Market Commentary Monday, October 11, 2021

October 11, 2021

EXECUTIVE SUMMARY

Buckingham on *Barron's Live* – 12:00 PM Eastern; 9:00 AM Pacific Today, October 11
Newsletter Trades – 10 Buys for 4 Portfolios
Week in Review – Stocks Rally Despite Media Warnings
Rising Rates – Bad for…Bonds
Econ News – Positive Numbers, Aside from Jobs Report
Wall of Worry – Tapering Perspective
Sentiment – Plenty of Pessimism; Lots of Cash in the Mattress
Valuations – Equities Still Attractive; Especially with Handsome EPS Growth Expected
Stock News – Updates on GM, VWAGY, TAK, AYI, STX & PNW

Market Review

For those interested in hearing directly from your Editor, I will be appearing on *Barron's Live* today (Monday, October 11) at 12:00 PM Eastern; 9:00 AM Pacific.

Registration (there is no charge to sign up) is available here https://www.barrons.com/live?page=1, and the event will be available on Apple Podcasts and Spotify for those who miss it live.

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As indicated in the October edition of *The Prudent Speculator*, we bought the following on Wednesday, October 6, in our two real-money accounts.

TPS Portfolio
740 **Verizon Communications** (VZ – $53.24) at $54.0756
35 **Alexandria Real Estate** (ARE – $192.44) at $190.2985
152 **Pinnacle West Capital** (PNW – $66.58) at $72.5546

Buckingham Portfolio
39 **Air Products & Chemicals** (APD – $265.43) at $253.7515
28 **MetLife** (MET – $64.99) at $63.3785

In our two hypothetical accounts, we added the following that same day.

Millennium Portfolio
208 **Lumentum** (LITE – $84.16) at $81.51
23 **Merck** (MRK – $80.63) at $81.50
46 **JM Smucker** (SJM – $121.63) at $121.16

PruFolio
583 **Big Lots** (BIG – $47.30) at $42.83
22 **Lockheed Martin** (LMT – $353.75) at $347.03

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Stocks certainly could have continued September's trip south over the first six trading days of October, but that was not the case, with the major market averages adding to their monthly gains last week and providing another reminder that it is impossible to predict short-term market movements. After all, we were told that stocks were in turmoil at the end of September,…

THE PRUDENT SPECULATOR

BONDS IN THE RED THIS YEAR, BUT SOMEHOW STOCKS ARE IN TURMOIL???

We understand that splashy headlines sell newspapers, and September was miserable, but though volatility has picked up considerably, stocks haven't exactly been in turmoil thus far in October...or in 2021 for that matter. Now it is a different story this year for supposedly safe bonds.


THE WALL STREET JOURNAL.

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What's News

Business & Finance

The S&P 500 rose for a sixth straight quarter, despite registering a 4.8% decline for September.

Stocks End Quarter in Turmoil, Worst Month Since March '20

Democrats Put Off Action on $1 Trillion Package

Infrastructure vote is delayed as factions fail to bridge differences on larger spending bill

Total Returns Matrix			
Sept. 2021	Since 9.30.21	YTD 2021	Name
-1.78	-0.36	-4.41	Bloomberg Global-Aggregate Bond
-0.87	-0.50	-2.05	Bloomberg U.S. Aggregate Bond
-4.20	2.71	15.17	Dow Jones Industrial Average
-3.72	2.38	15.68	New York Stock Exchange
-5.49	1.30	14.97	Russell 3000 Growth
-3.38	**2.52**	**19.52**	**Russell 3000 Value**
-4.49	1.89	17.17	Russell 3000
-4.65	1.99	18.23	S&P 500
-5.79	1.47	18.16	S&P 500 Growth
-3.29	**2.59**	**18.30**	**S&P 500 Value**
-5.33	0.16	18.68	S&P 500 Pure Growth
-1.67	**3.79**	**30.30**	**S&P 500 Pure Value**

As of 10.08.21. Source Kovitz using data from Bloomberg

…and that investors should be spooked by higher interest rates,…

Despite tons of evidence to the contrary, the financial press likes to point out that rising bond yields are bad for stocks. That is not to say that equities are immune to higher interest rates, and there will always be periods of time when stocks get hit as bond yields climb, but stocks have performed fine on average whether rates are rising or falling. We find it more interesting that there is usually little mention of the risk associated with bonds. After all, yields increase when bond prices fall!

STREETWISE | By James Mackintosh

Market Is Right to Be Spooked by Rising Bond Yields

No one likes losing money, but Tuesday's stock-price fall worries me more than the headline of a 2% fall in the S&P 500 should. In itself, 2% is no biggie: Three days this year had bigger falls, and on average we have had seven worse days a year since 1964.

What bothers me is that the rise in bond yields that triggered the fall was quite small and there could easily be a lot more to come. The 10-year Treasury yield rose 0.05 percentage point, taking it above 1.5%, and the 30 year rose slightly more to just above 2%. Yields need to rise four times as much just to get back to where they were in March.

Why, you might reasonably ask, are stocks suddenly

flip side, if yields come back down, it might be good for stocks—as it was on Friday—rather than bad, as has usually been the case for a couple of decades.

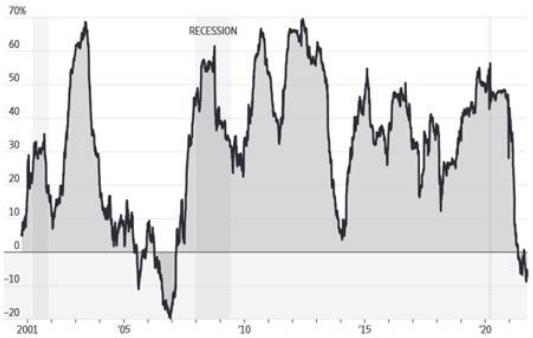
To see the threat, think back to the spring, when yields were marching higher. The outlook for inflation is about the same (investors are pricing it as high but temporary). The outlook for economic growth is worse, which provides less support for stocks generally. But central banks shifted stance from super-easy for pretty much forever to start talking about tightening.

This is the wrong sort of rise in bond yields. When yields were rising up to their March high of 1.75% for the 10-year Treasury, stocks were on a tear because yields were being driven up by the prospect of higher economic growth, and so stronger prof-

Bond yields and stocks mostly rose and fell together after 2000, but not recently.

Equity-bond yield correlation*

200-day correlation between one-day changes in S&P 500 and 10-year Treasury yield



triggers for the market's reassessment. First, Fed policy makers upped their "dotplot" predictions for interest rates next year and the year after, along with inflation. Second, the Bank of England, faced with an energy price crunch and higher-than-forecast inflation, warned of a possible rate rise before the end of this year. Many emerging-market central banks raised rates, as did oil-producer Norway.

If the economy reacts badly to higher yields, though, the Fed and Bank of England might well shift back to uber-dovishness. The withdrawal of emergency government spending measures in much of the world will also give the doves a new reason to keep rates low.

Finally, there's uncertainty about the market reaction itself. Maybe Tuesday's bond

…which has been the case so far in October, given the spike in yield for the benchmark 10-Year U.S. Treasury to 1.61%.

THE PRUDENT SPECULATOR

VOLATILITY NOT JUST AN EQUITY MARKET PHENOMENON

The upswing in government bond yields (drop in prices) picked up steam this month, with the interest rate on the benchmark 10-Year U.S. Treasury jumping from 1.49% on September 30 to a high of 1.62% on October 8, adding to the losses suffered by investors this year.

Of course, students of market history should not have been surprised to see stocks rally, as equities have performed well, on average, no matter the direction of interest rates,…

THE PRUDENT SPECULATOR

RISING INTEREST RATES ARE NOT BAD FOR STOCKS, ON AVERAGE

Rising Long-Term Government Rates - Annual Returns Review

Name	Value Stocks	Growth Stocks	Dividend Payers	Non-Dividend Payers	Long-Term Corp Bonds	Long-Term Government Bonds	Intermediate-Term Govt Bonds	U.S. Treasury Bills
Arithmetic Average	17.8%	12.5%	11.2%	15.7%	1.0%	-1.0%	2.2%	3.7%
Geometric Average	13.5%	9.4%	9.1%	10.1%	0.8%	-1.1%	2.1%	3.7%
Median	17.0%	12.2%	14.3%	10.9%	1.3%	-0.2%	1.8%	3.3%
Max	126.6%	93.1%	69.8%	88.2%	14.6%	9.2%	9.7%	14.7%
Min	-54.0%	-42.2%	-47.4%	-50.9%	-8.1%	-14.9%	-5.1%	0.0%
Count	46	46	46	46	46	46	46	46

Source: Kovitz using data from Ibbotson Associates SBBI. From 1930 to 2020.

Falling Long-Term Government Rates - Annual Returns Review

Name	Value Stocks	Growth Stocks	Dividend Payers	Non-Dividend Payers	Long-Term Corp Bonds	Long-Term Government Bonds	Intermediate-Term Govt Bonds	U.S. Treasury Bills
Arithmetic Average	15.7%	12.7%	14.3%	11.5%	12.3%	13.4%	8.5%	2.9%
Geometric Average	12.9%	10.5%	12.6%	7.6%	12.0%	13.1%	8.4%	2.9%
Median	16.4%	13.8%	14.9%	12.3%	10.8%	10.7%	7.8%	2.1%
Max	71.1%	48.3%	53.5%	90.5%	42.6%	40.4%	29.1%	10.5%
Min	-43.6%	-37.0%	-34.8%	-48.6%	2.6%	2.8%	1.4%	0.0%
Count	45	45	45	45	45	45	45	45

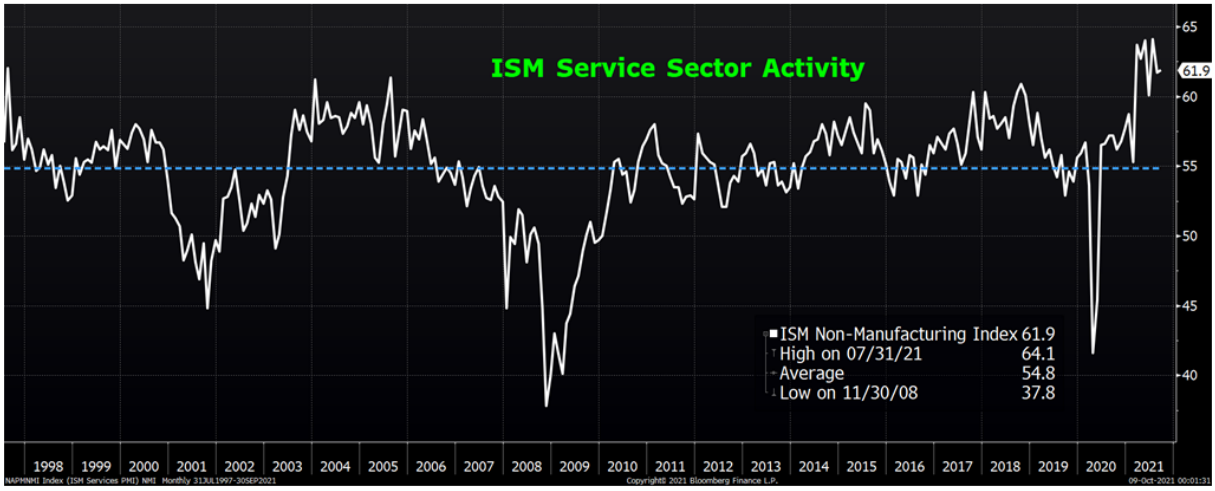
Source: Kovitz using data from Ibbotson Associates SBBI. From 1930 to 2020.

…and there were positive economic statistics out last week, including better-than-expected factory orders for August and the September reading on the health of the important service sector from the Institute for Supply Management.

THE PRUDENT SPECULATOR

ISM NON-MANUFACTURING RISES: 4.5% ANNUALIZED GDP GROWTH

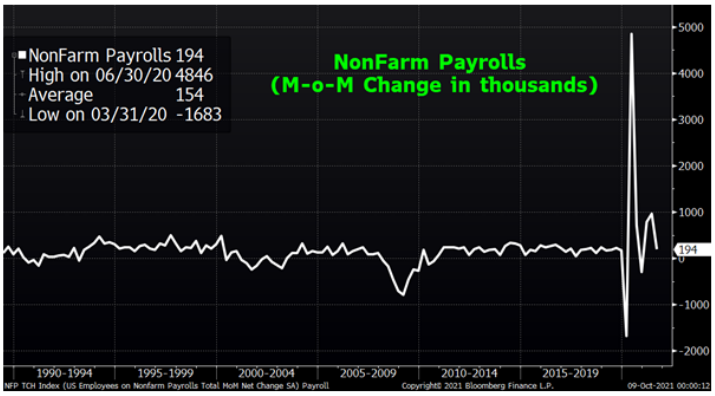
The latest read on the health of the service sector inched up to 61.9 in September, beating forecasts, coming in at one of the best numbers in the history of the index and suggesting a strongly growing non-manufacturing economy. Indeed, the Institute for Supply Management stated, "The past relationship between the Services PMI and the overall economy...corresponds to a 4.5% increase in real gross domestic product (GDP) on an annualized basis."



To be sure, even though the ADP National Economic Report showed a stronger-than-projected 569,000 new private sector payrolls last month, the critical September labor report from Uncle Sam saw far fewer jobs created than analysts had predicted,…

THE PRUDENT SPECULATOR

DISAPPOINTING INCREASE IN JOBS



Economists were looking for a big gain of 500,000 payrolls, so the increase of 194,000 in September was below expectations, though the July and August tallies were revised higher by a combined 169,000 jobs. Government payrolls fell by 123,000, mostly in education. Those who have jobs saw wages rise as employers struggle to fill positions, with early retirements, lack of child care, virus fears and Uncle Sam's largesse keeping many folks from returning to work.

…though the unemployment rate and first-time weekly filings for jobless benefits improved considerably.

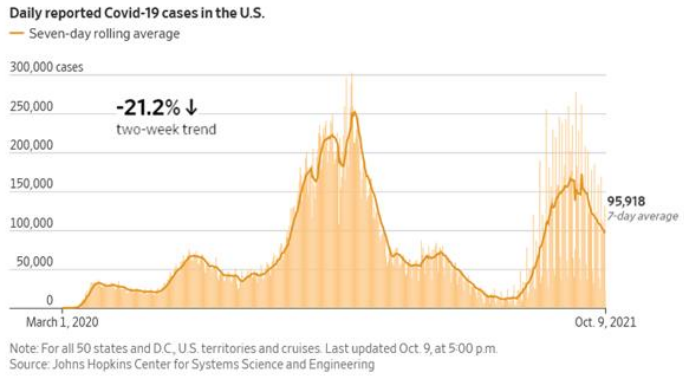
THE PRUDENT SPECULATOR

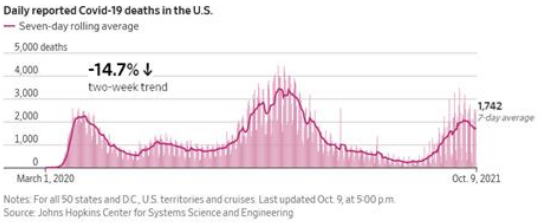
LOTS OF FOLKS OUT OF WORK…BUT NUMBERS SHOWING IMPROVEMENT

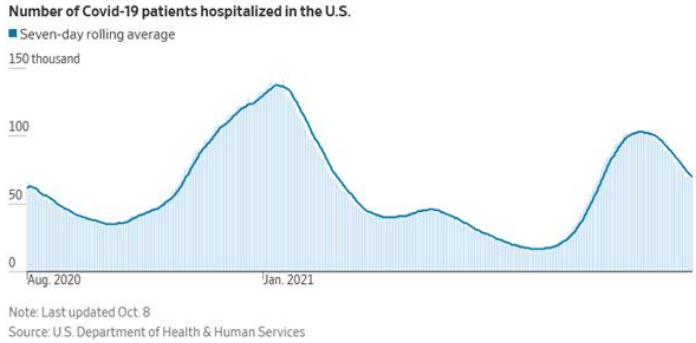
Despite fewer new jobs created than expected, the unemployment rate for September improved markedly, coming in at a new pandemic low of 4.8%, down from 5.2% in August. Of course, the labor force shrinking by 183,000 merited much of the credit. Sixteen months ago, the jobless rate hit a record 14.8%, so the labor situation has improved considerably, and first-time filings for unemployment benefits in the latest week dipped to 326,000, near a pandemic low.

Certainly, we recognize that equities have been bolstered this month by better news on the COVID-19 front,…

FALLING CASE/DEATH COUNTS AND HOSPITALIZATIONS…AND AN ANTIVIRAL







HEALTH

Merck's antiviral pill reduces hospitalization of Covid patients, a possible game-changer for treatment

By Matthew Herper Oct. 1, 2021 Reprints

KENA BETANCUR/GETTY IMAGES

An investigational antiviral pill reduced the chances that patients newly diagnosed with Covid-19 would be hospitalized by about 50%, a finding that could give doctors a desperately needed new way to treat the sick, the drug maker Merck announced Friday.

…and word that Congress had reached agreement on a deal to extend the debt ceiling…until December anyway, averting, per U.S. Treasury Secretary Janet Yellen, "a financial crisis and economic recession if the Treasury can't repay bondholders as debts mature."

The risk of an American debt default postponed for the time being, and the disappointing payrolls figure notwithstanding, most are still of the mind that the economy remains healthy enough for the Federal Reserve to soon initiate a tapering of its bond-buying program. As the latest Federal Open Market Committee statement reminded, "Last December, the Committee indicated that it would continue to increase its holdings of Treasury securities by at least $80 billion per month and of agency mortgage-backed securities by at least $40 billion per month until substantial further progress has been made toward its maximum employment and price stability goals."

With a reduction in Fed bond buying pending, we would expect the financial press to ramp up their warnings about the risks of such an event to the equity markets, even as few will bother to do their homework to show what actually took place the previous time the Fed threatened and then embarked on a tapering.

THE PRUDENT SPECULATOR

TAPER TANTRUM: LONG-TERM TREASURIES, YES, BUT STOCKS, NOT SO MUCH

With folks trying to figure out when the Federal Reserve might become less accommodative, pundits have been offering reminders like, "In 2013, the Fed's previous taper announcement drove markets into a tantrum and led long-term debt to sell off." Memories become fuzzy with time and the yield on the 10-Year U.S. Treasury did soar from 1.63% on 5.22.13 to 3.02% on 12.31.13, due to fears about Fed tightening, but stocks performed very well in 2013 and 2014, even as the actual tapering of bond purchases began in January 2014. Indeed, **the Russell 3000 Value index returned 50%** and had only two downturns of 5% or greater during the period, just a third of the three-per-year average.

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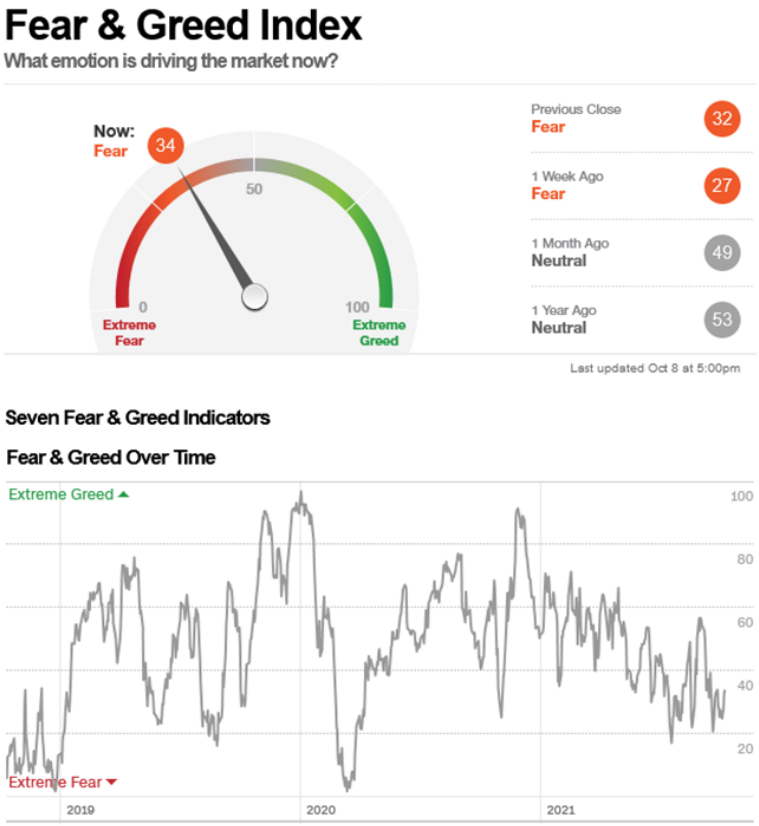
If truth be told, given our contrarian nature, we really don't mind that so many are wary of equities,…

FEAR & GREED INDEX…STILL SHOWING FEAR



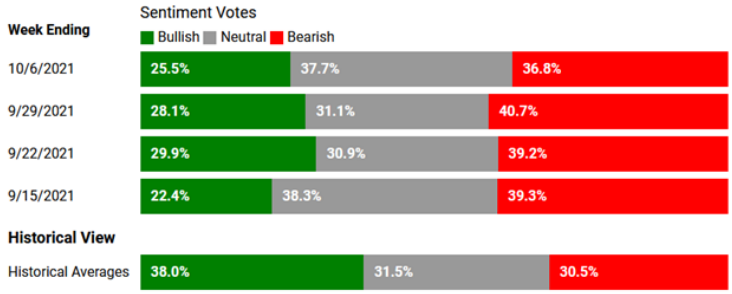
Even with the major market averages bouncing back from a dismal September, folks remain scared. The *CNNMoney* Fear & Greed Index is in Fear territory. Extreme Fear readings for Stock Price Strength, Market Momentum and Put and Call Options, and Fear in Safe Haven Demand and Stock Price Breadth, were offset only by Extreme Greed in Junk Bond Demand.

…as history shows that it is good to be greedy when others are fearful.

AAII SENTIMENT BUY SIGNAL: LOW BULLISHNESS & HIGH BEARISHNESS

AAII Investor Sentiment Survey

What Direction Do AAII Members Feel The Stock Market Will Be In The Next 6 Months?



AAII Bull-Bear Spread

Decile	Low Reading of the Range	High Reading of the Range	Count	R3K Next 1-Week Arithmetic Average TR	R3K Next 1-Week Geometric Average TR	R3K Next 1-Month Arithmetic Average TR	R3K Next 1-Month Geometric Average TR	R3K Next 3-Month Arithmetic Average TR	R3K Next 3-Month Geometric Average TR	R3K Next 6-Month Arithmetic Average TR	R3K Next 6-Month Geometric Average TR
	Below & Above Median Bull Bear Spread = 8.00										
BELOW	-54.0	8.0	910	0.27%	0.23%	1.26%	1.13%	3.65%	3.27%	7.17%	6.42%
ABOVE	8.1	62.9	872	0.17%	0.15%	0.51%	0.42%	1.96%	1.71%	4.56%	4.08%
	Ten Groupings of 1782 Data Points										
1	-54.0	-15.0	182	0.55%	0.49%	2.15%	1.91%	5.86%	5.31%	10.63%	9.40%
2	-14.9	-7.3	175	0.35%	0.32%	0.95%	0.82%	3.82%	3.47%	7.08%	6.31%
3	-7.3	-1.4	178	0.31%	0.28%	1.49%	1.39%	3.29%	2.88%	7.24%	6.61%
4	-1.3	3.0	181	0.09%	0.05%	1.10%	1.01%	2.96%	2.60%	6.38%	5.85%
5	3.0	8.0	194	0.05%	0.02%	0.66%	0.56%	2.42%	2.17%	4.67%	4.15%
6	8.1	12.1	159	0.09%	0.07%	0.40%	0.27%	1.60%	1.36%	4.55%	4.07%
7	12.1	16.5	178	0.20%	0.18%	0.71%	0.61%	2.48%	2.23%	5.15%	4.72%
8	16.5	22.0	185	0.17%	0.15%	0.71%	0.64%	2.13%	1.86%	5.99%	5.57%
9	22.0	29.1	171	0.09%	0.07%	0.40%	0.32%	2.06%	1.78%	4.39%	3.81%
10	29.2	62.9	179	0.27%	0.25%	0.31%	0.24%	1.51%	1.28%	2.66%	2.22%

From 07.31.87 through 10.7.21. Unannualized. SOURCE: Kovitz using data from American Association of Individual Investors and Bloomberg

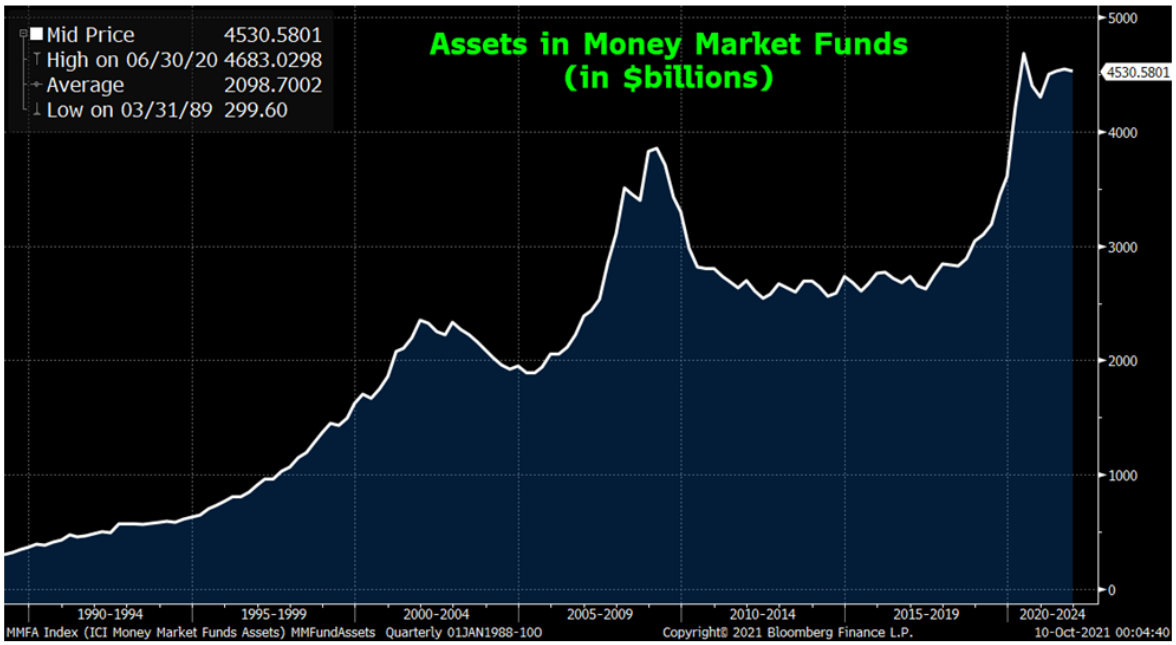
The gauge is widely viewed with a contrarian eye, so the tally of Bulls in the latest AAII Sentiment Survey 12.5 points below normal and the number of Bears more than 6 points above average is a major positive, as is the minus 11.3-point Bull-Bear spread in the second lowest decile.

Of course, we realize that with the major equity market averages not too far from their all-time highs, some will challenge our view that folks are pessimistic, but our argument is supported by the massive amount of cash hibernating in money market funds,…

THE PRUDENT SPECULATOR

MONEY MARKET FUND ASSETS OVER TIME

Despite yields near zero, total assets in money market funds have seldom 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.

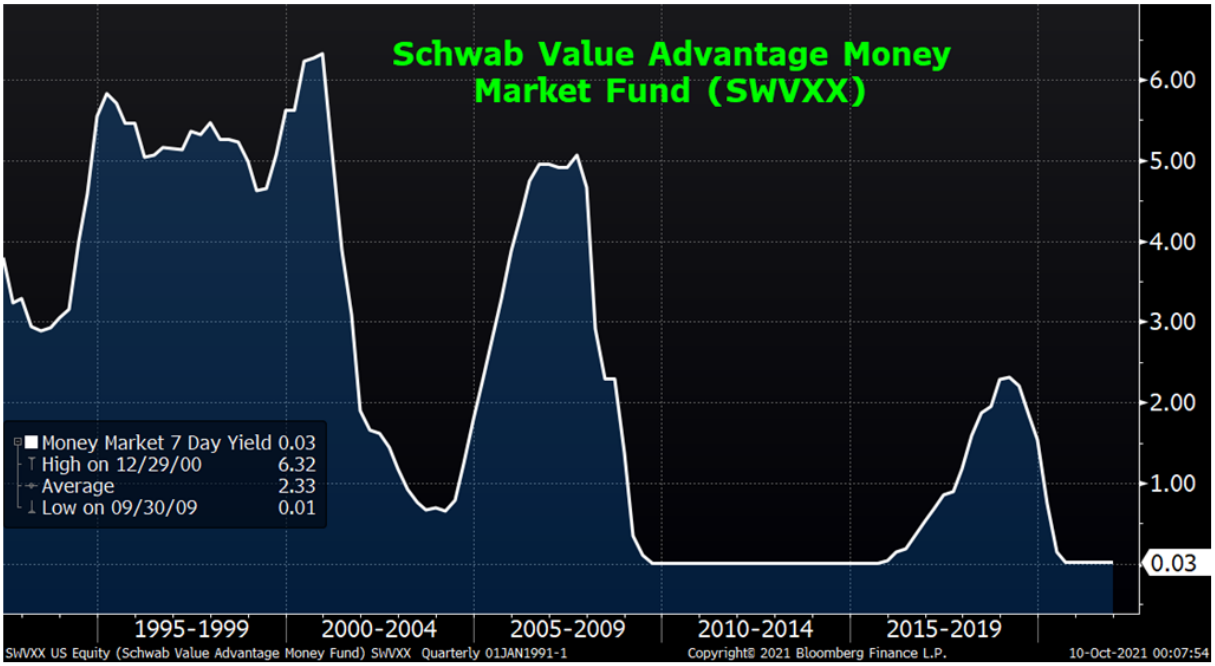


…where the microscopic yields available today would allow money to double in 2,311 years,…

THE PRUDENT SPECULATOR

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 2007 and 2000.



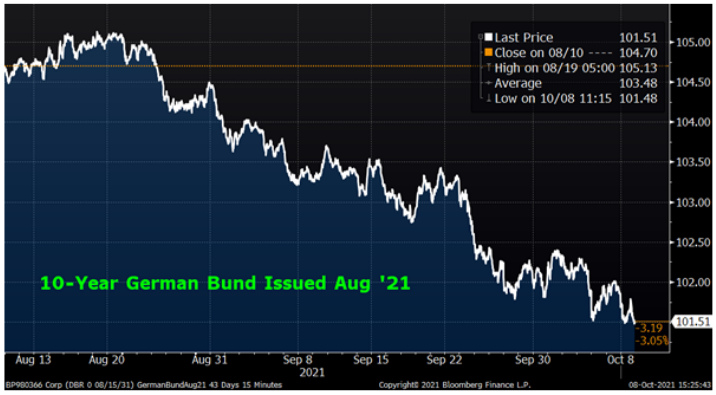
…not to mention the more than $12 trillion of assets held around the world in negative yielding government debt,…

Incredibly, investors around the world continue to love government debt, despite losses this year on the price of the bonds to go along with the negative yields. Yes, we understand that the pros can utilize derivatives and leverage 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.

…which in our view offers reward-free risk.

THE PRUDENT SPECULATOR

REWARD FREE RISK – GERMAN BUNDS



On 8.11.21, Germany issued €5 billion of 10-year bonds with a coupon of 0% in a deal that attracted plenty of "interest" at a price of €104.56. That is not a typo! In order to receive €100 back in 10 years and NO interest along the way, "investors" gladly paid €104.56, locking in a sizable loss if held to maturity. Hoping to lose roughly 0.46% per annum, they must be thrilled with more than five times their expected annual return (the bonds have lost more than 3.00%) in just two months!

Obviously, stocks are not without risk of their own, but they historically have afforded sizable rewards for those who remember that time in the market trumps market timing!

THE PRUDENT SPECULATOR

VOLATILITY IS NORMAL BUT VALUE & DIVIDENDS WIN RACE

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

Advancing Markets

Minimum Rise %	Average Gain	Average # Days	Count	Frequency (in Years)	Last Start	Last End
20.0%	112.9%	990	27	3.4	3/23/2020	9/2/2021
17.5%	67.9%	579	39	2.3	3/23/2020	9/2/2021
15.0%	66.5%	563	45	2.0	3/23/2020	9/2/2021
12.5%	44.9%	338	72	1.3	3/23/2020	9/2/2021
10.0%	35.3%	248	98	0.9	3/23/2020	9/2/2021
7.5%	23.8%	149	157	0.6	9/23/2020	9/2/2021
5.0%	14.8%	73	306	0.3	10/30/2020	9/2/2021

Declining Markets

Minimum Decline %	Average Loss	Average # Days	Count	Frequency (in Years)	Last Start	Last End
-20.0%	-35.4%	286	26	3.5	2/19/2020	3/23/2020
-17.5%	-30.4%	217	38	2.4	2/19/2020	3/23/2020
-15.0%	-28.4%	189	44	2.1	2/19/2020	3/23/2020
-12.5%	-22.8%	138	71	1.3	2/19/2020	3/23/2020
-10.0%	-19.6%	102	97	0.9	2/19/2020	3/23/2020
-7.5%	-15.5%	65	156	0.6	9/2/2020	9/23/2020
-5.0%	-10.9%	36	306	0.3	9/2/2021	9/30/2021

From 02.20.28 through 9.30.21. Price return series. We defined a Declining Market as an instance when stocks dropped the specified percentage or more without a recovery of equal magnitude, and an Advancing Market as in instance when stocks appreciated the specified percentage or more without a decline of equal magnitude. SOURCE: Kovitz using data from Bloomberg, Morningstar and Ibbotson Associates

LONG-TERM RETURNS

	Annualized Return	Standard Deviation
Value Stocks	13.2%	26.0%
Growth Stocks	10.0%	21.3%
Dividend Paying Stocks	10.8%	18.0%
Non-Dividend Paying Stocks	9.4%	29.3%
Long-Term Corporate Bonds	6.1%	7.6%
Long-Term Gov't Bonds	5.5%	8.6%
Intermediate Gov't Bonds	5.1%	4.3%
Treasury Bills	3.3%	0.9%
Inflation	3.0%	1.8%

From 06.30.27 through 08.31.21. Growth stocks = 50% Fama-French small growth and 50% Fama-French large growth returns rebalanced monthly. Value stocks = 50% Fama-French small value and 50% Fama-French large value returns rebalanced monthly. The portfolios are formed on Book Equity/Market Equity at the end of each June using NYSE breakpoints via Eugene F. Fama and Kenneth R. French. Dividend payers = 30% top of Fama-French dividend payers, 40% of middle Fama-French dividend payers, and 30% bottom of Fama-French dividend payers rebalanced monthly. Non-dividend payers = Fama-French stocks that do not pay a dividend. Long term corporate bonds represented by the Ibbotson Associates SBBI US LT Corp Total Return index. Long term government bonds represented by the Ibbotson Associates SBBI US LT Govt Total Return index. Intermediate term government bonds represented by the Ibbotson Associates SBBI US IT Govt Total Return index. Treasury bills represented by the Ibbotson Associates SBBI US 30 Day TBill Total Return index. Inflation represented by the Ibbotson Associates SBBI US Inflation index. SOURCE: Kovitz using data from Professors Eugene F. Fama and Kenneth R. French and Ibbotson Associates

True, we must always be braced for downside volatility, but we like the long-term prospects of our portfolios of what we believe to be undervalued stocks, generally of dividend payers. We continue to think valuations for equities in general are attractive,…

THE PRUDENT SPECULATOR

INTEREST RATES STILL VERY SUPPORTIVE OF STOCKS

The so-called Fed Model suggests that the yield on 10-Year Treasuries should be similar to the S&P 500 Earnings Yield, which is the inverse of the P/E ratio. If the 10-Year is greater than the S&P Earnings Yield, a market is overvalued and if the reverse is true, as it is today, a market is undervalued. Though many dismiss the Fed Model, investing is always a choice of this or that, and we like today's rich (and rising) earnings yield (3.80% vs. 1.61% 10-Year) and S&P 500 dividend yield of 1.35%.

…especially with the "E" part of the Earnings Yield appearing poised to grow over the balance of this year and in 2022 and beyond.

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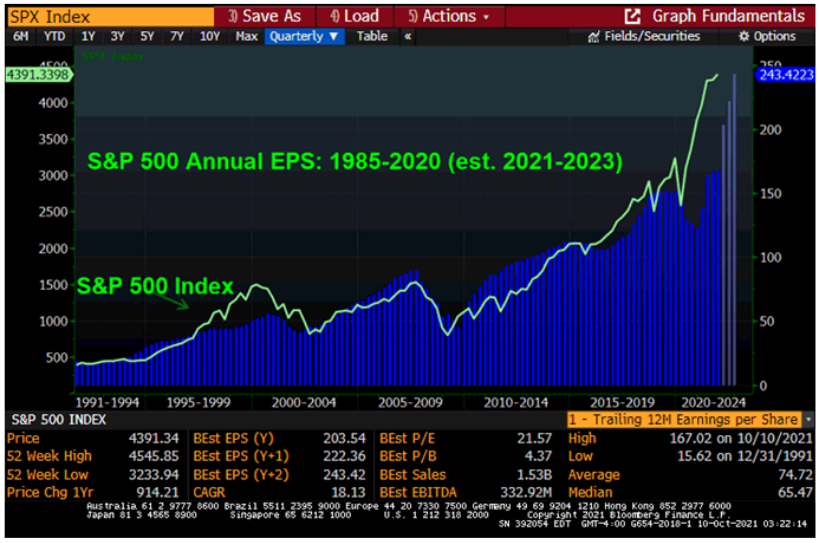
EPS PLUNGED IN '20 BUT LIKELY TO REBOUND MIGHTILY IN '21 & '22

Q2 2021 earnings reporting season has been terrific on both an absolute and a relative basis. Of course, full-year 2020 COVID-19-impacted EPS were miserable, so a massive rebound was expected, but estimates have been moving higher for 2021, 2022 and 2023.



S&P 500 Earnings Per Share		
Quarter Ended	Bottom Up Operating EPS 3 Month	Bottom Up Operating EPS 12 Month
ESTIMATES		
12/31/2022	$57.00	$217.59
9/30/2022	$55.32	$211.19
6/30/2022	$54.03	$204.07
3/31/2022	$51.24	$202.09
12/31/2021	$50.60	$198.26
9/30/2021	$48.20	$185.84
ACTUAL		
6/30/2021	$52.05	$175.54
3/31/2021	$47.41	$150.28
12/31/2020	$38.18	$122.37
9/30/2020	$37.90	$123.37
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

Source: Standard & Poor's. As of 10.07.21

Stock Updates

Keeping 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*.

Jason Clark, Chris Quigley and Zack Tart offer updates on several of our recommended stocks that reported quarterly results or had other material developments that impacted their Target Prices.

Shares of **General Motors** (GM – $58.57) rallied more than 10% last week on the back of the company's latest Investor Relations event. During the presentation, the giant auto maker provided details on how it plans to double its annual revenue and expand margins 12% to 14% by 2030. GM said it believes it can deliver a compound annual growth rate of 4% to 6% on auto sales and financing revenue, and approximately 50% in software and new businesses revenue.

GM defined its entire forward business strategy as a "Transformation Roadmap" or what many could call a Core to Future transition, including prior actions of restructuring and phasing out

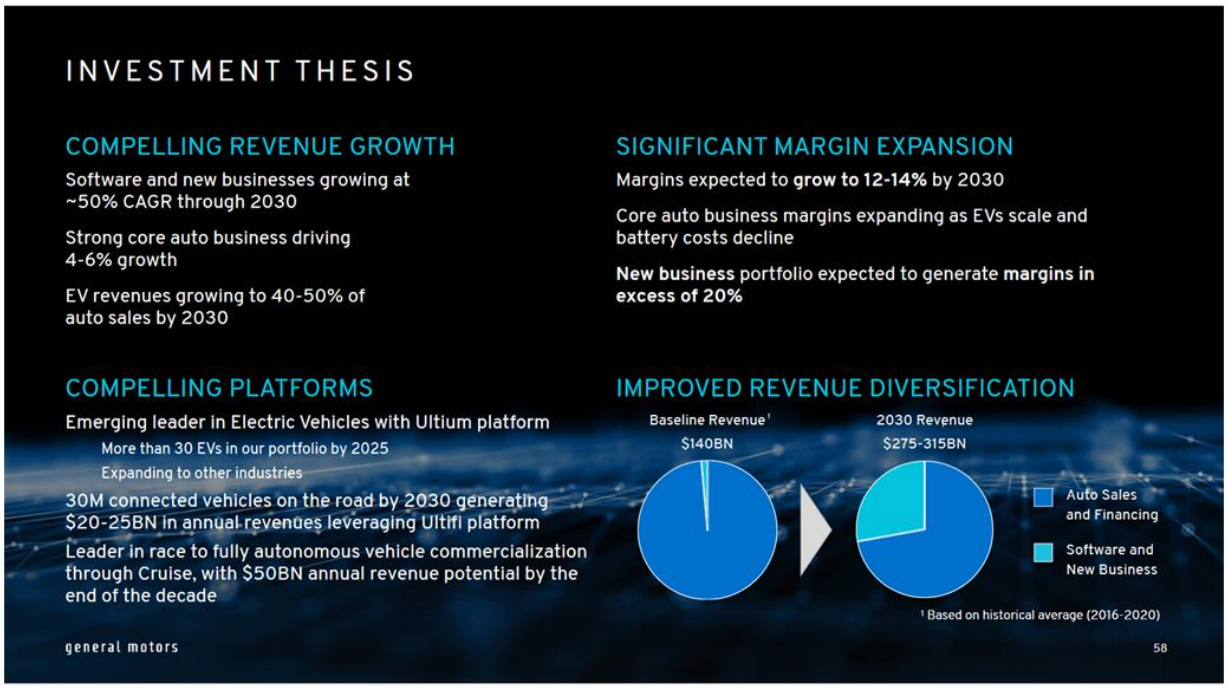
internal combustion engine (ICE) sedans, as well as continuing to invest in ICE CUVs, SUVs, and Trucks, and future actions (through the mid-2020s) of significantly ramping EV launches, commercializing autonomy via Cruise, commercializing BrightDrop and building out New Businesses.

Management reiterated its targets for more than $35 billion in EV/AV investment spend during 2020-2025 ($10 billion in battery/propulsion R&D and battery plants, $20 billion in capital/engineering related to EV programs, $6 billion in Cruise). Management noted that 20% of its North American manufacturing footprint will be EV capable by 2025 and more than 50% by 2030, while its vehicle launch process has also been accelerated from ICE to EV.

GM discussed a number of new projects in which it is currently incubating and investing, which have addressable markets ranging from $3 billion to $500 billion. Key new businesses already in commercialization (and relevant target for each) include OnStar (OnStar Insurance = $6 billion+ revenue opportunity by 2030), BrightDrop (targeting $10 billion+ in revenue at low 20% margin in 2030) and GM Defense ($25 billion total addressable market).

CEO Mary Barra commented, “GM has changed the world before and we’re doing it again. We have multiple drivers of long-term growth and I’ve never been more confident or excited about the opportunities ahead.”

CFO Paul Jacobson added, “GM is unlocking a secular growth story that is changing the trajectory of our business. Simply stated, we are at an inflection point in which we expect revenue to double by 2030 while also expanding our margins. We will achieve this by growing our core business of designing, building, and selling world-class ICE, electric and autonomous vehicles, growing software and services with high margins and entering and commercializing new businesses.”



We continue to like GM and believe that the company's move away from sedans and towards trucks and SUVs was important and supplies the huge amounts of cash flow required to launch more than 30 EVs in the very near term. The pivot to EVs has been impressively swift across the entire industry (after a slow start) and we think it'll prove valuable for a multitude of reasons. The valuation for GM remains very compelling, despite a share price that is up 40% this year, as consensus EPS estimates for 2021 and 2022 presently reside at $6.01 and $6.76, meaning that the stock is trading for a single-digit multiple of those figures. And, if the company can deliver anything close to its long-term growth targets we think our current $80 Target Price will be increased substantially in the years to come.

Shares of **Volkswagen AG** (VWAGY – $31.20) have slumped since we first recommended them in May at $36 or so, but we aren't losing our faith. The German carmaker has been hampered by ongoing chip shortages (along with most other auto manufacturers), even though premium brand sales have been strong and cost controls have proven beneficial. VWAGY expects to report Q3 results towards the end of this month and in its July update said that it expects revenue to come in "significantly higher" than last year's 222.9 million euros. Of course, there was a little bit of manufactured controversy last week when CEO Herbert Diess tweeted that bike riding is fun and good for the environment. We envision city-centers of the future to be emissions free (bicycle, car, bus, train) and expect VW to be a major part of that outcome.

We continue to like VWAGY's differentiated brands that target volume (VW, Skoda, Seat), premium buyers (Audi, Lamborghini, Bentley), sports cars (Porsche) and trucks (MAN, Scania). We continue to like VW's electric car future, bankrolled in large part by enormous profits at Porsche and expect the chip shortages to be resolved (although we have no concrete timeline). With investors clamoring for often profitless stocks in the EV space, we continue to have a preference for value-priced Volkswagen. Our Target Price for VWAGY is $55.

Shares of **Takeda Pharma** (TAK. $14.25) took a shellacking last Wednesday, sinking over 11% after the Japanese drugmaker announced that a safety signal had emerged in Phase 2 studies of TAK-994, an investigational oral orexin agonist. As an immediate precautionary measure, the company has suspended dosing of patients and has decided to stop both Phase 2 studies early to reevaluate TAK-994's benefit/risk profile and determine next steps for the program.

In a press release the firm stated, "Ensuring the safety of patients participating in clinical studies is of the utmost importance as we strive to develop transformative medicines. We are grateful to all of the patients, physicians and site staff who participated in these important clinical trials. Takeda is committed to bringing innovative, safe and effective treatments to patients with narcolepsy. We are working to quickly assess the totality of available data to inform the further development of TAK-994."

The announcement comes as a surprise for many given that the Food and Drug Administration (FDA) granted Breakthrough Therapy designation to TAK-994 back in July for the treatment of excessive daytime sleepiness in patients with narcolepsy type 1. And management's enthusiasm for its suite of multiple orexin-targeting drugs in the pipeline has been building over the last year, with revenue potential supposedly in the $4 billion to $6 billion range.

Of course, the decision to cancel the study altogether is quite a blow, particularly as several Takeda drugs are set to meet their patent expiry in the next few years. But our current interest in the stock stems from an ability for Takeda to build on its operational scale and reduce costs as new formulations marginally extend the life cycle of top, existing drugs. We also note the firm's distribution capabilities, as it has been a key partner in distributing COVID vaccines within its home country.

No doubt, this is a big setback, and our Target Price has been cut to $22, though we note that annual revenue for Takeda is in the $30 billion range. After the recent selling, TAK trades at around 10 times expected fiscal 2022 EPS and offers a net dividend yield near 5%.

Shares of **Acuity Brands** (AYI – $202.83) lit up by more than 16% last week on the strength of a very favorably received fiscal Q4 earnings report. The lighting and lighting control systems concern generated $992.7 million of net sales for the period, an increase of 11% on a year-over-year basis. The company earned $3.27 per share in the quarter, as gross margins expanded 10 basis points, pushing full-year EPS to $10.17, a 23% improvement over 2020.

CEO Neil Ashe commented, "In the face of a challenging global environment, we have demonstrably improved our company and its performance. We have demonstrated our ability to grow sales through innovation and our ability to service our customers. We have improved our

gross profit margins through product and productivity improvements. We have improved our operating profit margin by leveraging our costs. We have allocated capital efficiently through reinvestment in the business, acquisitions and share repurchase. We have the talent and the tools to build upon the operating strength we have developed over the last 18 months. As we look forward, we expect to continue this performance. We are strategically positioned at the intersection of sustainability and technology. We have assembled a world-class team. We have demonstrated the ability to both build and acquire businesses. We have strong organic cash generation, and we have demonstrated that we know what to do with it to create value."

CFO Karen Holcomb added, "This is a complicated global environment and input costs have been changing frequently. For example, freight costs. I'd like to use this as a window into how we are managing these challenges. We balance our long-term freight contracts, which are at favorable cost with additional capacity at current cost to deliver high levels of service to our customers. We have passed along some of these costs through price increases, and we are balancing delivering on our margin expectations and delivering on our most important promise, which is to be the company which our customers can rely upon. As we head into 2022, we are confident in our businesses and in our team. We expect ABL to grow net sales in the high single digits for the full year of 2022. We expect ISG to deliver net sales growth in the mid-teens. We expect a 42%-plus annualized gross profit margin for the full year of 2022, and we believe we can continue to leverage our operating costs as we increase net sales."

We continue to appreciate the financial flexibility built into Acuity's business model, which allows it to scale with prevailing demand while a strong competitive position allows it to defend margins through price increases despite increasing costs.

We like AYI's product and productivity improvements, and we are optimistic about the several channels for growth the company has on the horizon. While the divided yield is small, management has been opportunistic with its share repurchase program, buying back 3.8 million of outstanding shares at an average price of $114 in fiscal 2021, with 3.8 million shares still remaining under the current authorization. We have boosted our Target Price to $242.

Shares of hard-disk-drive (HDD) maker **Seagate Technology PLC** (STX – $79.73) dropped more than 5% last week after the company was downgraded by an analyst at Morgan Stanley. The analyst shifted views on the overall hardware stock peer group to "cautious" and whacked the twelve-month target price from $118 to $88. While the industry's outlook at Morgan Stanley seems to have dimmed a bit, we think Seagate can continue to grow earnings at an above-GDP rate as cloud computing continues to grow in importance and scale.

There are 27 analysts that cover STX, 12 have "Buy" ratings and 15 are "Holds" with an average target of $101, so there are plenty of fans still out there. We also note that Morgan Stanley said that it was bullish on the long-term outlook for STX and the HDD industry, as greater than 50% of HDD revenue and capacity shipments are now to secularly growing end markets such as Cloud and VIA. As a group, analysts expect STX to earn more than $9 in fiscal 2024, compared with less than $5 in 2020, which pencils out to a 2024 P/E ratio under 9 times, to go along with the current dividend yield of 3.4%. Our Target Price, which is much longer in time horizon than a typical sell-side analyst, is $114.

Shares of **Pinnacle West Capital** (PNW – $66.58) took a 7.5% haircut last week after the Arizona Corporation Commission (ACC) proposed a reduction in the allowable return on equity from 10% (as requested by management) to 8.7% for the company's Arizona Public Service (APS) utility. The announcement came after three days of debate between the five commissioners, which are elected officials, about dozens of proposed amendments that also involve recovery of $400 million PNW spent on pollution controls for the Four Corners coal plant. Those costs are a result of previous penalties incurred from a settlement over suspected violations of the Clean Air Act. Pinnacle bought the site from Southern California Edison in 2013 but has expressed plans to significantly reduce the plant's capacity by late 2023 before ultimately retiring it by 2031. The firm is seeking to recover the cost of foregoing the remaining seven years of planned operation under the agenda set forth by previous management.

We reached out to the firm's investor relations given the lack of a public comment despite the news prompting multiple sell-side analyst downgrades and revised earnings estimates. Management responded, "The ACC has not voted on a final decision. They voted on amendments to the Recommended Opinion and Order and will be reconvening on Oct 26-27 for more discussion on additional amendments and will have a final decision after that." Subsequently, PNW stated, "This is a shortsighted outcome that will make it significantly more difficult for APS to attract the investment necessary to build new infrastructure to support economic growth."

We respect that there will likely be room to appeal but we have to accept that a more favorable outcome related to allowable returns may have to wait several years until the next rate cycle. Of course, it was interesting to hear Lea Marquez Peterson, chairwoman of the ACC, say that she was the lone commissioner who dissented on the return on equity proposal, which she estimated would be one of the lowest in the country for a utility the size of APS. Ms. Marquez Peterson noted, "There certainly was a desire to penalize APS."

On top of the rate case decision seemingly going against the company, PNW has its work cut out to make up for many years of alleged control over the ratemaking board through purportedly dark campaign contributions. For his part, new CEO Jeffrey Guldner has pledged not to spend money on political campaigns for the ACC. And despite some two decades of fighting renewable mandates, as energy storage costs have fallen in recent years, PNW has implemented its own goal to achieve 100% clean energy by 2050. We applaud the move as bipartisan political demands for the same have only intensified in recent years and as the changes required to meet such a goal will likely require multiple decades.

Taking into consideration that the analyst community is now thinking EPS will likely fall below $5.00 in 2022 and 2023, before rebounding above that figure in 2024, we think the decline in the stock has been overdone, especially as the shares now yield a very generous 5.0%. PNW should benefit from what we believe to be rapid long-term growth potential in the Phoenix metropolitan area that is bolstered by major corporations (Microsoft, Intel, TSMC and others) committing to building infrastructure in the state. Further, the company managed to blow away earnings expectations in the second quarter thanks to record heat during the month of June. We have cut our Target Price for PNW to $96, but we retain our long-term optimism for the total return potential of the investment.