/31/2021	$37.19	$133.37
12/31/2020	$35.98	$115.68
9/30/2020	$33.41	$118.88
ACTUAL		
6/30/2020	$26.79	$125.28
3/31/2020	$19.50	$138.63
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 10.22.20

That is not to say that happy days are somehow here again, as news on the COVID-19 front remains disconcerting, with the U.S. seeing record highs in new coronavirus diagnoses, Spain implementing a new overnight curfew that will likely be in place for six months and Italy imposing a month of new restrictions across the country.

COVID-19 GLOBAL SPREAD





With access to testing remaining high, there was big jump of more than 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 more than 225,000 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 weekly increase in the fatality count has remained in the 40,000 range. No doubt, the approaching flu season will represent another health risk.

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

Of course, at the risk of sounding callous, folks have adapted as best they can and life, even in a COVID-19 world, has carried on, albeit with some not-so-insignificant adjustments. Obviously, the current pandemic is far more severe than other recent health scares, but the equity markets have persevered through all other viral infections, including HIV, where the global death count from AIDS-related illnesses stood at 32.7 million and climbing as of 2019.

THE PRUDENT SPECULATOR

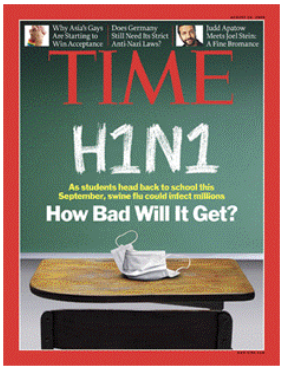
VIRUSUS HAVE YET TO KILL THE STOCK MARKET

September 29, 2014

March 30, 2020

Magazine Cover	Date	S&P End Value	3 Months Later	6 Months Later	12 Months Later	36 Months Later	60 Months Later	Event thru Present
Time Magazine: The Aids Hysteria	7/4/1983	168.91	-2%	-1%	-9%	49%	61%	1952%
Time Magazine: The Truth About SARS	5/5/2003	926.55	4%	14%	21%	43%	52%	274%
Time Magazine: Avian Flu Death Threat	9/26/2005	1,215.63	4%	7%	10%	0%	-6%	185%
Time Magazine: H1N1 How Bad Will It Get?	8/24/2009	1,025.57	8%	8%	3%	38%	94%	238%
Bloomberg BusinessWeek: Ebola Is Coming	9/29/2014	1,977.80	6%	4%	-5%	27%	50%	75%
Time Magazine: Coronavirus	3/30/2020	2,626.65	18%	28%				
Price Changes Only. Does not Include Dividends								
		Averages:	**6%**	**10%**	**4%**	**31%**	**50%**	**545%**

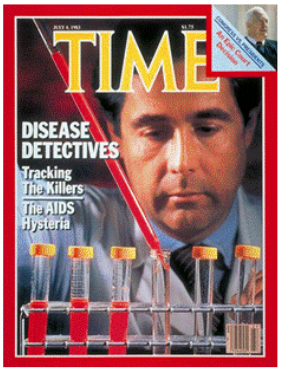
Source: Kovitz Investment Group using data from Bloomberg. As of 10.23.20



August 24, 2009

September 26, 2005

May 5, 2003



July 4, 1983

There are no guarantees, certainly, that stocks will continue to hold up and appreciate, but such was the case during the even-more-deadly Spanish Flu in 1918-1919,…

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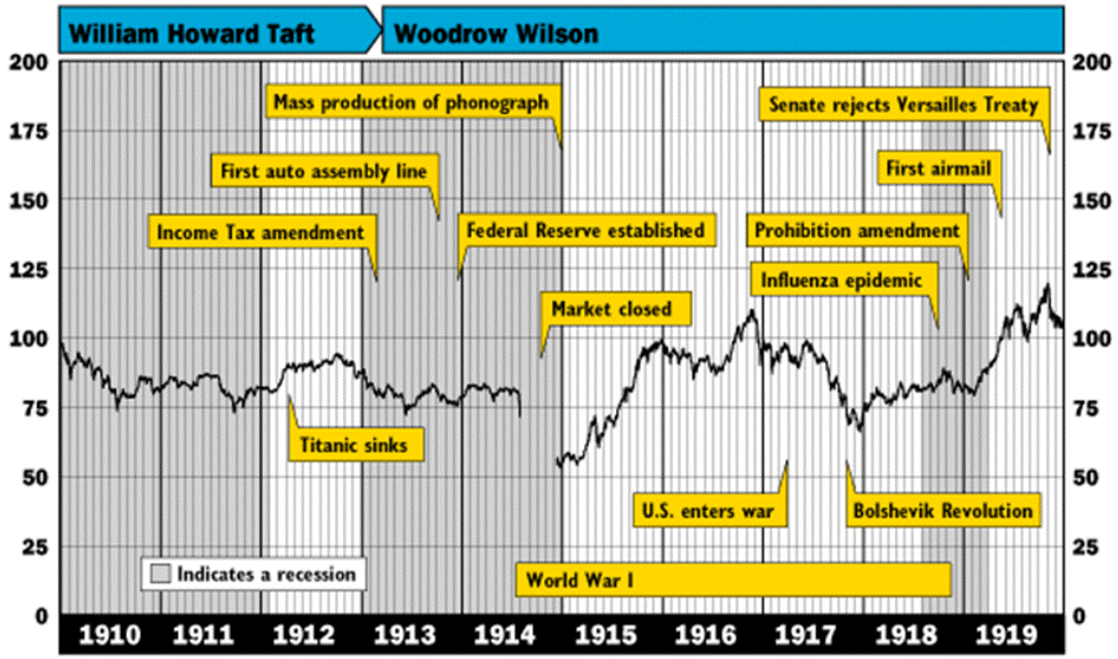
PANDEMIC PRECEDENT – SPANISH FLU

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



https://leduc998.wordpress.com/2008/05/14/dow-jones-history-1910-1919/

…while there is plenty of firepower hard at work on therapeutics and vaccines, with even Dr. Anthony Fauci expressing cautious optimism last week on prospects for the latter.

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PROGRESS BEING MADE ON VACCINES

WEDNESDAY, Oct. 21, 2020 (HealthDay News) -- Dr. Anthony Fauci, the leading infectious disease expert in the United States, said on Wednesday he is "cautiously optimistic" that a COVID-19 vaccine will be ready by year's end.

OUR SCIENCE / Coronavirus disease (COVID-19) Scientific Resources / Coronavirus COVID-19 Vaccine Update: Latest Developments

OUR PROGRESS IN DEVELOPING A POTENTIAL COVID-19 VACCINE

en Español

In the fight against COVID-19, a vaccine is a critical part of addressing the global health crisis by decreasing rates of infection, disease and death worldwide. But today, there is no vaccine available. Pfizer and BioNTech are leveraging our decades of scientific expertise and working together to develop, test and manufacture a mRNA vaccine to help prevent COVID-19. The Phase 2/3 clinical trial began in late July, and participants 12 and over are now eligible to participate.

Developing a potential breakthrough vaccine to help prevent COVID-19 is only possible through the dedicated work of thousands of individuals and those who volunteer to take part in research. We are committed to diversity in our clinical trial and ensuring that individuals from communities that have been most affected by COVID-19 have the opportunity to participate.

We are grateful to each of the more than 130 clinical trial investigators and their study teams who are partnering with us in this effort and to all of the participants who have volunteered, and will volunteer, to help make a difference for society.

PHASE 2/3 TRIAL UPDATE

Trial Locations

More than 130 clinical trial sites in 5 countries, including 39 U.S. states

Trial Progress

The Phase 2/3 clinical trial is now enrolling participants 12 and over. 39,862 participants are enrolled in the study, with 34,601 having received a second vaccination

Participant Diversity

Approximately 43% of overall and 29% of U.S. participants have diverse backgrounds

Participants	Overall Study	U.S. Only
Asian	4%	5%
Black	10%	10%
Hispanic/Latinx	28%	13%
Native American	0.7%	0.8%
Ages 56 to 85	42%	47%

Updated as of Monday, October 19, 2020 at 09:00am ET. Updates are made on a weekly basis.

Against the backdrop of a pandemic that has claimed over 220,000 American lives, Fauci noted that the United States' "strategic approach" to vaccine development appears to be bearing fruit. Six U.S. companies, he said, are working around the clock to either facilitate vaccine trials or compile the supplies necessary to distribute a coronavirus vaccine once it's ready.

Multiple studies are testing three vaccine approaches, Fauci said. And five of those studies are already in Phase 3, which means testing is underway on large groups of people.

"We feel confident that we will have an answer likely in mid-November to the beginning of December," Fauci said, speaking at a virtual meeting of the Infectious Diseases Society of America.

While stressing there is no guarantee of success, Fauci said he is "cautiously optimistic that we will in fact have a safe and effective vaccine by the end of the year, which we can begin to distribute as we go into 2021."

At the same time, Fauci, director of the U.S. National Institute of Allergy and Infectious Diseases, took pains to paint a realistic picture of the significant hurdles that lie ahead.

Clearly, health is far more important than wealth, and we remain braced for significant equity market volatility, especially with the elections just eight days away, but the latest slew of economic numbers remained robust in regard to housing,…

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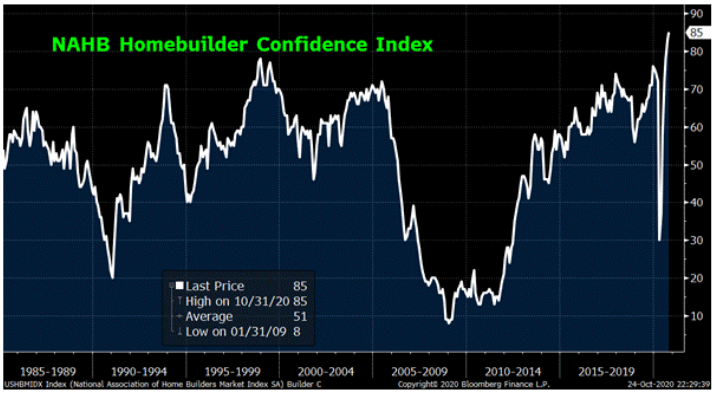
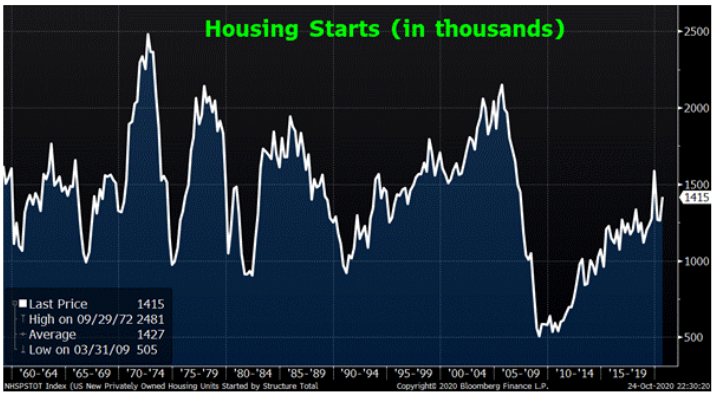
STRONG HOUSING STATS





The National Association of Home Builders' monthly confidence index for October continued to climb, rising to a third consecutive monthly record of 85 for the 35-year-old gauge. No doubt, record low mortgage rates are supporting the housing market, but builders do not seem to be engaging in irrational exuberance as housing starts for September edged up to a seasonally adjusted annual rate of 1.42 million units.

…and were improving on the labor market front.

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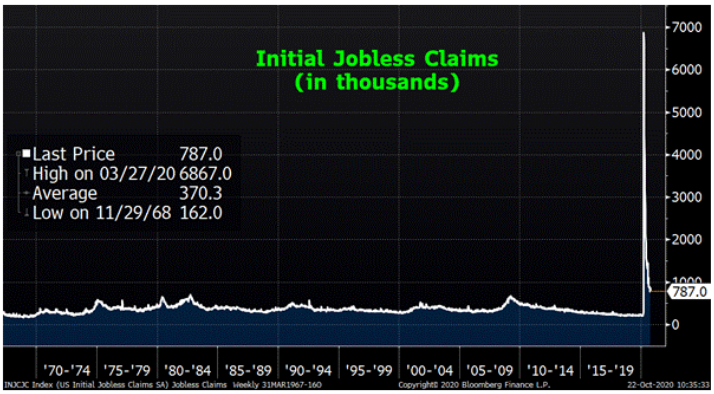
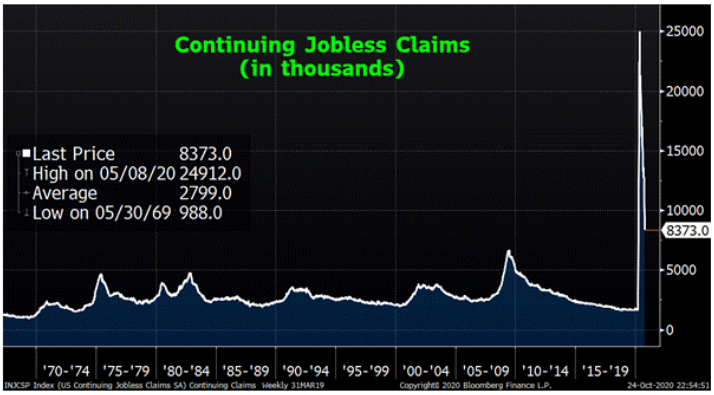
DISMAL (BUT IMPROVING) EMPLOYMENT NUMBERS





While we respect that the labor picture hardly can be called good, even as the numbers today are significantly better than many had projected a few months back, first-time filings for unemployment benefits in the latest week came in at 787,000 figure, the second lowest since March. Also, continuing jobless claims filed through state programs fell by 1.02 million to a seasonally adjusted 8.37 million in the latest week, dropping to another pandemic low.

True, millions of folks remain out of work, so we realize that many are concerned about the economic situation in the current quarter and into 2021, but the most recent data from American purchasing managers on the health of the factory and service sectors was upbeat,…

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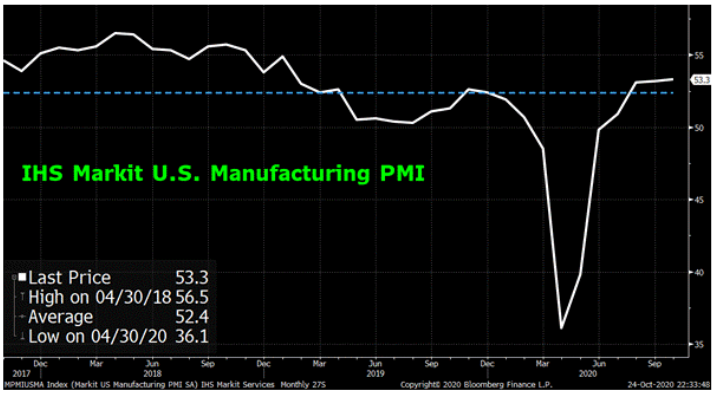
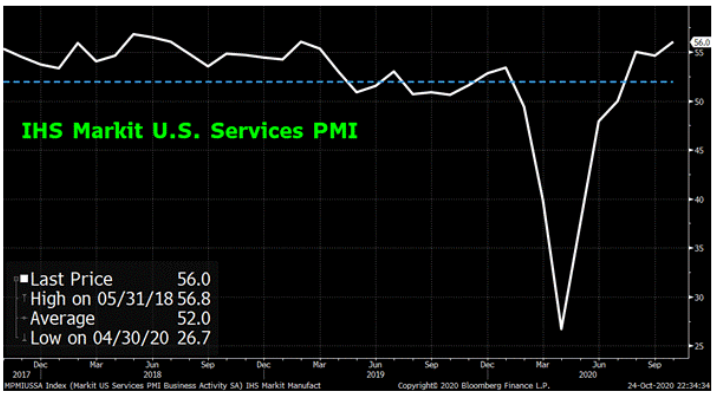
VERY GOOD IHS MARKIT PMI RELEASES





With each gauge expanding at the fastest rates in 20 months, the IHS Markit U.S. PMIs for the manufacturing and service sectors rose in October to 53.3 and 56.0, respectively, both figures well above the historical average. Commenting on the data, IHS Chief Business Economist Chris Williamson said, "The U.S. economy looks to have started the fourth quarter on a strong footing, with business activity growing at a rate not seen since early 2019."

…the important index of leading economic indicators came in at 0.7% in September, well above average,…

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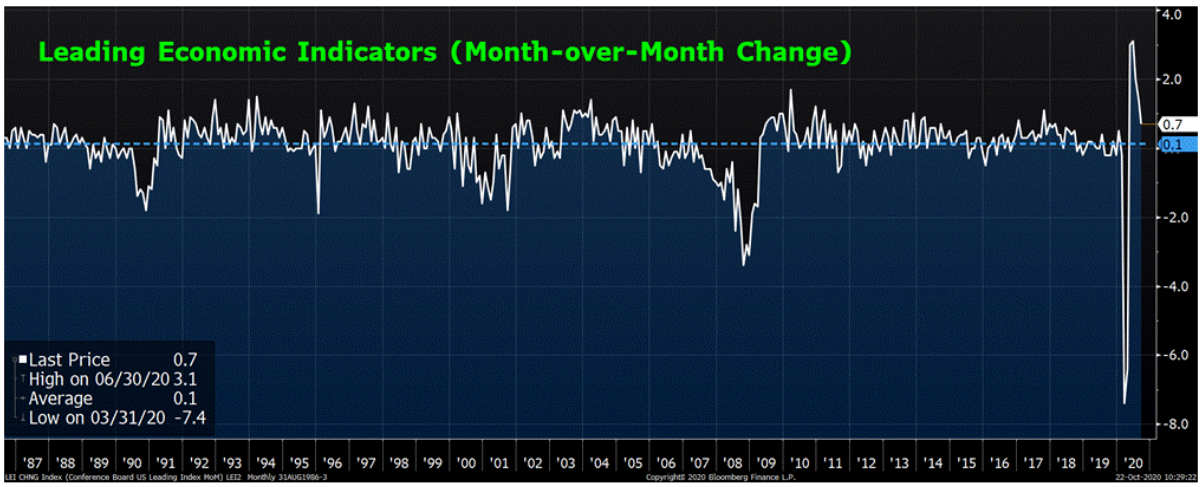
LEI STILL WELL INTO POSITIVE TERRITORY…FOR NOW

The forward-looking Leading Economic Index rose by 0.7% on a month-over-month basis in September, down from a 1.2% advance in August. The average gain in the LEI back to 1986 has been just 0.1%, but the keeper of the metric, stated, "The LEI increased, driven primarily by declining unemployment claims and rising housing permits. However, the decelerating pace of improvement suggests the US economy could be losing momentum heading into the final quarter of 2020."



…and Federal Reserve Vice Chair Richard H. Clarida sounded somewhat optimistic last week in a speech in which he offered his assessment of the current economic situation and outlook,…

FED VICE CHAIR RICHARD H. CLARIDA SPEACH TO ABA: 10.19.20

Current Economic Situation and Outlook

In the first half of this year, the COVID-19 (coronavirus disease 2019) pandemic and the mitigation efforts put in place to contain it delivered the most severe blow to the U.S. economy since the Great Depression. Gross domestic product (GDP) collapsed at an almost 32 percent annual rate in the second quarter, and more than 22 million jobs were lost in March and April. This recession was by far the deepest one in postwar history, but it also may go into the record books as the briefest recession in U.S. history. The flow of macrodata received since May has been surprisingly strong, and GDP growth in the third quarter is estimated by many forecasters to have rebounded at roughly a 30 percent annual rate. This development is especially noteworthy when set in relief against the surge in new COVID-19 cases that were reported this summer in a number of U.S. states and the coincident flatlining in a number of high-frequency activity indicators that we follow to track the effect of the virus on economic activity.

Although spending on many services continues to lag, the rebound in the GDP data has been broad based across indicators of goods consumption, housing, and investment. These components of aggregate demand have benefited from robust fiscal support—including expanded unemployment benefits and the Small Business Administration's Paycheck Protection Program (PPP)—as well as low interest rates and efforts by the Federal Reserve to sustain the flow of credit to households and firms. In the labor market, about half of the 22 million jobs that were lost in the spring have been restored, and the unemployment rate has fallen since April by nearly 7 percentage points to 7.9% as of September.

I remind you that in the spring, many voices questioned what good rate cuts, forward guidance, asset purchases, and lending programs could do in an economy in which people do not venture out to buy cars or build houses nor do companies invest to augment their capital stock. Well, the data indicate that with rates low, credit available, and incomes supported by fiscal transfers, the answer is—at least so far—that they do build houses, buy cars, and order equipment and software. That said, the COVID-19 recession threw the economy into a very deep hole, and it will take some time, perhaps another year, for the level of GDP to fully recover to its previous 2019 peak. It will likely take even longer than that for the unemployment rate to return to a level consistent with our maximum-employment mandate…I must also acknowledge that the economic outlook is unusually uncertain, and, moreover, that the ultimate course the economy follows will depend on the course of the virus, social-distancing norms, and mitigation efforts put in place to contain it.

…with comments that the recession that began in March may have already ended especially interesting to those of us who follow a value-based investment approach.

VALUE STOCKS HAVE OUTPERFORMED COMING OUT OF RECESSION

U.S. Recession Trough (per NBER) & Equity Returns

S&P 500 and Fama/French Value Performance

Recession Trough Date	1 Year Post S&P 500 TR	1 Year Post FF Value TR	1 Year Post FF Growth TR	3 Year Post S&P 500 TR	3 Year Post FF Value TR	3 Year Post FF Growth TR	5 Year Post S&P 500 TR	5 Year Post FF Value TR	5 Year Post FF Growth TR
Mar-33	81.5%	88.7%	82.9%	155.7%	135.3%	169.1%	62.4%	69.5%	96.2%
Jun-38	-1.7%	-14.5%	2.7%	0.8%	4.6%	14.5%	43.9%	129.3%	65.5%
Oct-45	-7.2%	-2.2%	-6.8%	14.7%	26.6%	-1.3%	64.8%	76.2%	38.5%
Oct-49	35.1%	43.8%	29.9%	92.8%	96.5%	66.3%	177.8%	174.6%	131.2%
May-54	36.1%	60.2%	34.4%	83.7%	95.5%	69.4%	145.2%	200.3%	143.0%
Apr-58	37.2%	61.0%	51.4%	66.4%	94.4%	86.4%	89.9%	128.4%	84.1%
Feb-61	13.6%	16.9%	8.6%	35.2%	49.1%	12.1%	68.4%	137.0%	55.6%
Nov-70	11.2%	11.0%	20.5%	20.6%	13.5%	-0.7%	25.1%	44.4%	1.5%
Mar-75	28.3%	51.5%	31.3%	22.1%	98.6%	44.4%	55.6%	157.8%	96.9%
Jul-80	13.0%	22.9%	22.8%	56.1%	113.6%	69.7%	100.5%	207.7%	75.2%
Nov-82	25.6%	39.8%	21.1%	66.8%	99.7%	36.4%	103.0%	123.9%	38.2%
Mar-91	11.0%	25.5%	16.7%	29.8%	73.2%	25.8%	98.0%	154.7%	82.9%
Nov-01	-16.5%	-11.9%	-18.5%	8.4%	39.8%	13.7%	34.3%	93.7%	33.5%
Jun-09	14.4%	25.5%	14.7%	57.7%	53.2%	62.3%	136.9%	158.2%	140.8%
Averages	**20.1%**	**29.9%**	**22.3%**	**50.8%**	**71.0%**	**47.7%**	**86.1%**	**132.6%**	**77.4%**

Source: Kovitz Investment Group using data from Bloomberg, Professors Eugene F. Fama & Kenneth R. French and the National Bureau of Economic Research

Despite the economic rebound and the improving outlook for corporate profits, investors remain skeptical about the prospect for stocks,..

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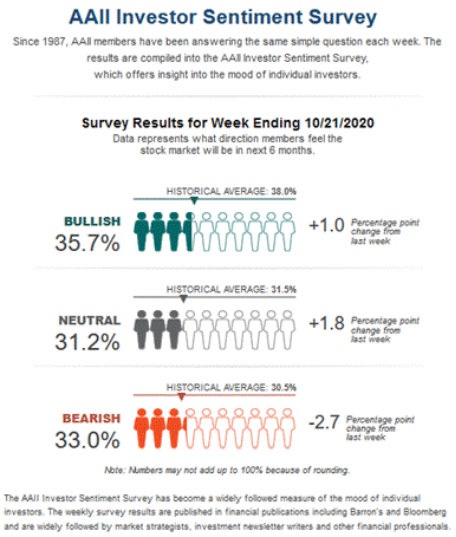
STILL NOT A LOT OF ENTHUSIASM FOR U.S. STOCKS

While folks on Main Street became much less pessimistic last week, they are hardly upbeat on stocks as the latest AAII Sentiment Survey saw the number of Bulls at 2.3 percentage points below normal and Bears at 2.5 points above average.

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.



Combined Estimated Long-Term Fund Flows and ETF Net Issuance

Millions of dollars

Week Ended	10/14/2020	10/7/2020	9/30/2020	9/23/2020	9/16/2020
Total Equity	-17,602	-15,578	-11,825	-19,267	7,864
Domestic	-7,202	-16,441	-897	-17,278	9,184
World	-10,400	862	-10,929	-1,989	-1,320
Hybrid	-1,003	-2,544	-2,092	-1,711	-1,111
Total Bond	20,801	25,021	4,404	5,036	15,465
Taxable	19,372	22,542	3,390	3,572	13,479
Municipal	1,428	2,479	1,015	1,464	1,986
Commodities	840	668	187	1,355	-334
Total	3,037	7,568	-9,327	-14,586	21,884

Source: Investment Company Institute

…with money continuing to pour into bonds, so much so that the amount of negative yielding debt around the globe stands at more than $16 trillion,…

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NEGATIVE YIELDING GOVERNMENT BONDS

Incredibly, money continues to pour into government bonds, with this year's surge pushing yields on another $5 trillion below zero. Yes, we understand that the pros can utilize derivatives to attempt to hedge against the guaranteed loss of principal if the debt is held to maturity, but hoping for a greater fool to drive prices higher and yields even lower in the interim seems to us like reward-free risk.

…and assets in U.S. money market funds total a massive $4.3 trillion,…

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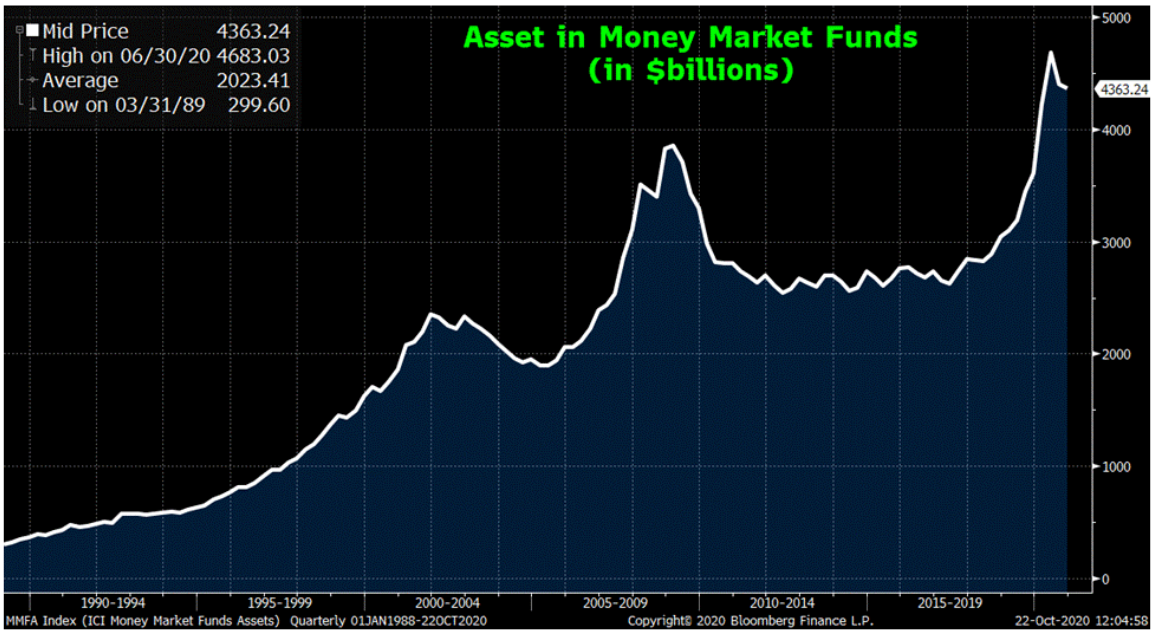
MONEY MARKET FUND ASSETS OVER TIME

Despite yields near zero, total assets in money market funds have never been greater...which we think bodes very well for stocks, given previous asset spikes in 2000 following the bursting of the Tech Bubble and in 2008 after the brunt of the Global Financial Crisis damage.



…even as yields on these instruments are now at microscopic levels.

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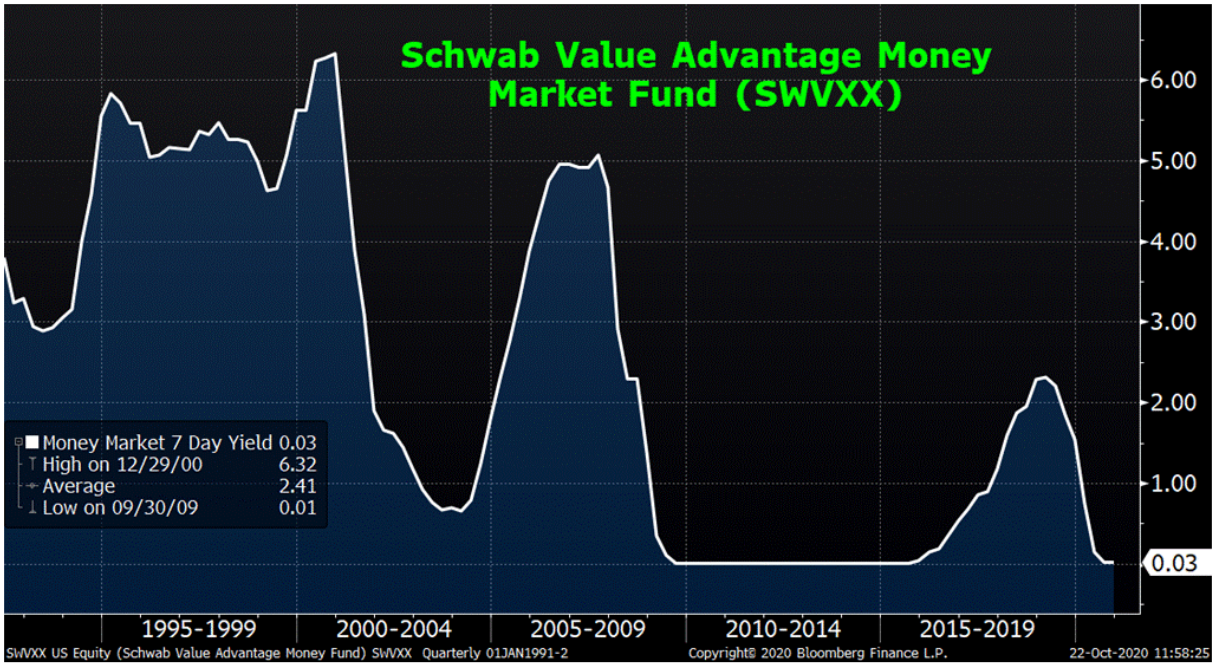
MONEY MARKET FUND YIELDS OVER TIME

The yield on the Schwab Value Advantage Prime Money Market Fund has cratered to 0.03% today, which sharply contrasts to the respective 5.00%+ and 6.00%+ at prior market peaks in 2000 and 2007.



True, equity investors must deal with fluctuating values of their holdings, all while doing their best to remember that the secret to success in stocks is not to get scared out of them, but we continue to believe that the interest rate environment is highly supportive of stocks,…

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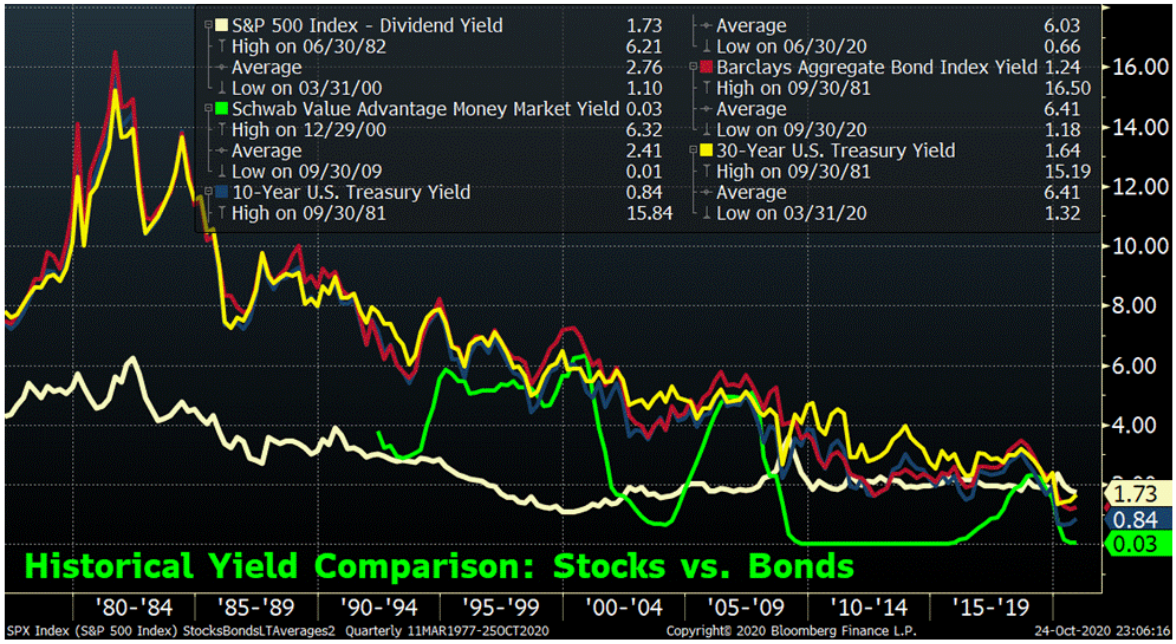
EQUITY VS. FIXED INCOME YIELDS

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!**



… especially those of undervalued dividend-paying companies.

THE PRUDENT SPECULATOR

25 FAVORED UNDERVALUED DIVIDEND PAYERS

Even as the major market averages are not too far off their all-time highs, we continue to find many stocks to be significantly undervalued. Even better, in today's low interest rate environment, the 25 selections below all pay a generous dividend (the average yield is 3.7%).

October 2020 Undervalued Dividend Payers

Symbol	Common Stock	10.22.20 Price	Target Price	52-Week High	% Below High	52-Week Low	% Above Low	Sector	P/E	P/S	P/TBV	ROCE	EV/ EBITDA	FCF Yld	Debt/ TE (%)	Div Yld	Mkt Cap
AMGN	Amgen	$227.98	$283.29	$264.97	-14%	$177.05	29%	Pharmaceuticals, Biotech	14.5	5.5	nmf	68.0	12.7	7.6	nmf	2.8%	133,526
ARE	Alexandria Real Estate	$160.16	$221.01	$177.70	-10%	$109.22	47%	Real Estate	22.4	12.1	2.1	4.6	27.9	-15.3	7%	2.6%	20,199
AVGO	Broadcom	$373.37	$423.41	$387.80	-4%	$155.67	140%	Semiconductors	17.6	6.5	nmf	10.8	18.6	7.2	nmf	3.5%	151,029
CSCO	Cisco Systems	$38.82	$58.02	$50.28	-23%	$32.40	20%	Technology Hardware	12.1	3.3	64.6	31.4	9.5	8.9	482%	3.7%	163,860
CVS	CVS Health	$59.48	$108.59	$77.03	-23%	$52.04	14%	Health Care Equip/Srvcs	7.3	0.3	nmf	12.8	7.7	17.5	nmf	3.4%	77,842
GLW	Corning	$35.47	$41.22	$35.83	-1%	$17.44	103%	Technology Hardware	26.3	2.5	4.0	1.0	18.9	3.6	125%	2.5%	27,020
HAS	Hasbro	$89.82	$109.33	$109.50	-18%	$41.33	117%	Consumer Durables	24.5	2.5	nmf	17.4	21.3	3.6	nmf	3.0%	12,307
HPE	Hewlett Packard Enter	$9.46	$16.88	$17.59	-46%	$7.43	27%	Technology Hardware	6.4	0.5	nmf	0.0	9.0	3.6	nmf	5.1%	12,169
IBM	Int'l Business Machines	$115.76	$182.37	$158.75	-27%	$90.56	28%	Software & Services	10.2	1.4	nmf	40.4	10.1	12.8	nmf	5.6%	103,093
IP	International Paper	$46.59	$56.11	$47.64	-2%	$26.38	77%	Materials	13.2	0.9	7.1	8.7	9.4	11.8	377%	4.4%	18,314
JPM	JPMorgan Chase	$102.88	$144.39	$141.10	-27%	$76.91	34%	Banks	13.4	nmf	1.6	10.0	nmf	nmf	nmf	3.5%	313,538
KIM	Kimco Realty	$11.46	$18.11	$21.86	-48%	$7.45	54%	Real Estate	8.6	4.5	1.0	21.0	16.1	2.3	9%	3.5%	4,956
LMT	Lockheed Martin	$368.96	$496.99	$442.53	-17%	$266.11	39%	Capital Goods	15.8	1.6	nmf	147.8	11.4	6.0	nmf	2.8%	103,229
MAN	ManpowerGroup	$75.28	$105.71	$100.99	-25%	$49.57	52%	Commercial & Pro Srvcs	16.6	0.2	3.8	3.3	9.7	22.4	121%	2.9%	4,372
MDC	MDC Holdings	$45.93	$59.07	$52.50	-13%	$15.75	192%	Consumer Durables	11.3	0.8	1.6	14.9	8.9	1.1	56%	2.9%	2,912
MET	MetLife	$40.61	$73.00	$53.28	-24%	$22.85	78%	Insurance	7.2	nmf	0.6	10.8	nmf	nmf	nmf	4.5%	36,860
MMM	3M	$170.71	$192.83	$182.55	-6%	$114.04	50%	Capital Goods	20.2	3.1	nmf	49.0	13.3	6.0	nmf	3.4%	98,332
MRK	Merck & Co	$79.21	$102.89	$92.64	-14%	$65.25	21%	Pharmaceuticals, Biotech	14.3	4.2	nmf	37.9	13.9	4.6	nmf	3.1%	200,341
MS	Morgan Stanley	$51.77	$78.11	$57.57	-10%	$27.20	90%	Diversified Financials	8.9	nmf	1.4	11.6	nmf	nmf	nmf	2.7%	93,570
NTAP	NetApp	$46.70	$75.94	$65.38	-29%	$34.66	35%	Technology Hardware	11.2	1.9	nmf	138.3	7.8	8.2	nmf	4.1%	10,368
NTR	Nutrien Ltd	$41.88	$53.13	$50.78	-18%	$23.85	76%	Materials	25.2	1.2	2.9	3.6	9.9	nmf	131%	4.3%	23,836
PNW	Pinnacle West Capital	$85.73	$102.17	$105.51	-19%	$60.05	43%	Utilities	16.1	2.8	1.9	11.2	11.3	-3.6	121%	3.7%	9,650
TOT	Total SE	$32.82	$56.24	$56.91	-42%	$22.13	48%	Energy	10.2	0.6	1.1	-2.7	5.3	9.9	80%	7.9%	87,076
TSN	Tyson Foods	$59.44	$88.09	$94.24	-37%	$42.57	40%	Food, Beverage & Tobacco	11.8	0.5	nmf	12.6	8.2	11.6	nmf	2.8%	21,652
VZ	Verizon Communications	$57.33	$70.62	$62.22	-8%	$48.84	17%	Telecom Services	11.9	1.8	nmf	29.5	8.0	9.1	nmf	4.4%	237,232

As of 10.22.20. nmf=Not meaningful. ROCE = Return on Common Equity. TBV = Tangible book value. EV/EBITDA = Enterprise value to earnings before interest, taxes, depreciation and amortization. FCF Yield = Free Cash Flow Yield

Stock Updates

Jason Clark, Chris Quigley and Zach Tart look at 13 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.

While we respect that shares of the appliance maker had been on a tear, we were perplexed by investor reaction to spectacular Q3 results and terrific forward guidance from **Whirlpool** (WHR – $198.11). The stock was down 1.7% last week, despite the company turning in Q3 revenue of $5.29 billion, more than 11% above expectations. Further, adjusted EPS for the period of $6.91 was more than 64% greater than the consensus analyst estimate. Management also reinstated full-year 2020 adjusted EPS guidance of $17.50 to $18.00.

We think margins can widen driven by higher selling prices, somewhat stable material costs, and structural reductions that bring EMEA to profitability. For Q3, net sales in North America declined 1.6% (56% of total sales), while other geographies were as follows: EMEA +19%

(24%), Latin America +14% (14%) and Asia -1% (6%). Whirlpool continues to have strong liquidity, with $3.5 billion in cash and $2.5 billion in undrawn credit facilities.

THIRD-QUARTER RESULTS HIGHLIGHTS

Whirlpool CORPORATION

Profitable Growth	
Net Sales	YoY Change
$5.3B	3.9% *7.0% organic(4)*

Margin Expansion	
Ongoing EBIT Margin(1)	YoY Change
12.0%	4.8pts

Cash Conversion	
Free Cash Flow(2)	YoY Change
$170M	$975M

(4) Organic net sales reflects YoY change in net sales adjusted for currency and the Embraco divestiture. See Organic Net Sales reconciliation in the appendix.

- Organic net sales growth of 7% driven by solid global industry demand
- Exceptional execution of early, decisive actions resulted in:
  - ✓ Ongoing EPS(1) of $6.91
  - ✓ Ongoing EBIT(1) margin expansion of 480 bps to 12.0%
  - ✓ Significant year-over-year margin expansion in North America, Latin America, and EMEA
  - ✓ Positive YTD free cash flow(2) of $170M
- Reinstating guidance for full-year 2020 of $17.50 - $18.00 in ongoing EPS(1) and ~$900M in free cash flow(2)
- Announced dividend increase to $1.25; plans in place to repay all COVID-related short-term borrowing by year-end

Whirlpool Corporation Third-Quarter 2020 Earnings Review 4

CEO Marc Bitzer commented, “From the outset of this global crisis, we have taken decisive actions to weather the uncertainty and win in the eventual economic recovery. Our results this quarter are a testament to those actions, the exceptional execution by our employees, and the resiliency of our long-term strategy. Looking ahead, while uncertainty remains, our Q3 performance serves as an additional proofpoint that we are well-positioned to capitalize on the structural improvements in housing and consumer trends, and firmly demonstrates the viability of our long-term shareholder value creation strategy.”

CFO Jim Peters added, “We are pleased to announce that we are increasing our full-year revenue expectations and reinstating our earnings per share guidance for full-year 2020 above our initial range, despite the ongoing COVID-19 pandemic. Our liquidity position remains exceptionally strong, and we expect to continue to strengthen our balance sheet by paying down the short-term debt we took on at the outset of the pandemic by the end of the year. Finally, we are happy to have announced a dividend increase for the eighth consecutive year, reflecting the confidence we have in our business now and in the future.”

Even with the recent run of WHR shares, we believe there is more potential as the U.S. housing market continues to be stellar. Also, as people continue to spend a lot more time at home in WHR's global markets, replacement and upgrades of more efficient and capable appliances represent a very favorable backdrop. We think that the company benefits globally from the world progressing technologically and emerging markets incorporating modern conveniences into daily living. WHR's well-covered dividend has been increased and the yield is now 2.5%. Our Target Price has been hiked to $241.

Shares of **Abbott Labs** (ABT – $107.79) fell almost 2% last week, even as the medical device maker turned in a solid Q3. Abbott beat consensus analyst estimates on the top and bottom lines. On an organic basis, sales grew almost 39% for the Diagnostics business, 4% for Nutrition and 2.6% for Medical Devices. Established Pharmaceuticals fell more than 3%. ABT's largest segment, medical devices, outperformed and Diabetes Care grew 25.2% organically with the help of the Libre 2 launch. Exceptional strength in the Diagnostics business was driven by global Covid-19 diagnostic testing-related sales, which contributed $881 million in the quarter, up from $615 million in Q2. With the continued call for increased testing, Covid-19 test sales should ramp further in Q4 and remain strong throughout 2021, especially with the August debut of Abbott's instrument-free, 15-minute rapid antigen test called BinaxNOW.

"Our strong results and increased guidance are a direct reflection of our ability to innovate and deliver despite challenging conditions," said CEO Robert B. Ford. "Our new product pipeline continues to be highly productive, and we're well-positioned to finish the year with a lot of momentum."

We continue to believe that Abbott's cash generation potential remains strong, which can be used to improve the balance sheet, return capital to shareholders and invest in the business. We also like that the company continues to invest heavily in R&D as it focuses on wringing new products out of previous acquisitions. Abbott's testing franchise provides some EPS protection and an ability to accelerate investments. The company's pipeline (Mitral, Tricuspid, Amulet, CardioMEMS, Libre 3) suggests the potential for a solid growth outlook for 2021 and 2022. All that said, we continue to keep a close eye on ABT shares as the valuation isn't exactly cheap (trailing P/E ratio of 34) at face value, though we are comfortable continuing to hold our remaining shares of this high-quality name for the time being as our Target Price has been hiked to $120.

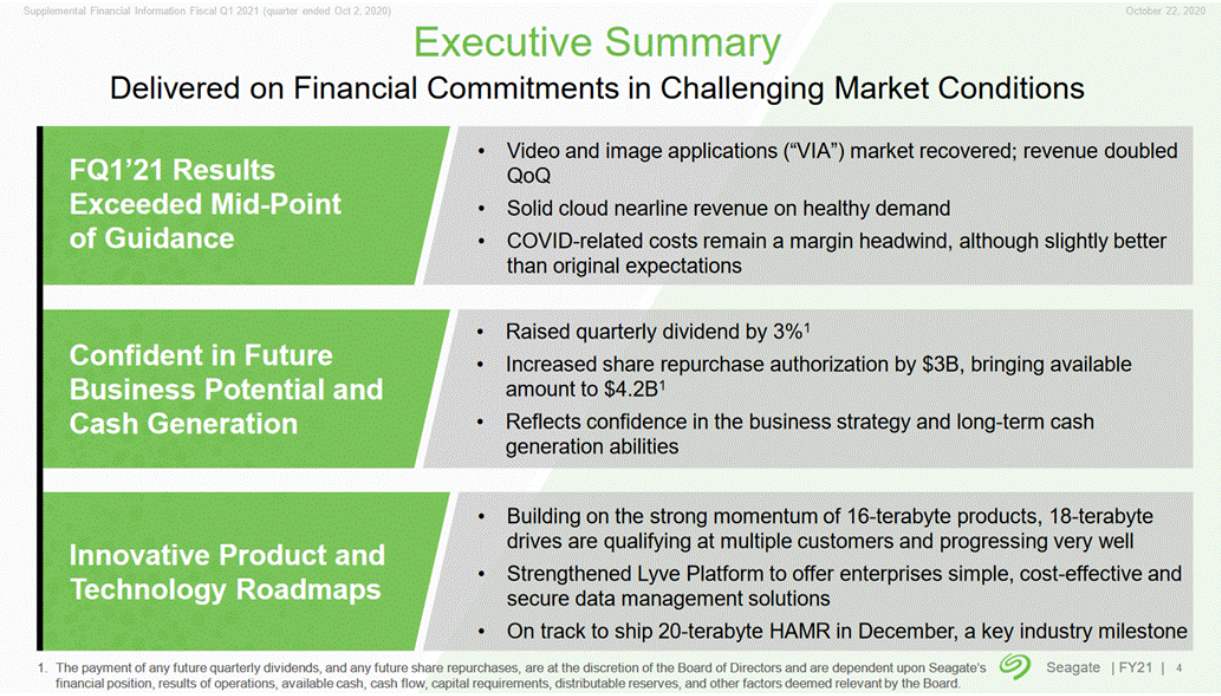
Shares of **Snap-On** (SNA – $163.39) rose 6.4% last week as the tool and diagnostic maker delivered a better-than-expected Q3. Top-line results came in at $942 million, more than 17% above the consensus analyst estimate, and adjusted EPS of $3.28 beat average forecasts by 51%. The strong performance was driven by much better-than-expected earnings in the tools group as well as higher gross margins across the board. Management highlighted that vehicle repair saw a nice uptick during the period.

"We're encouraged by Snap-on's third quarter, which included sequential improvements in each of our operations, as well as overall year-over-year progress," said CEO Nick Pinchuk. "The momentum we experienced in the month of June continued in the period, confirming the ongoing accommodation to the virus as we deploy measures to proceed safely in the COVID-19

environment. Despite the turbulence of these times, our performance rose, even as we maintained and expanded our advantages in product, brand, and people. To that end, the benefits of Snap-on Value Creation Processes continued to be realized in a variety of ways. We were honored again this year with product awards from both Motor Magazine and Professional Tool & Equipment News, demonstrating our deep understanding of work and our ability to translate that insight into winning innovations that add to the considerable strength of our line-up. At the same time, while prioritizing the health and well-being of all our constituents, we remain focused on seizing the abundant opportunities inherent in our essential business segments and on driving improvements that we believe will combine to author overall progress going forward. Finally, and especially in the current conditions, I want to thank our franchisees and associates worldwide for their ongoing dedication, continued contributions, and unfailing confidence in our future."

While a shift to more work from home could impact the repair space, consumers might keep their autos longer, which should drive increased maintenance. Additionally, we could see SNA's Commercial and Industrial arm potentially benefiting as both U.S. presidential candidates have discussed the need for a major national infrastructure stimulus spend. While there are numerous competitors and headwinds in its international businesses, we like that the Snap-on brand carries weight with professional mechanics and technicians, and we still think the underlying fundamentals for the U.S. tool business are supportive of long-term growth as increased complexity in autos and industrial equipment has spurred demand for specialty tools and sophisticated diagnostics. The company's fast-growing repair systems and information segment offers high-margin revenue that should be sticky. Snap-on, which boasts a reasonable earnings multiple and a 2.6% yield, has broad geographic coverage with a massive mobile sales force. Our Target Price for SNA has been adjusted higher to $187.

Hard disk drive maker **Seagate Technology PLC** (STX – $50.74) reported earnings per share of $1.04, versus the $0.88 estimate, in fiscal Q1 2021. STX had sales of $2.3 billion (vs. $2.3 billion est.). Shares fell 1.4% last week, even as we thought the results were more than fine.



STX CEO Dave Mosley said, "We began fiscal year '21 executing well across several key objectives, keeping us on pace for our full year revenue outlook. First, we delivered on our financial commitments, navigating challenging market conditions to achieve September quarter revenue of $2.31 billion and non-GAAP EPS of $0.93, both exceeding the midpoint of our guidance range. Second, we advanced our innovative product and technology road maps, which position the company for future data growth opportunities, including the introduction of CORTX, an open-source, object-storage software; and Lyve Rack, which offers a simple and cost-effective solution for enterprises to manage their massive volumes of data and in turn unlock data value. And third, to demonstrate Seagate's long-term commitment of returning cash to our shareholders, the Board approved a 3% increase to our quarterly dividend and a $3 billion increase to our existing share repurchase authorization. These actions exemplify our confidence in the business potential and future cash generation capabilities."

Mr. Mosley offered some detail on data center demand, "Investments vary among cloud service provider and internet content customers depending on their respective end market demand outlooks, expansion plans and architectural needs. Responding to these trends, HDD storage investments depend upon mass capacity transition readiness and installed base replacement timing. Taking these factors into account, we currently expect cloud data center demand to

improve in the December quarter and throughout the fiscal year, which supports a more elongated cycle than we've seen in the last couple of years."

CFO Gianluca Romano added, "Our outlook for the December quarter supports calendar year 2020 exabyte shipment growth that is well ahead of the long-term demand CAGR of 35% to 40% forecasted for this market…Our outlook for the December quarter is as follows. Revenue is expected to be $2.55 billion, plus or minus $200 million, up 10% sequentially at the midpoint. Non-GAAP operating margin is expected to improve sequentially and be in the lower half of our target range of 13% to 16% of revenue. And non-GAAP EPS is expected to be $1.10, plus or minus $0.15, an increase of 18% sequentially at the midpoint. Seagate has continued to execute well during this prod of prolonged uncertainty. We are navigating the current market and executing a strategy to capture the significant opportunities associated with the secular demand growth for mass capacity storage and the emerging need to manage massive volume of data from the endpoint to edge to cloud core."

STX repurchased 1.5 million shares for $68 million and has 258 million shares outstanding. The company continues to generate solid free cash flow, which was $186 million last quarter, giving management flexibility to invest in new projects or return cash to shareholders. The company's just-increased dividend translates to a yield of 5.3%, while this year's share price softness offers an opportunity for broadly diversified portfolios to gain exposure to a solid tech company with a reasonable valuation (including a forward P/E ratio around 10). Our Target Price for STX has been raised to $67.

Global provider of computer solutions and advanced technologies leader **Int'l Business Machines** (IBM – $116.00) earned $2.58 per share in fiscal Q3 2020 (vs. $2.49 est.). IBM had sales of $17.6 billion (vs. $17.5 billion est.). Despite the top- and bottom-line beats, shares have fallen 7.6% since the announcement as analysts were not impressed with another quarter of revenue decline, with one forecaster proclaiming, "We continue to view IBM as a 2022 stock."

CEO Arvind Krishna commented, "We are redefining our future as a hybrid cloud platform and AI company. Over the last few years, we have built a solid foundation for hybrid cloud. With the acceleration of the Red Hat platform adoption and the changes to clients' needs for application versus infrastructure services, we are separating our Managed Infrastructure Services into a new publicly traded company. The result is two market leaders with focused strategies and missions and improved growth trajectories. IBM is the #1 hybrid cloud platform and AI company. Newco will become the #1 managed infrastructure services company. As separate businesses, each can capitalize on their respective missions. Both will have more agility to focus on their operating and financial models. Both will have greater freedom to partner with others, and both will align their investment and capital structure to their strategic focus areas. All of this will create value for clients and for you, the investors, with an improved financial profile of both companies."

Mr. Krishna concluded, "Regarding today's environment, clients continue to balance short-term challenges and opportunities for transformation. In the short term, they are focused on operational stability and cash preservation. We see this especially in our largest software license transactions and delays in some services projects. But more of my conversations with CEOs are around how they become digital businesses. How do they tap into open source innovation? How

can they securely deploy and manage their data and applications across various clouds? That's what we call hybrid cloud. We see this as a continued momentum in Red Hat and the large client engagements that enable a journey to cloud, leveraging both OpenShift and application modernization."

CFO Jim Kavanaugh added, "With our focused hybrid cloud platform strategy and the increased investments starting now, we expect to drive sustainable mid-single-digit growth after the separation of newco is complete. In the near term, the rate and pace of recovery remains uncertain, and as a consequence, we have not seen a fundamental shift in overall demand levels. Given this uncertainty and consistent with our direction for most of this year, we are not going to provide guidance. But I will remind you, from a historical perspective, the fourth quarter seasonally is our strongest quarter in terms of revenue and operating earnings per share due to our high-value software and hardware transactions. Looking at our year-to-year dynamics at the end of 2020, we're wrapping on a strong fourth quarter of 2019 when we had a very strong software performance, our first full quarter of z15 availability and our first full quarter of Red Hat contribution. So going into this fourth quarter, as always, we have a lot of work to do. It's our largest transactional quarter. We'll be focusing our investments in hybrid cloud and AI, and of course, we're starting the detailed work to separate our Managed Infrastructure Services business. We're confident in the focus and direction of our business and what it means for our future."

We believe that the new leadership team can transform IBM, especially by leaning on Red Hat for growth. However, the revenue declines, now three quarters running, aren't encouraging. At least the company is moving in the right direction and continues to make major changes to the business, which will result in a $2.3 billion charge to operating results next quarter. While we appreciate large dividends from sustainable sources, we would not be surprised if IBM's payout (the yield is a very rich 5.6%) were temporarily cut to free up cash flow for growth initiatives. Plus, stock buybacks, which had been propping up EPS numbers by reducing the share count, are still on hold until 2022 as the company deleverages from the Red Hat deal. We continue to believe that the sum of the parts at "Big Blue" is worth more than the whole, though our Target Price for IBM is now $182. We note that the stock presently trades for an inexpensive 12.5 times unusually depressed pre-spinoff NTM EPS estimates.

Semiconductor equipment firm **Lam Research** (LRCX – $353.92) earned $5.67 per share in fiscal Q1 2021 (vs. $5.19 est.). LRCX had sales of $3.2 billion, versus the $3.1 billion estimate. Shares have tumbled 3.8% since the release, despite Lam's fiscal Q2 EPS guidance between $5.20 and $6.00, which was ahead of the consensus estimate of $5.16. Revenue is expected to come in between $3.1 billion and $3.5 billion.

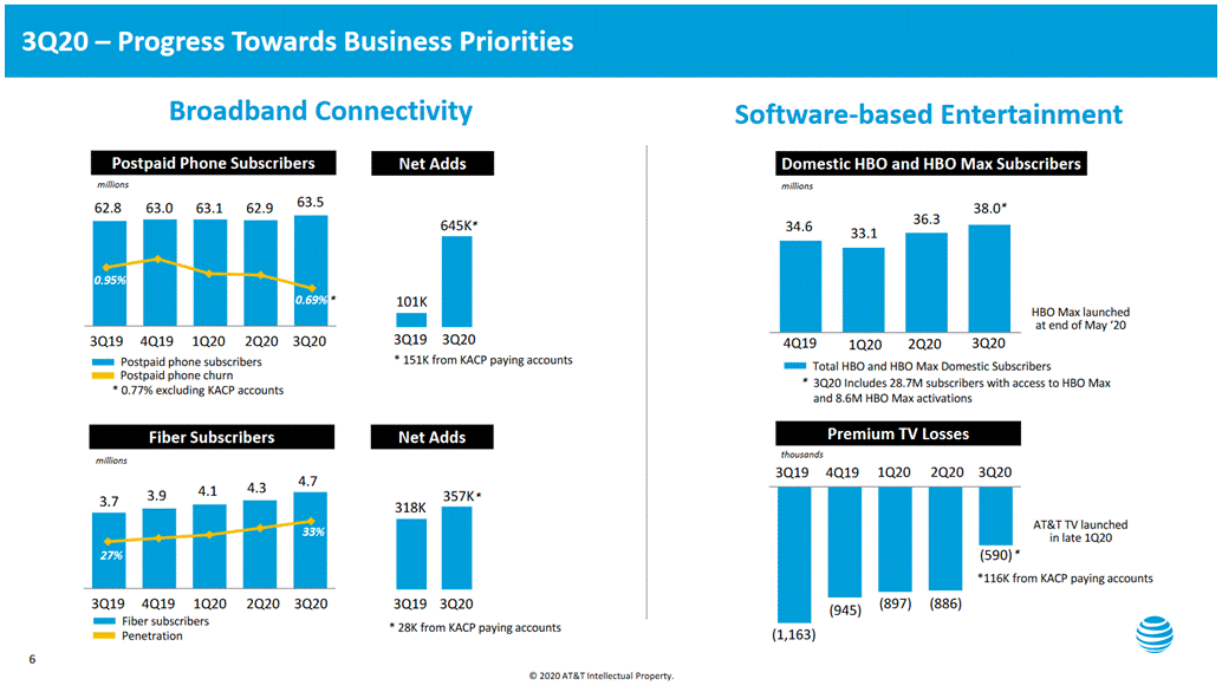
CEO Tim Archer commented, "The operating environment remains challenging due to the COVID-19 pandemic, but the tremendous dedication of Lam's employees and our partners worldwide is enabling us to perform at a high level. Notably, the September quarter marked record revenue and diluted earnings per share for the company and was also the first quarter in which we have exceeded $1 billion in revenue from our customer support business group. At the midpoint of our December quarter guidance, we will be growing EPS more than 35% year-over-year in 2020. Investments we are making in manufacturing and supply chain resilience are

enabling us to meet customers' critical needs in a period of strong demand and are preparing us for the continued growth we see ahead."

Mr. Archer continued, "Looking forward, I am more confident than ever that Lam's capabilities and strategic investments are well aligned with the fundamental needs of our customers and our industry. The complexity and cost scaling challenges for future technology nodes require comprehensive innovation in products and services that drive efficiencies from the very beginning of the design process all the way through to the support and maintenance activities in a high-volume manufacturing fab. This focus is fast becoming the thread that ties together our strategic growth objectives, and we are pleased that we are beginning to see the results of our efforts reflected in our strong financial performance."

Mr. Archer said that China-related trade regulations have adversely impacted the company's ability to ship equipment to large customers in China and Lam has applied for licenses that would allow shipments to resume. Until then, Mr. Archer warned that guidance would reflect a revenue impact. Despite the trade headwind, Lam shares have gained more than 20% this year, although the ride has not been smooth. Shares touched as low as $187.89 in March and as high as $384.96 in August. We think that the volatility is fairly normal for Lam, given the sensitive nature of the products, plus the ever-present potential to get unexpectedly caught in the middle of a diplomatic spat. For those that can stomach the additional volatility, we think LRCX can benefit from numerous technological jumps in the future, including 5G, more video streaming at higher bandwidths and growth in NAND storage. The company is sitting on $6.7 billion in cash, which is offset by $5.8 billion of debt, a formula for opportunistic spending we believe particularly valuable in this climate. Management repurchased $450 million of stock in the September quarter and spent $167 million on dividends. Our Target Price for LRCX has been lifted to $417.

Integrated telecom services provider **AT&T** (T – $27.82) earned $0.76 per share in fiscal Q3 2020, just ahead of the consensus estimate. T had sales of $42.3 billion, a 5% reduction compared to the same quarter a year ago. Shares popped 4% as results were released Thursday morning, fading slightly into the weekend. AT&T added a strong 645,000 net postpaid subscribers in Q3, more than double the 283,000 added by Verizon. The firm continues to invest in its fiber business and HBO Max, and has ramped Warner Media up to 130 productions since halting the 180 that were in the works back in February due to the pandemic. Management now expects to generate $26 billion of free cash flow in the full year, up from the $24 billion previously projected.



CEO John Stankey had the following to say about T's fiber investment, "The Net Promoter Scores we're achieving with our fiber product are materially better than cables and are helping drive increasing penetration rates across our markets. I'm really pleased with the great execution from our AT&T Communications team, led by Jeff McElfresh, under some really challenging circumstances."

He continued, "The reality of everybody moving to home and sitting on video calls all day, all of a sudden, upstream bandwidth has become pretty important in homes. And fiber, given its symmetrical characteristics is great. And the dynamic around that, I think, has been incredibly helpful, and I expect that our share growth and our opportunity to do well will come from the symmetrical nature of our architecture that we put in place. And then you can go through a whole bunch of other things that help it out, which is attractive bundling. You've got a great wireless product that goes with it. You have an SVOD product that sits on top of it that makes it attractive. All those things help our market effectiveness, and we can get even more market effective if we have a little less of a patchwork in our fiber footprint. And it's what I said earlier that you shouldn't think about the next incremental homes we add as being similar to the previous homes because we're now filling in areas where we already have people trained. We have a marketing presence. There's some footprint that's in place. The core central office equipment is already there. So you're literally just having to string fiber and connect it to

infrastructure that's already there. And the investment-to-revenue return interval should be shorter. And so those are all good things around that."

With a target of 50% of free cash flow, we doubt the massive 7.5% dividend is at material risk. And while AT&T has a lot of debt on the books in absolute terms, the burden is not unmanageable. The maturity structure extends to a weighted average 17 years (nearly 20% is due in 2050 or later), and the average coupon approaches 4%. There are sure to be challenges on the horizon as the firm shifts closer to entertainment and media, but we like the long-term, better-than-utility-like exposure. Shares trade at 8.8 times the full-year earnings estimate. Our Target Price has been edged up to $41.

Semiconductor giant **Intel** (INTC – $48.20) reported earnings per share of $1.11, versus the $1.10 estimate, in fiscal Q3 2020. INTC had sales of $18.3 billion, versus the $18.2 billion estimate. Despite the top- and bottom-line numbers that just beat estimates, shares tumbled 10.6% after the company's data center revenue came in far behind analyst estimates. The segment's revenue was $5.91 billion, down 7.5% year-over-year and behind the analyst estimate of $6.21 billion. While the revenue miss wasn't large in terms of overall company revenue, it was alarming because of the unit's importance to Intel's overall growth prospects.

CEO Bob Swan announced that the company would be divesting its NAND business, "This week, we signed an agreement to sell SK hynix, our NAND memory business, for $9 billion. We believe this is a fantastic win-win transaction that allows us to focus our energy and investment in differentiated technologies where we can play a bigger role in the success of our customers and deliver attractive returns to our shareholders. At the same time, SK hynix can build on the success of our NAND technology at a greater scale and grow the memory ecosystem to the benefit of our data center customers, partners and employees. We are retaining our Optane technology and intend to continue investing, developing and scaling the Optane business. We've also significantly improved supply for our customers. We've expanded our capacity by more than 25% in 2020 and currently have 3 high-volume fabs producing 10-nanometer products to meet our customer demands." The deal includes $7 billion up-front cash and $2 billion paid in March 2025.

CFO George Davis offered full-year guidance, "We expect revenue of $75.3 billion and EPS of $4.90, $300 million and $0.05 higher, respectively, versus our July expectations. We expect our PC business to be up mid-single digits year-over-year against the TAM that is also up mid- to high single digits year-over-year. We expect revenue from our data-centric businesses to be up mid-single digits year-over-year on strong cloud demand, NSG growth and increased 5G build-outs, offset by COVID-related weakness in our IOTG business. Gross margin is expected to be 57% for the year, down approximately 1 point versus July guidance on the mix dynamics we are seeing in both Q3 and Q4 and higher 10-nanometer volumes. Year-over-year, gross margin is most heavily impacted by higher volumes of 10-nanometer products, partially offset by higher NAND margins on ASPs and lower modem volumes from exit of that business."

On a positive note, laptop PC shipments have been strong and were a challenged market nearly every quarter until the pandemic struck. But the data center miss was large, especially as many cloud providers are ramping their capabilities as fast as possible. Intel said that government and

enterprise demand was lower as a result of COVID, but we think that argument would have been more reasonable earlier in the year. Of course, we understand that the upcoming election and ongoing budget battles can significantly impact spending decisions, so we don't see a reason to throw in the towel.

After repeated manufacturing delays, Intel finally started shipping its 11th generation 10-nanometer Core processors, while the company is still working to get the 7-nanometer chips out the door at scale. The balance sheet is in good shape and can support the restructuring that Intel needs. The company's forward P/E ratio stands at 11 and shares yield 2.7%. Our Target Price for INTC now resides at $69.

Despite blowing the consensus earnings estimate out of the water last Tuesday, shares of **ManpowerGroup** (MAN – $72.01) actually dipped nearly 2% by the close of trading before rallying 6.8% over the remaining 3 trading days. The staffing solutions provider turned in $1.20 of earnings per share in Q3 (above the upper band of management's guidance and the $0.64 estimated by analysts). Period revenue was $4.58 billion, a 13% decline year-over-year.

MAN CEO Jonas Prising addressed diverging segments of the global economy, "Since our last earnings call in July, much has happened in the world, and I'm pleased to say that we see the early shoots of a global recovery taking hold during the third quarter, and our results reflect a stronger market environment than we anticipated a few months ago. As a result of the COVID-19 pandemic, we are seeing some of the fastest changes to the global economy with industries like retail, hospitality and aviation, previously more resilient than others, impacted in ways never seen before. Other industries such as tech, e-commerce and logistics are benefiting from new ways of working and new consumer preferences. At the same time, job protection initiatives have been implemented worldwide and have helped support jobs, livelihoods and households. Around the world, governments are mindful of the need to bring confidence back while also managing pressures on health and social services."

Manpower has weathered many crises throughout its 70-plus history. We appreciate management efforts to maintain solid financial footing through building cash, which continued to rise in the latest quarter, and expense management. While the still quite uncertain economic environment has placed many business decisions on hold, we expect MAN's broad geographic footprint, wide range of offerings and shifts to recruitment outsourcing to provide a ramp as conditions eventually improve, and as organizations move to retrain existing employees for the changing landscape as well as hire new ones. MAN's dividend is paid twice a year, with the next payout expected in December. The current yield is 2.9%. Our Target Price is now $106 and we continue to note that MAN shares doubled in price over the two years following the Global Financial Crisis.

Global defense contractor and security company **Lockheed Martin** (LMT – $386.21) reported Q3 financial results last Tuesday that modestly beat analyst estimates. The company earned $6.25 per share on $16.5 billion of revenue (year-over-year growth of 10% and 9%, respectively). Shares, however, dipped roughly 5% Tuesday and Wednesday before posting a bit of a recovery to end the week.

With elections in our midst, CEO James Taiclet had the following commentary regarding federal budgets, “You’ll recall that the Bipartisan Budget Act of 2019 was enacted into law last year and established spending levels for discretionary defense budgets, with a total fiscal year 2021 national defense spending target of approximately $740 billion. Lawmakers continue to work on authorization and appropriations bills, and in the interim, the federal government is operating under a continuing resolution for fiscal year 2021 through December 11. While we do not expect impacts to our 2020 financials should the continuing resolution be extended beyond December 11, 2020, we could experience some level of impact to our 2021 trending data depending on the duration of the CR. Similarly, Section 3610 of the CARES Act, which was passed in March to provide authorization for federal contractors continuing to support government initiatives despite COVID-19 disruption, was also extended through December 11. To date, no additional funding has been provided for issues introduced by the coronavirus. As with the DoD appropriations bill, we do not anticipate a material impact to our 2020 financial results should a delay in CARES Act funding continue, and we remain engaged in discussions with the Defense Department regarding a macro settlement for issues caused by the virus.”

The Aeronautics segment continues to stand out, and represents 40% of total revenue, driven in large part by F-35 revenue. The company slightly grew its record backlog to $150.4 billion, which gives us continued confidence in its future revenue-generating ability, and led management to bump up a tad its sales and operating profit projections compared to its outlook in July.

Preliminary Trends – 2021

2021 Outlook

- **Sales Increase to ≥ $67 Billion**
- **Segment Operating Margin* 10.9% – 11.1%**
- **Cash from Operations ≥ $8.1 Billion**
- **Pension Funding Requirement ~$1.0 Billion**
- **Share Repurchases ≥ $1.0 Billion**
- **Debt Maturity ~$0.5 Billion**

FAS/CAS Outlook**

- **2021 Net FAS/CAS Pension Adjustment ~$2.1Billion**
  - Assumes 2.5% Discount Rate at Year-End 2020
  - Assumes 7.0% Return on Plan Assets in 2020
  - Assumes 7.0% Long-Term Return on Assets

Strong Cash and Margin Performance Driving Value Creation

*See Chart 13 for Definitions of Non-GAAP Measures; **Chart 15 for FAS/CAS Details

Chart 10 October 20, 2020

COVID-19 has added unprecedented challenges and uncertainty, but Lockheed seems to have handled the situation well. LMT continues to benefit from the production ramp of the F-35 program, while international sales, and additional contract wins in hypersonics and classified content combine to drive robust cash flow which should support continued share repurchases and dividends. In fact, the dividend was raised 8.3% in July and the yield is now 2.8%. Our Target Price for LMT is now $494.

Regional banking concern **Old National Bancorp** (ONB – $14.73) released Q2 2020 financial results last week that were much better than the consensus analyst estimate ($0.47 vs. $0.33 est.). Loan growth contributed to pre-provision net revenue of $94.6 million (a 6.7% improvement year-over-year) despite net interest margin compression. Efficiency improvements drove the efficiency ratio 73 basis points lower to 53.1%. ONB had net recoveries of $3 million vs $0.5 million of net charge-offs in the quarter. At quarter end, non-performing loans represented 115 basis points of total loans vs. 95 basis points of loan reserves.

CEO Jim Ryan, who took the helm earlier this year, took a shot at his larger peers suggesting they had taken the year off due to the pandemic, and that the bank had hired a few relationship managers from those firms. He declared, “Many larger banks have told the relationship managers to stay home and not worry about goals this year. By contrast, our relationship managers are

proactively serving existing clients and winning new relationships rather than being distracted or derailed by COVID. Jim Sandgren and I have also been actively calling on new client opportunities to help win business. I've been impressed by the quality of the new relationships we've been able to win this quarter, many of them moving from long-term relationships from other larger banks. I would like to thank our team members for their hard work and dedication."

Commenting on ONB's current stance, he continued, "On last quarter's call, I stated, we are open for business and are setting new credit. Old National has always managed with a long-term view. We will continue to make new loans if we are comfortable with the underlying cash flow structure and pricing. The loans we are booking today are generally with better structures than we would have accepted last year. We do not jump into businesses or sectors during the good times only to exit during the tough times. Our balance sheet and capital remains strong, our markets are diverse, and our experienced team will help us manage this uncertain time."

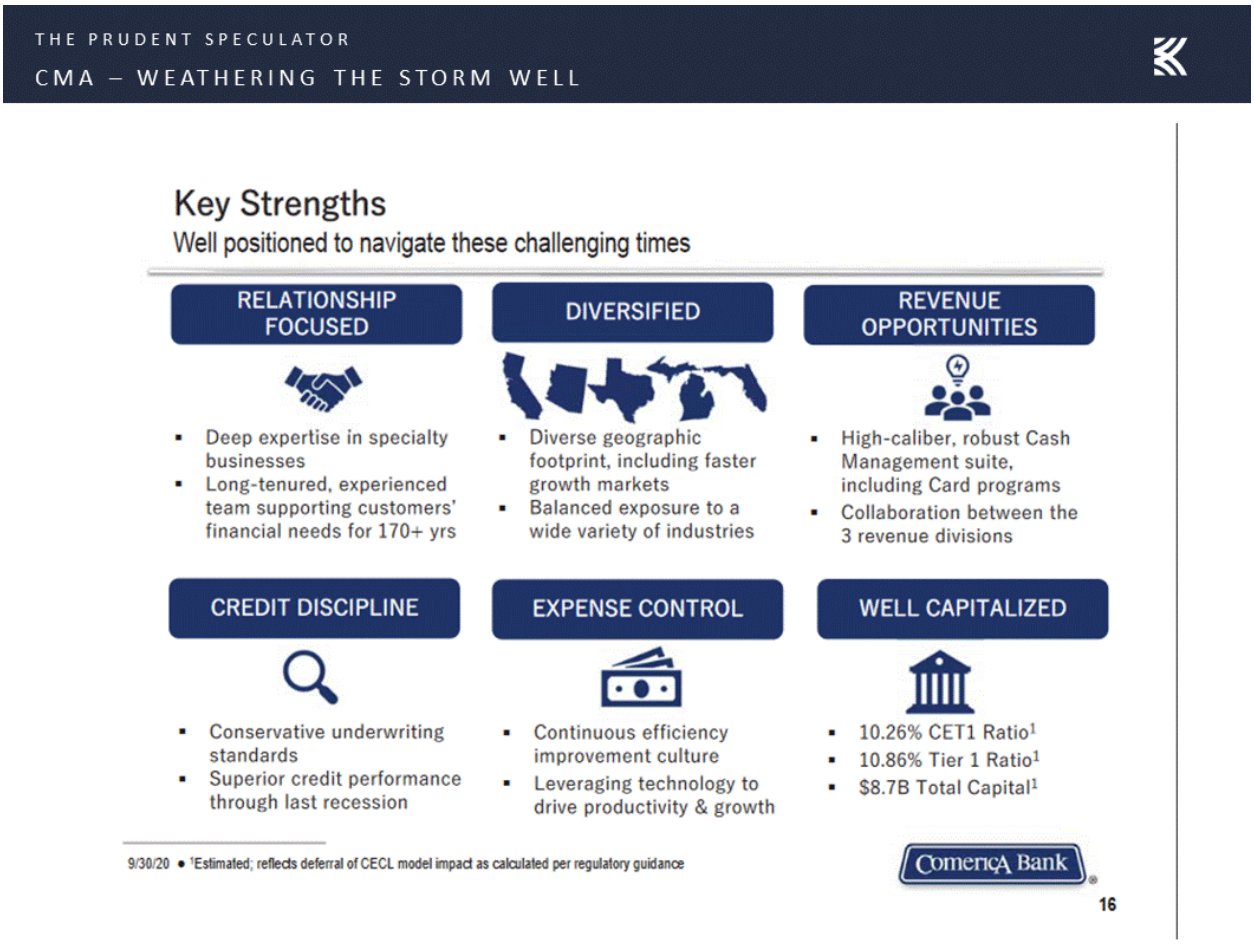
The interest rate environment remains a headwind for most banks, and for Old National in particular, given that interest income accounts for nearly 70% of total revenue. Still, we are encouraged by progress the bank is making under its *ONB Way* program to drive efficiency, shed costs and invest in technology. ONB's growing deposit base also appears an area of strength given the low and shrinking cost of funds. The stock rebounded 7% last week, but shares still yield 3.8% and trade for 83% of book value and 11 times NTM earnings estimates. Our Target Price for ONB has been hiked to $21.

Comerica Inc. (CMA – $46.39) shares soared more than 11% last week, supported by a solid Q3 earnings release. Adjusted EPS for the three-month period came in at $1.44, more than 72% above the consensus estimate of $0.83. Even in the face of interest rate pressures, CMA turned in a return on tangible common equity of more than 11%. Year over year, noninterest income was down roughly 1.5%, but we believe fee income can return to growth in 2021 and expenses can be kept in check post technology investments that the bank continues to make. CMA's loan-loss provisioning returned to a more normal state with only $5 million set aside in Q3, compared to over $100 million in Q2 and over $400 million Q1.

"Our third quarter earnings of $211 million, or $1.44 per share, reflected the resiliency of our relationship-focused business model," explained CEO Curt C. Farmer. "Our customers are acting prudently by conserving cash and adjusting their operations, which resulted in a reduction in loans and continued deposit growth. The allowance for credit losses remained near 2% of total loans, resulting in a provision of $5 million, and reflected lower loan balances, along with our portfolio's stable performance and an improving, yet uncertain, economic path. The impact from lower interest rates on net interest income waned, card fees remained robust and other fee income categories began to recover. Expenses were well-controlled and included a $4 million increase in charitable contributions. Our book value per share grew to $53.78, the seventh consecutive quarterly increase, and we remain focused on continuing to enhance shareholder value."

Mr. Farmer continued, "The unwavering dedication of our team to provide a high-level of customer service as well as support each other and our communities during this unprecedented time continues to be a source of pride. As previously announced, we have significantly increased

our commitment to help small businesses and communities that have been impacted by the pandemic. Since early March, Comerica, together with the Comerica Charitable Foundation, has distributed over $9 million to over 150 non-profit and other community service organizations. With strong liquidity and capital levels, together with our experience and deep expertise, we are well-positioned to assist our customers and communities, as we continue to build and solidify enduring relationships."



With low interest-rates, a weak energy market and Corporate America still rebuilding, the current environment continues to provide stiff headwinds for Comerica's operations. That said, we continue to believe that the stock price discounts a far more dire future than what we think will occur. As contrarians, we like that CMA is unloved by most of the analysts following it, but we acknowledge that the forward sledding will be through rough terrain. Management remains committed to the dividend for now (the yield is presently 5.9%) and given the recent quarter, the company can likely maintain it at these levels through a few uglier quarters unless the Federal Reserve directs otherwise. A higher-risk, greater-reward bank in our portfolios, CMA trades significantly below our current Target Price of $76.

Shares of thinly traded **Greenbrier Companies** (GBX – $30.01) plunged over 9% on Friday after the railcar manufacturer reported $0.16 of fiscal Q4 earnings per share, well short of the

$0.30 analysts expected. Sales in the quarter did beat the consensus estimate by 6.5% but were down 30% year-over-year. Although slightly lower than the $2.7 billion last quarter, Greenbrier still boasts a backlog made up of 24,600 units valued at $2.4 billion. Shares are up nearly 20% since the release of the firm's last quarterly filing in July.

Management has shed a massive 38% of its workforce since the end of 2019 in an effort to meet financial and liquidity goals set as the pandemic hit. Greenbrier has been rightsizing its capacity over the last few quarters given softening demand, especially in North America. That trend, however, appears to be slowly reversing. CEO Bill Furman elaborated, "Unless there's some dramatic change for the worse, we think we are over the rightsizing. We still have some pockets maybe in Europe that we need to address…We don't want to lose our capability to bounce back very quickly."

We still acknowledge that railroad manufacturing is a cyclical business and appreciate steps the company has taken to weather a difficult and ongoing economic environment. Mr. Furman continued, "I've been in this business a long time, as you know, I know that it can be boom and doom 1 day and all of a sudden, kaboom, the sun comes out and things come back. But I sure don't think that's going to happen for many months, many quarters and we've got to be cautionary about COVID-19. We're not out of this yet. Those who are saying we're out of it and it's going to be great. It's not going to be great. It's going to be — people are going to continue to die at a high rate and through the winter until we have some ability to address it. And that addressing of it is going to come through treatment, probably not a vaccine that is universally going to be a panacea. So we just are being cautionary, and we can't predict the future. I think that's one of the things you're hearing from us is that we want to be sure we're strong that we able to come back when the market comes back, we'll be back. Meanwhile, we'll make adequate cash — really good cash flow and adequate results in the circumstances."

Despite the challenging operating environment, we think consolidating acquisitions in North America and expansion abroad have both strengthened the company's competitive position and added beneficial diversification. The drop on Friday reminds us that GBX continues to be a volatile stock, and that is unlikely to dissipate in the near-term. But for those able to stay on the ride, Greenbrier has potential to significantly benefit as the economy eventually hits its stride. We point out that the firm has grown book value per share by a multiple of 3 over the past decade, while paying out substantial income to shareholders through dividends since 2014. Shares currently yield 3.5% and our Target Price now sits at $42.