Market Commentary Monday, July 11, 2022

July 10, 2022

EXECUTIVE SUMMARY

Newsletter Trades – 7 Buys for 4 Portfolios
Market Week – Growth Tops Value
GameStop Zaniness – Short-Term Stock Movements Don't Always Make Sense
Rising Interest Rate Regimes – More Favorable for Value
Economy – Outlook Improved Last Week
Inflation – Equities Historically a Good Hedge
Fed Speak – Fed Funds Rate Likely to Rise 75 Basis Points this Month, but Economy Can Handle
Recession – Odds Favor GDP Growth, but Stocks Historically Have Performed OK in Economic Contractions
Sentiment – Mr. Market is Depressed
Stock News – Updates on XOM & Bank Stress Tests

Market Review

As discussed in the July edition of *The Prudent Speculator*, we bough the following on Wednesday morning, July 6, for our two real-money portfolios.

TPS Portfolio
675 **Civita Resources** (CIVI – $50.62) at $46.735 per share

Buckingham Portfolio
314 **Hewlett Packard Enterprise** (HPE – $13.19) at $12.6948
19 **PNC Financial** (PNC – $161.38) at $159.87

In our two hypothetical accounts, we added the following, also on Wednesday morning, July 6.

Millennium Portfolio
234 **Dick's Sporting Goods** (DKS – $83.95) at $80.88
185 **Verizon** (VZ – $50.49) at $51.42

PruFolio
45 **Whirlpool** (WHR – $160.81) at $161.65
121 **Zimmer Biomet** (ZBH – $105.34) at $106.65

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While the average member of the Russell 3000 index still has a negative total return of 19.6% on the year and the small-cap Russell 2000 index remains in Bear territory, the equity markets

enjoyed a positive week for a change. Of course, the Growth indexes significantly outperformed Value last week, though the year-to-date race remains decidedly in favor of less expensively priced stocks.

THE PRUDENT SPECULATOR

MARKET OF STOCKS – INDEXES CAN HAVE WIDE DISPERSION IN RETURNS

While the S&P 500 is off *only* 17.5% year-to-date, the Russell 2000 SmallCap index ended the latest week below the Bear Market (down 20% on a closing basis) threshold as traders continue to fret about the war in Ukraine, inflation, comments from the Federal Reserve, economic statistics and weaker-than-expected guidance on corporate profits. While there are no awards for the sizable losses on Value this year, inexpensive stocks have held up better than Growth, not unlike the Bursting of the Tech Bubble in 2000.

Total Returns Matrix

2000	2001		Last Week	YTD	Last 12 Months	Since 10.31.20	Last 2 Years	Since 3.23.20	Last 3 Years	Last 5 Years	Name	Symbol
-4.85	-5.44	M	0.82	-12.84	-7.18	22.25	25.03	76.48	24.60	63.33	Dow Jones Industrial Average	DJITR Index
1.01	-10.21	A	0.09	-13.56	-8.31	22.54	26.94	76.28	19.92	41.45	New York Stock Exchange Composite	NYA Index
-39.18	-20.81	R	4.58	-25.31	-19.49	8.02	12.58	72.64	47.48	98.44	Nasdaq Composite Index	CCMP Index
-22.43	-9.23	K	3.86	-26.12	-28.16	-2.27	4.33	58.15	9.58	32.14	Russell 2000 Growth	RU20GRTR Index
22.83	14.02	E	0.99	-15.24	-10.73	39.99	53.53	104.32	23.05	30.28	Russell 2000 Value	RU20VATR Index
-3.02	2.49	T	2.43	-20.66	-19.76	17.23	26.79	81.33	17.63	33.23	Russell 2000	RU20INTR Index
-11.75	-20.15		3.35	-27.68	-25.78	-3.09	2.65	60.73	17.32	60.29	Russell Midcap Growth Index Total Return	RUMCGRTR Index
19.18	2.33		0.41	-14.68	-7.25	30.65	40.98	99.71	22.84	38.64	Russell Midcap Value Index Total Return	RUMCVATR Index
8.25	-5.62	O	1.44	-19.31	-14.11	17.86	26.34	86.78	23.46	51.26	Russell Midcap Index Total Return	RUMCINTR Index
-22.42	-19.63	F	3.75	-24.72	-16.96	9.97	15.16	76.47	44.58	98.04	Russell 3000 Growth	RU30GRTR Index
8.04	-4.33		0.39	-11.68	-4.88	31.15	36.73	83.31	22.95	42.79	Russell 3000 Value	RU30VATR Index
-7.46	-11.46	S	2.07	-18.55	-11.18	19.97	25.36	80.99	35.09	70.68	Russell 3000	RU30INTR Index
9.64	-0.39	T	0.84	-14.92	-6.80	31.45	39.22	98.76	33.84	63.78	S&P 500 Equal Weighted	SPXEWTR Index
-9.10	-11.89		1.98	-17.52	-8.42	22.31	26.81	80.67	37.77	75.83	S&P 500	SPXT Index
-22.08	-12.73	O	4.24	-23.93	-13.81	14.67	19.74	79.45	44.18	97.23	S&P 500 Growth	SPTRSGX Index
6.08	-11.71	C	-0.10	-10.37	-2.85	30.79	34.10	77.85	27.07	49.87	S&P 500 Value	SPTRSVX Index
3.18	1.57	K	-1.12	-14.49	-16.42	-15.92	-14.12	-8.36	-9.56	-2.66	Bloomberg Barclays Global-Aggregate Bond	LEGATRUU Index
11.63	8.44	S	-0.87	-10.59	-11.24	-10.99	-11.17	-6.34	-2.99	4.55	Bloomberg Barclays U.S. Aggregate Bond	LBUSTRUU Index

As of 07.08.22. Source Kovitz using data from Bloomberg

No doubt, short-term price movements often are difficult to rationalize, with GameStop a perfect example. Shares of the money-losing meme-stock darling soared more than $17 on Thursday after management announced a 4-for-1 stock split, yet they gave back only $6 and change on Friday when the specialty retailer fired its CFO and laid off numerous employees as part of its latest turnaround plan. Most investors understand that a stock split in and of itself changes nothing about the value of a business, but letting go of a CFO is seldom viewed positively, while job cuts do not exactly inspire confidence in the future for a momentum-investor favorite.

THE PRUDENT SPECULATOR

SPECIALTY RETAIL – UNPROFITABLE GAMESTOP VS. THREE TPS SELECTIONS

GME Price: $128.54 Target: #N/A P/E: -21.: NTM P/E: -23.6

GameStop Corporation operates specialty electronic game and PC entertainment software stores. The Company stores sell new and used video game hardware and software, as well as accessories. GameStop markets its products worldwide.

ANNUAL EPS

	#	Mean	Low	High	Y-o-Y Mean Growth
01/22 Y	4	-$1.69	-$2.32	-$1.22	
01/23 Y	3	-$6.19	-$6.75	-$5.20	265.7%
01/24 Y	2	-$3.54	-$4.00	-$3.08	-42.8%
01/25 Y	0	#N/A N/A	#N/A N/A	#N/A N/A	#VALUE!
LTM		*-$6.09*			
NTM		*-$5.46*			

ANNUAL SALES ($millions)

	#	Mean	Low	High	Y-o-Y Mean Growth
01/22 Y	4	$6,026	$5,864	$6,200	
01/23 Y	3	$6,534	$6,396	$6,772	8.4%
01/24 Y	2	$6,720	$6,627	$6,812	2.8%
01/25 Y	0	#N/A N/A	#N/A N/A	#N/A N/A	#VALUE!
LTM		*$6,112*			
NTM		*$6,576*			Market Cap: $9,756

DKS Price: $83.95 Target: $129.24 P/E: 5.7 NTM P/E: 7.5

Dick's Sporting Goods, Inc. operates as a sporting goods retailer that manages stores primarily in the eastern and central United States. The Company owns stores that offers a broad selection of brand name sporting goods equipment, apparel, and footwear.

ANNUAL EPS

	#	Mean	Low	High	Y-o-Y Mean Growth
01/22 Y	20	$15.57	$14.98	$15.76	
01/23 Y	24	$11.05	$9.15	$13.37	-29.0%
01/24 Y	21	$11.48	$8.48	$13.50	3.9%
01/25 Y	13	$12.31	$9.01	$14.28	7.2%
LTM		*$14.76*			
NTM		*$11.17*			

ANNUAL SALES ($millions)

	#	Mean	Low	High	Y-o-Y Mean Growth
01/22 Y	21	$12,250	$12,062	$12,353	
01/23 Y	21	$11,893	$11,436	$12,536	-2.9%
01/24 Y	19	$12,161	$11,688	$12,800	2.3%
01/25 Y	12	$12,495	$11,712	$12,939	2.8%
LTM		*$12,075*			
NTM		*$11,883*			Market Cap: $6,549

FL Price: $25.56 Target: $58.60 P/E: 3.4 NTM P/E: 6.1

Foot Locker, Inc. retails footwear. The Company offers athletics footware, apparel, and equipment for men, women, and kids. Foot Locker serves customers worldwide.

ANNUAL EPS

	#	Mean	Low	High	Y-o-Y Mean Growth
01/22 Y	18	$7.54	$7.13	$7.74	
01/23 Y	21	$4.41	$3.53	$4.69	-41.5%
01/24 Y	18	$4.32	$3.37	$5.16	-2.0%
01/25 Y	12	$4.76	$3.45	$6.72	10.1%
LTM		*$7.41*			
NTM		*$4.17*			

ANNUAL SALES ($millions)

	#	Mean	Low	High	Y-o-Y Mean Growth
01/22 Y	19	$8,942	$8,706	$9,024	
01/23 Y	20	$8,440	$8,085	$8,616	-5.6%
01/24 Y	17	$8,255	$7,515	$8,997	-2.2%
01/25 Y	13	$8,325	$7,595	$9,178	0.9%
LTM		*$8,980*			
NTM		*$8,340*			Market Cap: $2,536

KSS Price: $29.17 Target: $60.72 P/E: 4.5 NTM P/E: 6.0

Kohl's Corporation operates a chain of family-oriented department stores. The Company's stores feature apparel, footwear and accessories for women, men and children; soft home products such as sheets and pillows; and housewares targeted to middle income customers. Kohl's also offers online shopping as well as offers store credit cards.

ANNUAL EPS

	#	Mean	Low	High	Y-o-Y Mean Growth
01/22 Y	16	$7.26	$7.07	$7.66	
01/23 Y	15	$4.88	$2.48	$6.80	-32.8%
01/24 Y	15	$5.36	$3.20	$7.45	9.7%
01/25 Y	8	$6.07	$2.90	$8.00	13.2%
LTM		*$6.44*			
NTM		*$4.84*			

ANNUAL SALES ($millions)

	#	Mean	Low	High	Y-o-Y Mean Growth
01/22 Y	5	$18,730	$18,471	$19,006	
01/23 Y	7	$17,865	$17,235	$18,602	-4.6%
01/24 Y	7	$18,082	$17,455	$19,216	1.2%
01/25 Y	5	$18,363	$17,445	$19,211	1.6%
LTM		*$19,261*			
NTM		*$18,203*			Market Cap: $3,734

We realize that many traders care far more about the story than the profitability of the businesses in which they invest, but we will continue to focus our attention on businesses with a proven ability to generate the right color ink, especially when they trade for single-digit P/E ratios.

While GameStop is an extreme case of a stock that should have moved opposite to what happened, we also would argue that Growth should not have performed so well, given the rise in interest rates,…

THE PRUDENT SPECULATOR

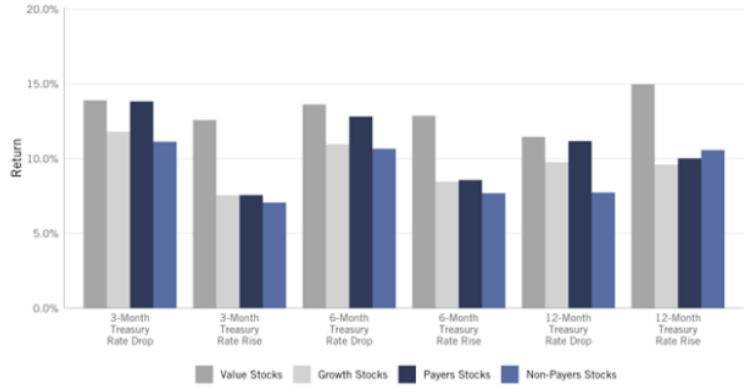
TREASURY YIELD JUMPS IN A RISK-ON WEEK FOR RISK ASSETS

We understand that traders are doing their best to balance comments from Federal Reserve officials with the latest economic statistics, but the odds of recession were reduced last week, arguably increasing the chances of a quicker pace of tightening from Jerome H. Powell & Co. and sending the yield on the 10-Year U.S. Treasury up from 2.88% to 3.08%.

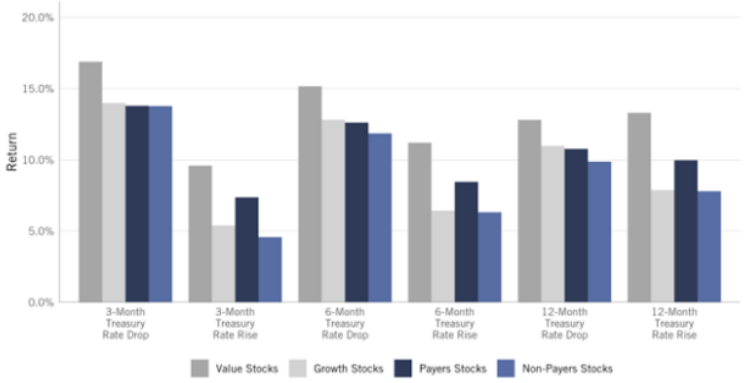
…and the historical propensity for Value to assert its propensity for outperformance when government bond yields are climbing.

THE PRUDENT SPECULATOR

10-YEAR TREASURY Δ AND VALUE/GROWTH & DIV/NO DIVS



From 06.30.27 through 04.30.22. Concurrent annualized 12-month returns. SOURCE: Kovitz using data from Bloomberg Finance L.P. and Professors Eugene F. Fama and Kenneth R. French



From 06.30.27 through 04.30.22. Subsequent annualized 12-month returns. SOURCE: Kovitz using data from Bloomberg Finance L.P. and Professors Eugene F. Fama and Kenneth R. French

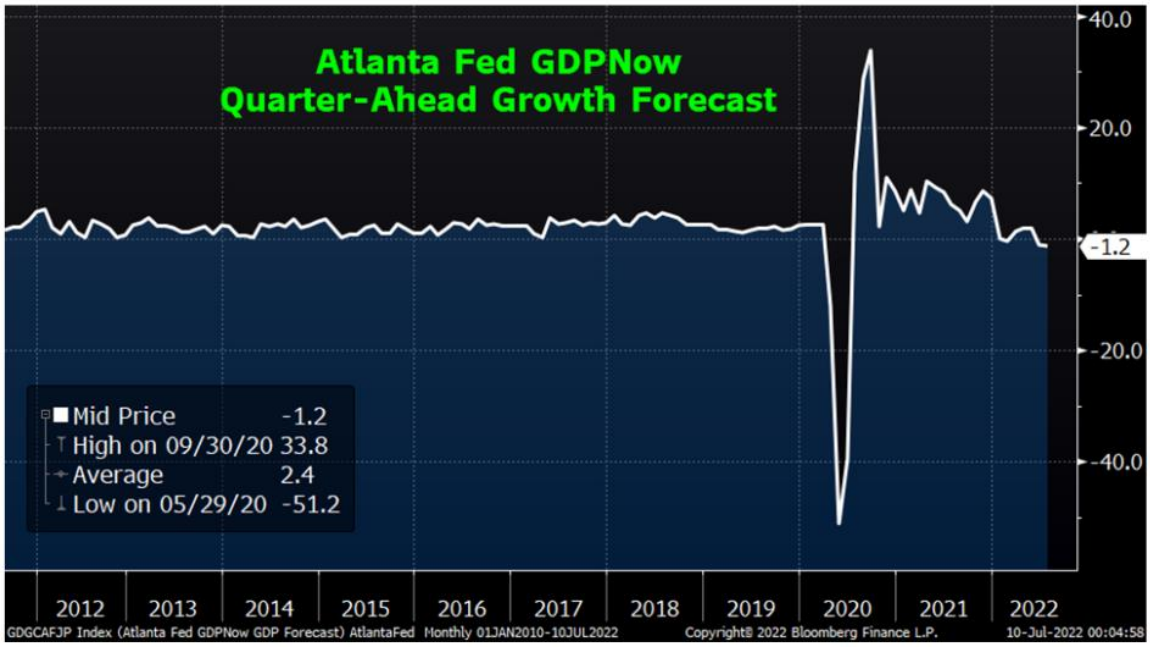
Many think rising interest rates will prove to be a big headwind for equities, but nine decades of returns data show that stocks in general have performed admirably on average, both concurrent with and subsequent to increases (as well as decreases) in the yield on the 10-Year U.S. Treasury over 3-, 6-, and 12-month time spans, with Value Stocks leading the charge no matter the direction.

Four trading days does not a trend make, but the fact that the Atlanta Fed's GDPNow forecast for second quarter growth improved last week from a 2.1% contraction to a 1.2% contraction should also have been a positive for Value stocks, many of which are economically sensitive.

THE PRUDENT SPECULATOR

Q2 U.S. GDP GROWTH PROJECTION IMPROVED LAST WEEK

Q1 2022 saw a 1.6% contraction in real (inflation-adjusted) GDP growth, as the Omicron variant, supply-chain difficulties, the war in Ukraine and inflation impacted the economy, and the Atlanta Fed's current projection for Q2 2022 real GDP growth on an annualized basis stands at a 1.2% contraction.

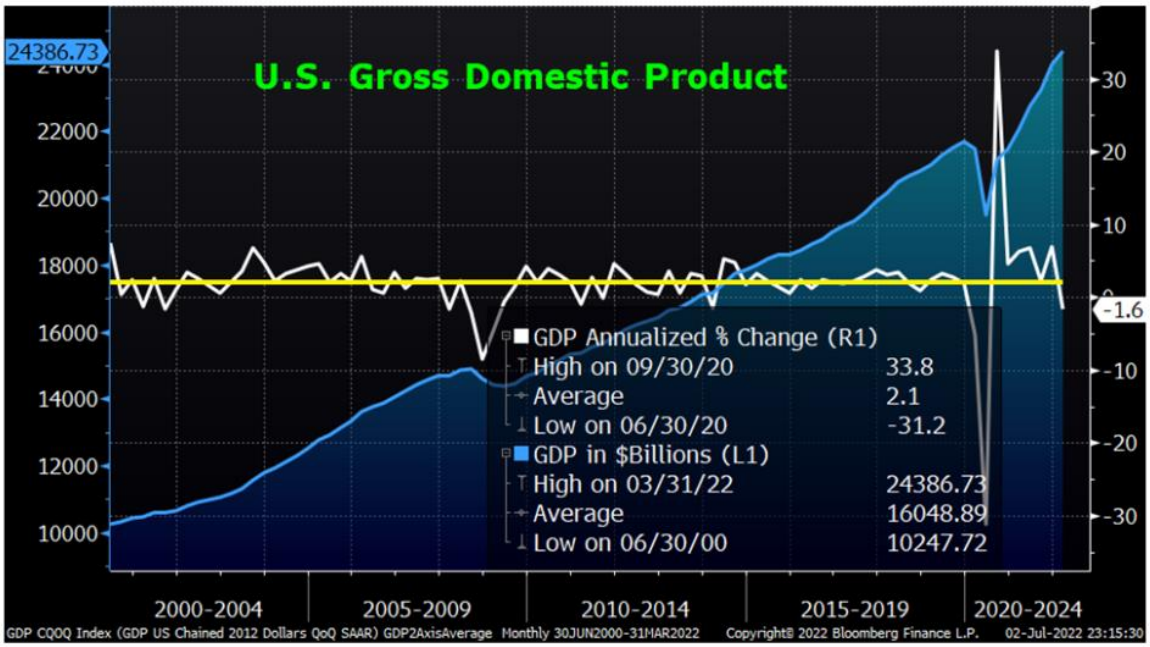


Obviously, negative economic growth for Q2 is nothing to get excited about, especially when it would follow the 1.6% drop in real (inflation-adjusted) GDP in Q1, but we continue to think the terrific nominal growth should not be ignored,…

THE PRUDENT SPECULATOR

HUGE 10.6% JUMP IN NOMINAL GDP, BUT REAL GDP CONTRACTS BY 1.6%

First quarter 2022 real (inflation-adjusted) domestic economic growth came in much weaker than expected at a 1.6% contraction on an annualized basis, even as the current-dollar nominal GDP figure of $24.4 trillion soared by 10.6% on an annualized basis to an all-time high.



…and we note that, historically speaking, Value stocks have been a terrific hedge against high inflation.

WSJ
THE WALL STREET JOURNAL WEEKEND
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The Age of Emotional OVERSTATEMENT
REVIEW

Eyes on Summer Beauty
OFF DUTY

What's News
World-Wide

Business & Finance

Inflation Hits Four-Decade High

U.S. consumer-price index, change from a year earlier

Change from a year earlier in consumer-price index for select items in May compared with the biggest historical change

Market expectation for the number of quarter-point Fed rate increases in 2022

Energy and food costs rose sharply in May; consumer sentiment sours on economy

By Owen Gollerd

U.S. consumer inflation reached its highest level in more than four decades in May as surging energy and food costs pushed prices higher, with little indication of when the upward trend could ease.

The Labor Department on Friday said that the consumer-price index increased 8.6% in May from the same month a year ago, marking its fastest pace since December 1981. That was also up from April's CPI reading, which was slightly below the previous 40-year high reached in March. The CPI measures what consumers pay for goods and services.

May's increase was driven in part by sharp rises in the prices for energy, which rose 34.6% from a year earlier, and groceries, which jumped 11.9% on the year, the biggest increase since 1979. But inflation pressures were distinctly broad-based in May, said Sarah Hense, senior economist at Wells Fargo Securities.

"Given everything from the implications of the Russian invasion of Ukraine, the Chinese lockdowns and just the sheer appetite for travel...what we've seen is the perfect storm of those factors hitting, along with some major refinery closures," she said. "Inflationary pressures were seen nearly everywhere."

The inflation news hit stock and bond prices, with investors' fearing the Federal Reserve could be forced to act more aggressively to tame surging price increases.

Prices for used cars and

Please turn to page A4

Stocks Retreat on Fears That Fed Will Need to Make Drastic Moves

By Sam Goldfarb, Hardika Singh and Caitlin Ostroff

A fresh inflation shock hammered stock and bond prices anew, heightening investors' fears that the Federal Reserve could be forced into more drastic action to tame surging consumer-price increases.

Declines hit across the board, with rising interest-rate expectations increasing worries about the possibility of recession. The Dow Jones Industrial Average fell 880 points, or 2.7%, to 31392.74. Technology shares slid along with banks and consumer stocks, sending the S&P 500 down 116.96 points, or 2.9%, to 3900.86, and the Nasdaq Composite tumbling 414.30 points, or 3.5%, to 11340.02. All three indexes declined for a second consecutive week.

Investors also dumped U.S. Treasurys, driving the yield on the two-year note—which tends to climb with investors' increases—to its highest level in more than a decade.

The moves came after new data wounded investors' hopes that easing supply-chain bottlenecks and rising borrowing costs could help precipitate a relatively rapid decline in inflation over the summer without the Fed needing to signal more-aggressive interest-rate increases than already anticipated.

Heading into Friday, various market gauges had indicated investors expected the Fed to mark short-term interest rate by half a percentage point next week and in July. After the report, investors priced in another such increase in September, and speculation about a three-quarter point increase as soon as next week—a step the Fed hasn't taken since 1994—was renewed on Wall Street.

"Given the high level of uncertainty with regards to the Fed's path of interest-rate increases, it's hard to pound the table and say buy stocks," said Erik Knutzen, chief investment

◆ Data is seen fueling push on rate increases A4
◆ Heard on the Street: Inflation

Inflation Rate >= 8.0% and Ensuing Value/Growth Returns Since 1927

Metric	Value Stocks 3 Month	Growth Stocks 3 Month	Value Stocks 6 Month	Growth Stocks 6 Month	Value Stocks 12 Months	Growth Stocks 12 Months
Arithmetic Average	4.2%	2.4%	10.4%	6.0%	25.1%	15.1%
Geometric Average	3.6%	1.8%	8.9%	4.6%	22.2%	12.8%
Median	3.8%	1.7%	6.7%	4.7%	17.7%	12.8%
Max	50.9%	32.9%	82.7%	60.8%	134.0%	64.2%
Min	-19.2%	-27.6%	-26.4%	-35.9%	-20.9%	-30.6%
Count	110	110	110	110	110	110

Source: Kovitz using data from Ibbotson Associates 06.30.27 - 4.30.22.

Inflation Rate <8.0% and Ensuing Value/Growth Returns Since 1927

Metric	Value Stocks 3 Month	Growth Stocks 3 Month	Value Stocks 6 Month	Growth Stocks 6 Month	Value Stocks 12 Months	Growth Stocks 12 Months
Arithmetic Average	4.2%	3.1%	8.1%	6.1%	16.4%	12.3%
Geometric Average	3.1%	2.4%	6.2%	4.8%	12.3%	9.4%
Median	4.0%	3.5%	8.0%	6.2%	16.6%	12.8%
Max	200.5%	136.1%	244.7%	140.3%	357.8%	221.9%
Min	-43.1%	-40.4%	-56.1%	-47.0%	-71.3%	-64.8%
Count	1027	1027	1024	1024	1018	1018

Source: Kovitz using data from Ibbotson Associates 06.30.27 - 4.30.22.

Inflation Rate >= 8.0% and Ensuing Value/Growth Returns Since 1957

Metric	Value Stocks 3 Month	Growth Stocks 3 Month	Value Stocks 6 Month	Growth Stocks 6 Month	Value Stocks 12 Months	Growth Stocks 12 Months
Arithmetic Average	4.0%	2.9%	8.8%	6.4%	22.4%	17.0%
Geometric Average	3.5%	2.2%	7.7%	4.6%	21.1%	14.4%
Median	4.7%	2.6%	6.9%	6.3%	21.7%	21.2%
Max	39.6%	32.9%	63.0%	60.8%	60.2%	63.4%
Min	-16.5%	-27.6%	-26.4%	-35.9%	-20.9%	-30.6%
Count	63	63	63	63	63	63

Source: Kovitz using data from Ibbotson Associates 03.31.57 - 04.30.22.

Inflation Rate < 8.0% and Ensuing Value/Growth Returns Since 1957

Metric	Value Stocks 3 Month	Growth Stocks 3 Month	Value Stocks 6 Month	Growth Stocks 6 Month	Value Stocks 12 Months	Growth Stocks 12 Months
Arithmetic Average	3.8%	2.9%	7.7%	5.8%	15.7%	11.8%
Geometric Average	3.3%	2.4%	6.7%	4.9%	13.7%	9.9%
Median	4.1%	3.3%	8.1%	6.1%	17.2%	12.7%
Max	37.8%	32.5%	68.5%	49.8%	105.8%	93.6%
Min	-39.5%	-34.9%	-54.2%	-41.7%	-52.2%	-48.0%
Count	716	716	713	713	707	707

Source: Kovitz using data from Ibbotson Associates 03.31.57 - 04.30.22.

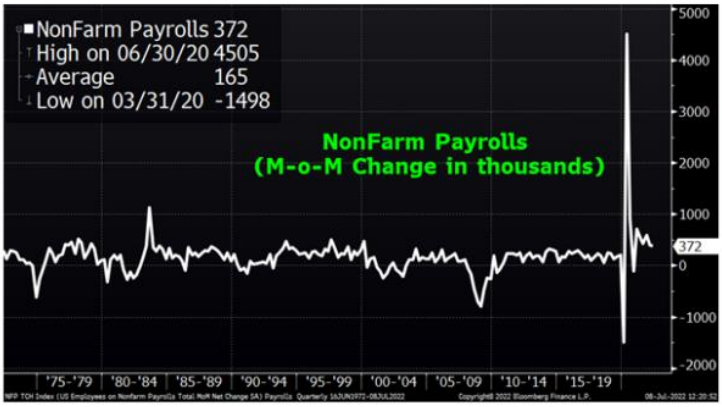
We also found statements that came out on Thursday St. Louis Federal Reserve President James Bullard interesting as he said that he doesn't see a U.S. recession on the horizon. "We've got a good chance of a soft landing here going forward," Mr. Bullard offered, arguing that though the economy is slowing, it is more to a 2% trend rate of growth after the strong 5.7% growth rate in 2021.

He pointed to gross domestic income – an alternate measure to the commonly-use GDP measure, indicating that it was positive in the first quarter of this year, even though GDP was down 1.6%, adding "Wall Street is talking a lot about recession – they're talking about two quarters of negative GDP growth. I'm not really getting that from anecdotal information like this."

Interestingly, the Bullard comments were made the day before the Labor Situation report was released on Friday, in which the number of jobs created for June came in well above expectations,…

THE PRUDENT SPECULATOR

VERY HEALTHY JOBS PICTURE

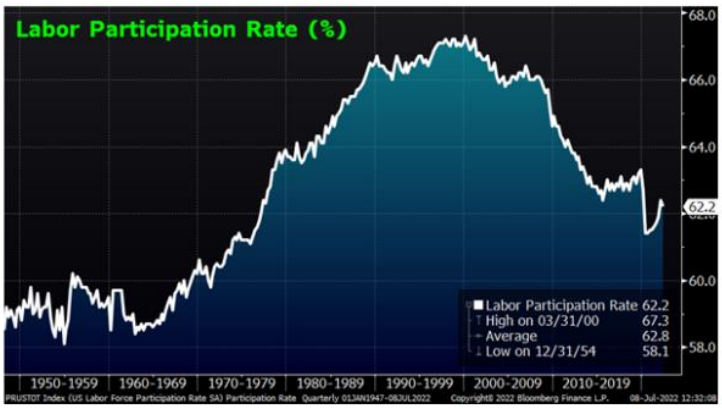


Economists were looking for a gain of 250,000 payrolls, so the increase of 372,000 in June was well above expectations, but the April and May tallies were revised lower by a combined 74,000 jobs, though this was the 14th straight month of job gains above 350,000. With strong demand for labor, wages continued to rise, though not as fast as in the month prior, as employers struggled to fill positions and the impact of the coronavirus pandemic continued to recede.

…and the unemployment rate held steady at a very low 3.6%, near a five-decade low.

THE PRUDENT SPECULATOR

PANDEMIC LOW JOBLESS RATE & NEAR PANDEMIC HIGH PARTICIPATION RATE



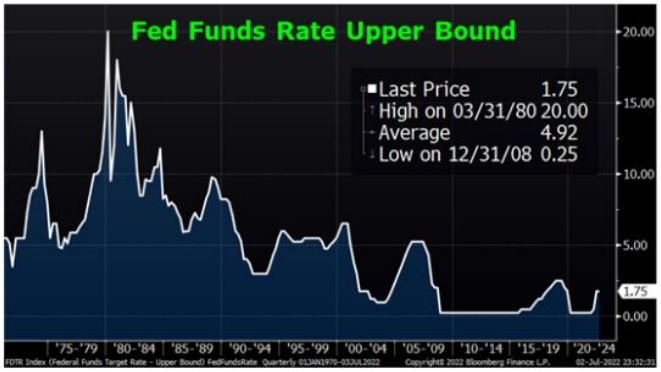
Despite more jobs created than expected, the unemployment rate for June held steady at 3.6%, the same as April, but down from 3.8% in February, with 353,000 fewer folks in the labor force, lowering the denominator in the jobless percentage calculation. The so-called participation rate inched up 0.1 points in June to 62.2%, near the highest level since the beginning of the pandemic, but well below levels witnessed over the past four decades.

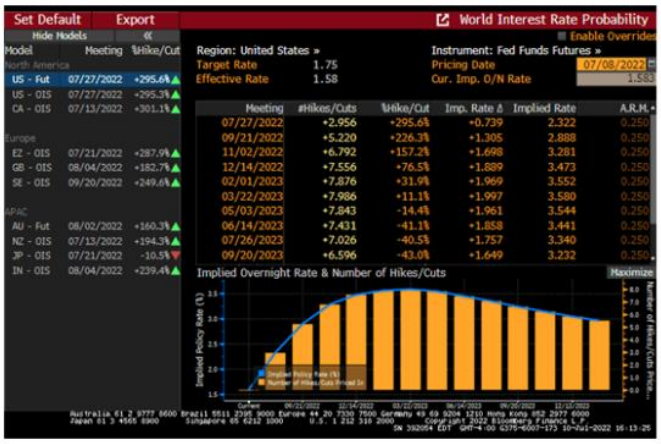
Despite the good news on the jobs front, Atlanta Federal Reserve President Raphael Bostic said on Friday, “We’re starting to see those first signs of slowdown, which is what we need.” However, he was quick to add, “The tremendous momentum in the economy to me suggests that we can move at 75 basis points at the next meeting and not see a lot of protracted damage to the broader economy.”

THE PRUDENT SPECULATOR

FED FIGHTING INFLATION – INTEREST RATES STILL HISTORICALLY VERY LOW

Although the estimate for GDP growth this year was pared to 1.7%, down from 2.8% in December, the Federal Reserve lifted its target for the Fed Funds rate by 75 basis points at the June FOMC meeting. Jerome H. Powell & Co. now project that the Fed Funds rate will likely end the year at 3.5%, though this still would be below the historical average. The Fed Funds futures are currently of a similar mind in terms of the number of hikes expected over the balance of the year, with the expectation that rates will be cut starting in May 2023.





For his part, Federal Reserve Governor Chris Waller, while talking tough on inflation, added on Thursday, “I personally think that some of the fears of a recession are kind of overblown.” This view is backed up by the current Bloomberg consensus prognostication,…

THE PRUDENT SPECULATOR

PLENTY OF DOOM & GLOOM TALK, BUT ODDS OF RECESSION 'ONLY' 33%

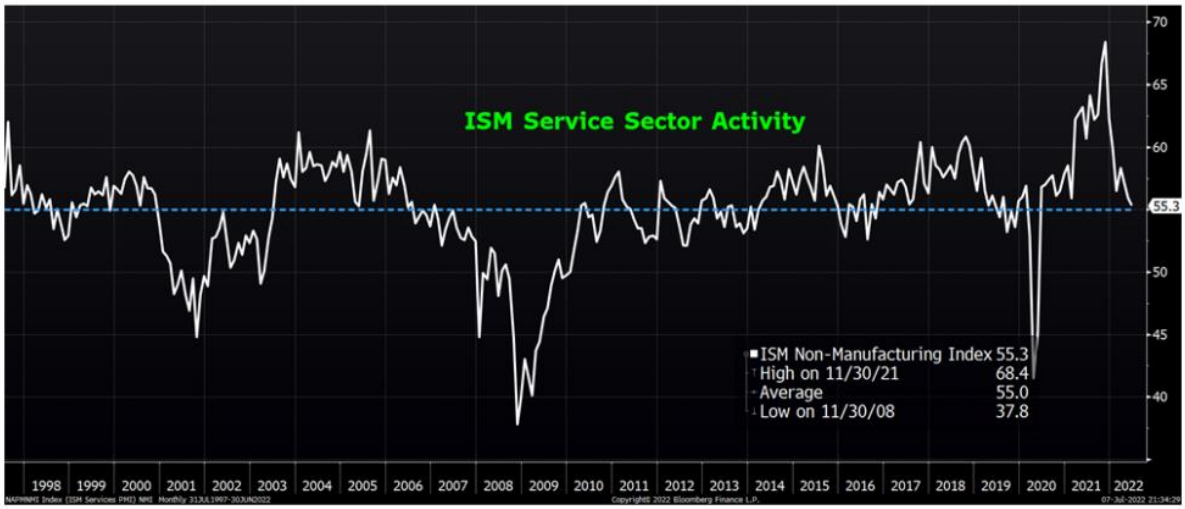
Certainly, the 1.6% contraction in Q1 2022 real (inflation-adjusted) GDP puts the economy half-way to the declaration of a recession, but the odds of such an event happening stand today at 33%, a figure that is elevated but the historical average probability has been 21.2%.

…along with the latest better-than-expected read on the health of the important services sector of the economy,…

THE PRUDENT SPECULATOR

ISM NON-MANUFACTURING FALLS: 1.9% ANNUALIZED GDP GROWTH

Soaring inflation and supply chain issues not helping matters, the latest read on the health of the service sector dipped to 55.3 in June. The figure was better than expected and is above average, suggesting a still-healthy non-manufacturing economy. The Institute for Supply Management stated, "The past relationship between the Services PMI and the overall economy...corresponds to a 1.9% increase in real gross domestic product (GDP) on an annualized basis."



…not to mention the Fed's own projections offered last month.

THE PRUDENT SPECULATOR

FED: HIGHER INFLATION AND FED FUNDS & LOWER GDP GROWTH EXPECTED

With the invasion of Ukraine by Russia, along with supply chain imbalances from the pandemic and broader price pressures adding to current and expected inflation numbers, Federal Reserve members have sharply increased their estimates for PCE inflation and their targets for the Fed Funds rate. The median inflation projection for 2022 now stands at 5.2% with the year-end forecast for the Fed Funds rate climbing to 3.4%, up from the prior 1.9% estimate offered in March.

Table 1. Economic projections of Federal Reserve Board members and Federal Reserve Bank presidents, under their individual assumptions of projected appropriate monetary policy, June 2022

Percent

Variable	Median[1]				Central Tendency[2]				Range[3]			
	2022	2023	2024	Longer run	2022	2023	2024	Longer run	2022	2023	2024	Longer run
Change in real GDP	1.7	1.7	1.9	1.8	1.5–1.9	1.3–2.0	1.5–2.0	1.8–2.0	1.0–2.0	0.8–2.5	1.0–2.2	1.6–2.2
March projection	2.8	2.2	2.0	1.8	2.5–3.0	2.1–2.5	1.8–2.0	1.8–2.0	2.1–3.3	2.0–2.9	1.5–2.5	1.6–2.2
Unemployment rate	3.7	3.9	4.1	4.0	3.6–3.8	3.8–4.1	3.9–4.1	3.5–4.2	3.2–4.0	3.2–4.5	3.2–4.3	3.5–4.3
March projection	3.5	3.5	3.6	4.0	3.4–3.6	3.3–3.6	3.2–3.7	3.5–4.2	3.1–4.0	3.1–4.0	3.1–4.0	3.5–4.3
PCE inflation	5.2	2.6	2.2	2.0	5.0–5.3	2.4–3.0	2.0–2.5	2.0	4.8–6.2	2.3–4.0	2.0–3.0	2.0
March projection	4.3	2.7	2.3	2.0	4.1–4.7	2.3–3.0	2.1–2.4	2.0	3.7–5.5	2.2–3.5	2.0–3.0	2.0
Core PCE inflation[4]	4.3	2.7	2.3		4.2–4.5	2.5–3.2	2.1–2.5		4.1–5.0	2.5–3.5	2.0–2.8	
March projection	4.1	2.6	2.3		3.9–4.4	2.4–3.0	2.1–2.4		3.6–4.5	2.1–3.5	2.0–3.0	
Memo: Projected appropriate policy path												
Federal funds rate	3.4	3.8	3.4	2.5	3.1–3.6	3.6–4.1	2.9–3.6	2.3–2.5	3.1–3.9	2.9–4.4	2.1–4.1	2.0–3.0
March projection	1.9	2.8	2.8	2.4	1.6–2.4	2.4–3.1	2.4–3.4	2.3–2.5	1.4–3.1	2.1–3.6	2.1–3.6	2.0–3.0

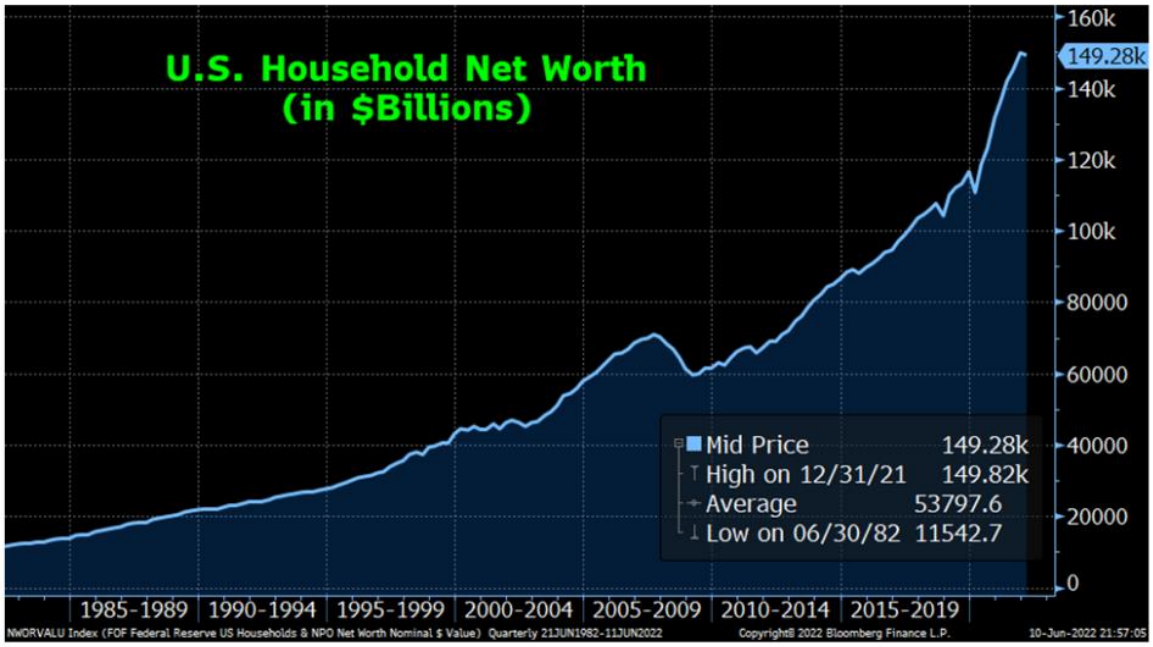
Source: Federal Reserve, June 15, 2022

We also can't forget that household balance sheets generally are in great shape, with *The Wall Street Journal* pointing out last week, "Households are flush with cash, too. At the end of the first quarter, they had $18.5 trillion in checking accounts, savings accounts and money market mutual funds, according to Fed data. That was up from $13.3 trillion before the pandemic, boosted in part by several rounds of relief checks sent to households in the past two years."

THE PRUDENT SPECULATOR

CONSUMER BALANCE SHEETS BETTER OFF TODAY THAN PRE-PANDEMIC

While Q1 2022 did see a small decline to $149.3 trillion, down from $149.8 trillion in Q4 2021, as gains in home values could not offset declines in equity values, household balance sheets were in terrific shape, with net worth some $30 trillion above pre-pandemic levels.



Certainly, Jerome H. Powell & Co. could be wrong about avoiding recession, but were such an event to occur, it is comforting that, on average, it has not been a reason to abandon equities, especially for those who share our long-term time horizon,…

THE PRUDENT SPECULATOR

EQUITY RETURNS AND RECESSIONS (PRE AND POST) – FAMA FRENCH VALUE

As the saying goes, the stock market (and economists) has predicted nine of the last five recessions, but the 15 prior instances of actual negative economic growth illustrate that long-term-oriented investors (on average) should stay invested (in Value, preferably) no matter what.

U.S. Recession Commencement (per NBER) & Equity Returns
S&P 500 and Fama/French Value Performance

Year Prior S&P 500 TR	Year Prior FF Value TR	Recession Start Date	1 Year S&P 500 TR	1 Year FF Value TR	3 Year S&P 500 TR	3 Year FF Value TR	5 Year S&P 500 TR	5 Year FF Value TR	10 Year S&P 500 TR	10 Year FF Value TR	To Present S&P 500 TR	To Present FF Value TR
51.9%	30.6%	August 1929	-32.6%	-32.0%	-73.5%	-65.1%	-71.1%	-61.7%	-58.0%	-48.4%	303020%	7691191%
18.2%	42.0%	May 1937	-39.3%	-55.8%	-33.2%	-55.0%	-32.5%	-44.7%	53.7%	140.3%	563117%	7280957%
26.3%	56.8%	February 1945	26.0%	42.0%	12.0%	28.6%	64.3%	75.6%	379.2%	469.5%	405852%	3545492%
4.0%	4.8%	November 1948	19.2%	12.2%	101.8%	109.3%	145.2%	130.8%	542.0%	586.7%	329652%	2567450%
3.1%	4.7%	July 1953	31.9%	25.4%	128.9%	118.2%	136.5%	138.6%	308.5%	385.1%	136206%	1075797%
-1.2%	-0.3%	August 1957	10.0%	16.6%	40.2%	55.8%	55.1%	79.0%	188.9%	421.8%	62545%	508225%
-2.4%	-6.3%	April 1960	24.2%	29.5%	41.7%	51.9%	92.4%	130.9%	107.7%	270.1%	47101%	343527%
-8.4%	-20.9%	December 1969	3.9%	8.7%	41.4%	39.8%	-11.3%	-7.6%	77.0%	264.4%	20274%	86989%
-15.2%	-19.4%	November 1973	-23.8%	-14.8%	20.8%	77.2%	23.7%	142.2%	182.3%	716.8%	17128%	76043%
20.6%	30.5%	January 1980	19.5%	12.5%	49.5%	81.1%	102.4%	183.6%	342.4%	480.0%	10738%	21990%
13.0%	23.2%	July 1981	-13.3%	-0.7%	34.0%	78.2%	127.9%	199.8%	343.5%	405.4%	8653%	17224%
6.5%	-7.2%	July 1990	12.7%	10.0%	38.2%	75.2%	83.2%	125.3%	407.4%	436.7%	2124%	3670%
-21.7%	22.3%	March 2001	0.2%	13.1%	1.9%	34.3%	21.4%	83.7%	38.3%	85.6%	436%	492%
5.6%	-8.0%	December 2007	-37.0%	-36.5%	-8.3%	-7.8%	8.6%	4.2%	125.8%	116.4%	277%	214%
8.2%	-9.6%	February 2020	31.3%	39.0%							45%	65%
7.2%	**9.5%**	**Averages**	**2.2%**	**4.6%**	**28.2%**	**44.4%**	**53.3%**	**84.3%**	**217.0%**	**337.9%**	**127144%**	**1547955%**

Through 4.29.22.TR = Total Return. FF Value = Value Weighted Book to Market Portfolios - Blend of Small Value and Big Value.Source: Kovitz Investment Group using data from Bloomberg, Professors Eugene F. Fama & Kenneth R. French and the National Bureau of Economic Research

…while most expect only a mild recession in a worst case, meaning that there still should be a favorable backdrop for corporate profits, which are reported in nominal (and not inflation adjusted) dollars.

THE PRUDENT SPECULATOR

VERY GOOD EPS IN Q1 '22 AND '22/'23 ESTIMATES STILL REMAIN STRONG

Q1 earnings reporting season generally was terrific in terms of the results, even as many stocks sold off sharply on the news. And, while analysts are sometimes overly optimistic in their forecasts, EPS estimates for 2022, 2023 and 2024 call for significant growth versus 2021.

S&P 500 Earnings Per Share

Quarter Ended	Bottom Up Operating EPS 3 Month	Bottom Up Operating EPS 12 Month
ESTIMATES		
12/31/2023	$65.21	$248.21
9/30/2023	$63.62	$243.23
6/30/2023	$60.72	$238.72
3/31/2023	$58.66	$232.84
12/31/2022	$60.23	$223.54
9/30/2022	$59.11	$220.04
6/30/2022	$54.84	$212.95
ACTUAL		
3/31/2022	$49.36	$210.16
12/31/2021	$56.73	$208.21
9/30/2021	$52.02	$189.66
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

Source: Standard & Poor's. As of 7.7.22

None of this means that the upcoming Q2 earnings reporting season will be a positive for equities, but we continue to think that the awful second quarter for stock prices has discounted a significant amount of bad news that may not materials, while we are of the mind that the pessimism in the financial press,…

THE PRUDENT SPECULATOR

MISSING THE WHOLE STORY: SOME OF US HAVE BEEN INVESTING FOR YEARS

The New York Times

"All the News That's Fit to Print"

Late Edition

VOL. CLXXI ... No. 58,454 ... NEW YORK, TUESDAY, JUNE 14, 2022 ... $3.00

The Stock Market's Bears

TRUMP REBUFFED AIDES OVER LOSS, DENYING REALITY

Rantings by Giuliani Carried the Day

No Interest in 'Actual Facts,' Barr Says

Growing Economic Fears Drive Markets Into Bear Territory

Down 22% Since Jan. 3 — Economists Worry Pain May Linger

People with retirement accounts are keeping more of their assets in stocks now, as opposed to bonds or a mix of other investments. "There has been a growing complacency of people keeping most of their nest eggs in stocks," said Monique Morrissey, who specializes in retirement at the left-leaning think tank Economic Policy Institute. "There has been a fundamental misunderstanding — returns do not always average out."

The bigger issue, according to Ms. Morrissey, is that many people have gotten used to the stock market going up. That's not a guarantee — especially in the near term.

"It's not just the loss from January; it's what happens going forward," she said. "If you were counting on the amount that you have in your 401(k) to continually grow, well, then you may never get to what you had planned for." – *New York Times* 06.14.22

Certainly, we are not trying to downplay the equity market losses in 2022, but we are perplexed that the "I-Told-You-So" crowd seems to have forgotten how well stocks have performed over the last two, three, five and ten years, and that many supposedly safe fixed income investments have been a disaster this year and over the last two, three, five and even ten years. To be sure, nobody knows what the future will hold, but those who have eschewed stocks will find that the highlighted portion of the *New York Times* story resonates.

Total Returns Matrix

YTD	Last Year	Last 2 Years	Since 3.23.20	Last 3 Years	Last 5 Years	Last 10 Years	Name
-12.84	-7.18	25.03	76.48	24.60	63.33	210.46	Dow Jones Industrial Average
-13.56	-8.31	26.94	76.28	19.92	41.45	144.62	New York Stock Exchange Composite
-26.12	-28.16	4.33	58.15	9.58	32.14	152.10	Russell 2000 Growth
-15.24	**-10.73**	**53.53**	**104.32**	**23.05**	**30.28**	**141.09**	**Russell 2000 Value**
-20.66	-19.76	26.79	81.33	17.63	33.23	150.56	Russell 2000
-27.68	-25.78	2.65	60.73	17.32	60.29	211.44	Russell Midcap Growth Index Total Return
-14.68	**-7.25**	**40.98**	**99.71**	**22.84**	**38.64**	**179.45**	**Russell Midcap Value Index Total Return**
-19.31	-14.11	26.34	86.78	23.46	51.26	199.94	Russell Midcap Index Total Return
-24.72	-16.96	15.16	76.47	44.58	98.04	302.29	Russell 3000 Growth
-11.68	**-4.88**	**36.73**	**83.31**	**22.95**	**42.79**	**175.03**	**Russell 3000 Value**
-18.55	-11.18	25.36	80.99	35.09	70.68	238.29	Russell 3000
-17.52	-8.42	26.81	80.67	37.77	75.83	250.18	S&P 500
-14.49	**-16.42**	**-14.12**	**-8.36**	**-9.56**	**-2.66**	**0.65**	**Bloomberg Barclays Global-Aggregate Bond**
-10.59	**-11.24**	**-11.17**	**-6.34**	**-2.99**	**4.55**	**15.61**	**Bloomberg Barclays U.S. Aggregate Bond**

As of 07.08.22. Source Kovitz using data from Bloomberg

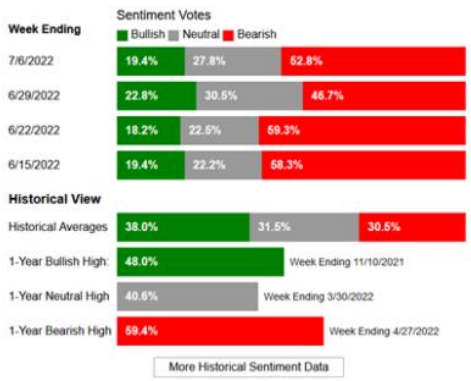
…has provided an added weight on investor psyches,…

THE PRUDENT SPECULATOR

MAJOR CONTRARIAN BUY SIGNAL: AAII SENTIMENT EXTREMELY PESSIMISTIC

The gauge is widely viewed with a contrarian eye, so the number of AAII Sentiment Survey Bulls coming in at 19.4% was still a major equity market buy signal, even as the tally was 1.4 points higher than two week's prior, when the weekly gauge reflected the 25th fewest total of optimists in its 35-year history. Interestingly, AAII itself understands that its measure is presently showing that it is time to be greedy when others are fearful, with a -33.4 Bull-Bear Spread.

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



CURRENT AAII SENTIMENT BULL-BEAR SPREAD:

The Sentiment Survey is a contrarian indicator. Above-average market returns have often followed unusually low levels of optimism, while below-average market returns have often followed unusually high levels of optimism. Click here to learn more.

BULL-BEAR SPREAD TRENDS:

Previous Week	1 Month Ago	3 Months Ago	6 Months Ago
-24	-39	-25	-30
Greedy	Greedy	Greedy	Greedy

AAII Bulls & Russell 3000 Forward TR

Date	Bulls	1W RET	1M RET	3M RET	6M RET
11/15/1990	12.0	-0.4%	3.6%	18.4%	20.1%
10/6/1988	13.0	0.7%	1.1%	3.2%	9.9%
3/9/1989	13.0	1.7%	1.3%	12.2%	19.9%
9/20/1990	13.0	-3.7%	-0.5%	6.9%	21.5%
10/18/1990	13.0	1.5%	4.5%	10.1%	32.1%
9/3/1992	14.0	0.5%	-1.5%	5.2%	10.7%
2/1/1990	15.0	1.7%	1.9%	1.9%	8.8%
10/4/1990	15.0	-5.5%	-0.5%	4.3%	26.2%
4/14/2022	15.8	-0.2%	-8.8%		
7/21/1988	16.0	-0.3%	-1.9%	6.1%	8.2%
9/13/1990	16.0	-2.3%	-6.4%	4.1%	20.5%
11/22/1990	16.0	0.4%	5.5%	18.1%	23.0%
12/20/1990	16.0	-0.3%	0.6%	13.7%	17.2%
4/28/2022	16.4	-3.3%	-3.0%		
4/14/2005	16.5	0.0%	-0.4%	7.2%	4.2%
9/8/1988	17.0	0.9%	4.3%	3.8%	12.0%
11/24/1988	17.0	1.5%	3.5%	8.4%	21.1%
12/8/1988	17.0	-0.7%	2.1%	7.9%	21.0%
5/26/2016	17.8	1.0%	-2.2%	4.8%	8.2%
1/14/2016	17.9	-2.8%	-3.3%	9.3%	14.4%
9/1/1988	18.0	2.6%	5.2%	5.1%	12.4%
3/30/1989	18.0	1.1%	5.9%	9.7%	20.7%
8/16/1990	18.0	-8.0%	-4.6%	-4.4%	13.3%
7/1/1993	18.0	-0.1%	0.0%	4.3%	5.8%
6/22/2022	18.2	-0.4%			
25 Period Average		-0.6%	0.3%	7.3%	16.0%
All Periods Average		0.2%	0.9%	2.8%	5.9%

Source: American Association of Individual Investors and Bloomberg

AAII Bull-Bear Spread & Russell 3000 Forward TR

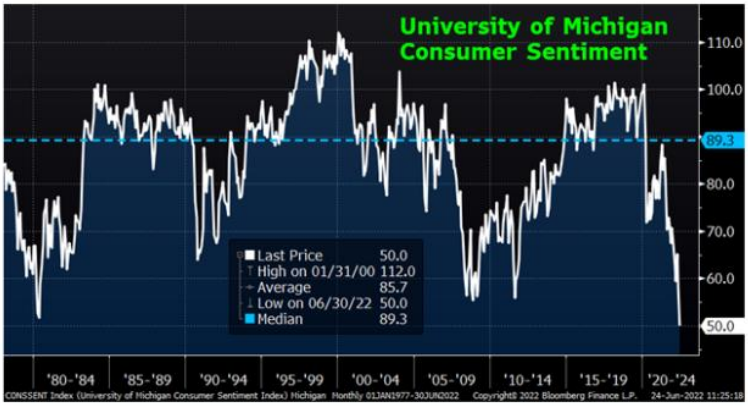
Date	Spread	1W RET	1M RET	3M RET	6M RET
10/18/1990	-54.0	1.5%	4.5%	10.1%	32.1%
3/5/2009	-51.4	10.3%	24.5%	40.3%	52.7%
10/4/1990	-44.0	-5.5%	-0.5%	4.3%	26.2%
9/20/1990	-43.0	-3.7%	-0.5%	6.9%	21.5%
11/15/1990	-43.0	-0.4%	3.6%	18.4%	20.1%
4/28/2022	-43.0	-3.3%	-3.0%		
6/22/2022	-41.1	-0.4%			
7 Period Average		-0.2%	4.8%	16.0%	30.5%
All Periods Average		0.2%	0.9%	2.8%	5.9%

Source: American Association of Individual Investors and Bloomberg

…and not helped consumer confidence.

THE PRUDENT SPECULATOR

RECORD LOW CONSUMER SENTIMENT, AND THAT COULD BE A GOOD THING



University of Michigan Consumer Sentiment
Cyclical Lows & Subsequent Equity Returns

Cyclical Low	U of M Sent.	1 Year SPX TR	1 Year Value TR	3 Year SPX TR	3 Year Value TR	5 Year SPX TR	5 Year Value TR	10 Year SPX TR	10 Year Value TR
May-80	51.7	25.2%	34.5%	70.8%	128.6%	118.2%	227.7%	395.6%	537.8%
Mar-82	62.0	44.3%	54.5%	86.5%	129.5%	224.0%	276.0%	431.0%	503.6%
Nov-87	83.1	23.3%	32.0%	55.7%	31.1%	121.8%	124.2%	455.1%	545.8%
Oct-90	63.9	33.4%	41.2%	68.6%	129.6%	121.4%	191.0%	490.0%	619.1%
Sep-01	81.8	-20.5%	-13.6%	12.6%	40.7%	40.0%	98.9%	32.0%	48.6%
Mar-03	77.6	35.1%	67.5%	61.0%	129.0%	71.0%	116.0%	126.8%	176.2%
Nov-08	55.3	25.4%	22.3%	48.6%	34.0%	124.8%	135.2%	280.7%	246.4%
Aug-11	55.8	18.0%	34.8%	75.4%	54.8%	98.3%	102.0%	353.7%	230.4%
Jun-22	50.0								
		23.0%	**34.1%**	**59.9%**	**84.7%**	**114.9%**	**158.9%**	**320.6%**	**363.5%**

TR = Total Return. SPX = S&P 500. Value = Value Weighted Book to Market Portfolios - Blend of Small Value and Big Value.
Source: Kovitz Investment Group using data from Bloomberg, Professors Eugene F. Fama & Kenneth R. French and the Univ. of Michigan

Incredibly, the latest read on the Univ. of Michigan's Consumer Sentiment gauge was the most pessimistic in its history...worse than when inflation was in the double-digits in the early'80's...and after the Crash of '87...and after the Gulf War Meltdown of '90... and after 9/11...and at the end of the Tech Wreck... and during the Great Financial Crisis...and after the downgrade of the U.S. credit rating. Believe it or not, the prior 8 cyclical lows, on average, proved to be great times for long-term-oriented investors to be adding to their (Value) equity exposure.

The equity futures on Sunday evening were suggesting that stocks will struggle anew when trading reopens this week, so it is likely that Warren Buffett's Mr. Market will remain grumpy,…

THE PRUDENT SPECULATOR

WARREN BUFFETT ON "MR. MARKET"

Ben Graham, my friend and teacher, long ago described the mental attitude toward market fluctuations that I believe to be most conducive to investment success. He said that you should imagine market quotations as coming from a remarkably accommodating fellow named Mr. Market who is your partner in a private business. Without fail, Mr. Market appears daily and names a price at which he will either buy your interest or sell you his.

Even though the business that the two of you own may have economic characteristics that are stable, Mr. Market's quotations will be anything but. For, sad to say, the poor fellow has incurable emotional problems. At times he feels euphoric and can see only the favorable factors affecting the business. When in that mood, he names a very high buy-sell price because he fears that you will snap up his interest and rob him of imminent gains. At other times he is depressed and can see nothing but trouble ahead for both the business and the world. On these occasions he will name a very low price, since he is terrified that you will unload your interest on him.

Mr. Market has another endearing characteristic: He doesn't mind being ignored. If his quotation is uninteresting to you today, he will be back with a new one tomorrow. Transactions are strictly at your option. Under these conditions, the more manic-depressive his behavior, the better for you.

But, like Cinderella at the ball, you must heed one warning or everything will turn into pumpkins and mice: Mr. Market is there to serve you, not to guide you. It is his pocketbook, not his wisdom, that you will find useful. If he shows up some day in a particularly foolish mood, you are free to ignore him or to take advantage of him, but it will be disastrous if you fall under his influence. Indeed, if you aren't certain that you understand and can value your business far better than Mr. Market, you don't belong in the game. As they say in poker, "If you've been in the game 30 minutes and you don't know who the patsy is, *you're* the patsy."

...[A]n investor will succeed by coupling good business judgment with an ability to insulate his thoughts and behavior from the super-contagious emotions that swirl about the marketplace. In my own efforts to stay insulated, I have found it highly useful to keep Ben's Mr. Market concept firmly in mind.

Letter to Shareholders, 1987 Berkshire Hathaway Annual Report

…but this is a big reason why the Oracle of Omaha recently has opened his pocketbook. Indeed, investors should be greedy when others are fearful!

WALL STREET HOLDS A SALE…AND THE ORACLE HAS BEEN SHOPPING

BUSINESS & FINANCE

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Buffett Buys Stocks as Markets Fall

By Akane Otani

The stock market's selloff has been bad news for most investors.

Not for Warren Buffett and his team.

Mr. Buffett's Berkshire Hathaway Inc. has used the slump as an opportunity to increase spending on stocks, deploying tens of billions of dollars the past couple of months after ending 2021 with a near-record cash pile.

The Omaha, Neb., company bought 901,768 shares of Occidental Petroleum Corp. last week, according to a regulatory filing. The move makes Occidental, in which Berkshire began buying shares in late February, one of its 10 biggest holdings.

In the past few months, Berkshire has also boosted its stake in Chevron Corp., placed a merger-arbitrage bet on Activision Blizzard Inc. bought shares of HP Inc., Citigroup Inc. and Ally Financial Inc., and continued adding to its position in Apple Inc., which remained its biggest stockholding.

Meanwhile, it exited from its position in Wells Fargo & Co., formerly one of its top stock holdings and a part of the Berkshire portfolio since 1989.

Investors got a look at what Berkshire has been buying and selling when it filed what is known as Form 13-F with the Securities and Exchange Commission on Monday. The SEC requires all institutional investors that manage more than $100 million to file the form within 45 days of the end of each quarter. Because institutions must disclose their equity holdings on the form, as well as the size and market value of each position, investors often use 13-Fs to gauge how large money managers are playing the stock market.

Mr. Buffett, an adherent of value investing, has long advised that investors "be greedy when others are fearful." That philosophy was likely difficult to practice for much of the past two years, during which investors' mood largely seemed anything but fearful. Now, that the market is slumping, Berkshire is in a prime position to add to its mammoth stock portfolio, investors say.

"Cash is dry powder, and he has a lot of it," said Rupal Bhansali, chief investment officer for global equities at Ariel Investments, of Mr. Buffett. Ms. Bhansali manages Ariel's global mutual

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Berkshire holdings Occidental and Chevron have both soared past the S&P 500 this year.

Share-price and index performance, year to date

Berkshire Hathaway's biggest holdings, ranked by market value*

*Data are as of first quarter 2022

Sources: FactSet (performance); the company (holdings)

Crypto's Plunge Punishes Alternative Portfolios

By Gregory Zuckerman

Cryptocurrency prices are moving in lockstep with stocks and bonds like never before, punishing those who bought bitcoin and other digital assets in part to diversify their investment holdings.

The three-month correlation between the cryptocurrencies bitcoin and ether and the major U.S. stock indexes hit its highest level on record last week, according to Dow Jones Market Data. That level, between 0.67 and 0.78, is more than triple the average correlation between crypto and the S&P 500 from 2019 to 2021. A correlation of 1 suggests the markets are moving in lockstep, while 0 says they aren't related. The one- and two-month correlations are at record levels.

The day of that record correlation, bitcoin dropped 10% and the Nasdaq Composite Index fell more than 4%, marking its steepest three-day point decline on record. Though bitcoin and other digital assets have long been viewed as among the riskiest investments in markets, analysts and portfolio managers say the depth of crypto declines this year and their tendency to echo other riskier assets such as stocks potentially could limit their adoption by

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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 stocks that had news out worthy of mention last week.

In a filing just before the July 4 holiday weekend, **Exxon Mobil** (XOM – $86.08) released factors that would affect its Q2 results. Taking these into account, the energy titan could generate as high as $18 billion of profit, while the Street was forecasting $13.6 billion. To be sure, either of these figures will be significantly larger than the more than $8 billion produced in the prior two quarters, boosted by higher oil and gas prices and rather thick refining spreads.

As we look forward to the actual release later this month, we note that success in the energy patch has not been without negative comments in politics and in the media, as higher prices at the pump plague the average American consumer. And, some have called for windfall taxes with

President Biden even claiming that "Exxon had made more money than God this year." Now, with recession seemingly on the tip of everyone's tongue, crude prices have dipped over the past month and some analysts have called for $60 barrels on expectations for weaker demand. Looking a few years out, XOM CEO Darren Woods recently said that he "expects 3 to 5 years of fairly tight oil markets."

Globally, members of OPEC+ have stepped up production volume to 44 million barrels per day, beyond pre-pandemic levels. And the cartel agreed last month to ramp production once again in August, though Saudi Arabia is the only member with material capacity.

While we continue to rigorously debate the topic internally, we are of the mind that war in Ukraine will weigh on supply for years to come, even if there is some sort of a ceasefire in the near-term. This, and a sizable pullback in the stock price, is the reason we chose to add to our Energy sector holdings with the aforementioned Civita Resources this month.

Of course, nobody knows what direction oil or gas prices are headed in the next week or month, so it is likely that oil-related stock prices will continue to gyrate. Nevertheless, we think pandemic-induced trauma will not be easily shrugged off for some time by industry CEOs, turning them cautious on ramping production even as domestic and international energy prices have skyrocketed. Indeed, we remind that the front month contract for barrels of West Texas Intermediate skidded into negative territory in April 2020, and even in the years prior, the drilling of wells while oil was at prohibitively low prices was self-destructive for the industry. Moreover, we view the conversion to variable capital return policies (dividends and share repurchases) a healthy choice no matter the price environment.

Turning our attention back to Exxon, following the addition of independent members to the board in recent years, management suggests it is making progress on the carbon reduction front via the Houston carbon capture hub. Meantime, the company continues to invest in its core business both domestically (the Permian) and abroad (Guyana), and boasts a global, break-even cost of production of $41 per barrel.

Exxon shares trade for 10 times where analysts expect earnings to normalize over the next few years and offer a 4.1% dividend yield. Our Target Price for XOM is $116.

With results from the Federal Reserve's latest bank stress test in the rear view mirror, several major banks announced hikes to their dividends, with a few detailing share repurchase plans. One might have thought that the news would have boosted sentiment, but the KBW banking index actually headed south in the days after with the mood souring over recession implications. Among the largest of the nation's financial institutions, **Goldman Sachs** (GS – $296.47) announced the biggest increase to its dividend (25%) while **JPMorgan Chase** (JPM – $114.36) and **Citigroup** (C – $46.82) kept payouts flat. We've detailed dividend updates for each of our banks as well as their Tier 1 common equity ratios relative to their regulatory hurdle in the chart below.

PASSING THE FEDERAL RESERVE'S STRESS TESTS

The nation's top financial institutions aced this year's Stress Tests, with the Federal Reserve stating, "Banks continue to have strong capital levels, allowing them to continue lending to households and businesses during a severe recession." As a result, Bloomberg estimates that some $80 billion will be returned to shareholders this year via dividends and buybacks.

Bank Stress Tests

						In Percentage Terms				
Symbol	Company	Mkt Cap	Total Assets	Div Comment	Qrtly Div Amt (Forecasted)	SCB requirement *	SIFI surcharge (if applicable)**	CET1 Ratio***	Req CET1	Surplus / Shortfall
JPM	JPMORGAN CHASE & CO	$335,881,091,292	$3,743,567	No Change	1.00	4.0	3.5	11.9	12.0	-0.1
BAC	BANK OF AMERICA CORP	$256,128,258,530	$3,169,495	Raise 5%	0.22	3.5	2.5	10.4	10.5	-0.1
MS	MORGAN STANLEY	$134,222,565,847	$1,188,140	Raise 10.7%	0.78	2.5	3.0	14.5	10.0	4.5
GS	GOLDMAN SACHS GROUP INC	$106,150,550,150	$1,463,988	Raise 25%	2.50	6.3	2.5	14.4	13.3	1.1
C	CITIGROUP INC	$90,920,719,776	$2,291,413	No Change	0.51	4.0	3.0	11.4	11.5	-0.1
PNC	PNC FINANCIAL SERVICES GROUP	$66,743,662,887	$557,191	Raised in April	1.50	2.9		9.9	7.4	2.5
TFC	TRUIST FINANCIAL CORP	$63,508,442,839	$541,241	Raised 8%	0.52	2.7		9.4	7.2	2.2
COF	CAPITAL ONE FINANCIAL CORP	$42,689,231,748	$432,381	No Chg	0.60	3.1		12.7	7.6	5.1
BK	BANK OF NEW YORK MELLON CORP	$33,838,668,399	$444,438	Raise 9%	0.37	3.0	1.0	10.1	8.5	1.6
FITB	FIFTH THIRD BANCORP	$23,230,921,497	$211,116	"Increase up to $0.03"	0.33	2.5		9.3	7.0	2.3
CFG	CITIZENS FINANCIAL GROUP	$17,989,645,458	$188,409	"Consider Increase"	0.39 (Current)	3.4		9.7	7.9	1.8
KEY	KEYCORP	$16,308,915,499	$186,346	Raised last July	0.195 (Current)	2.5		9.4	7.0	2.4
*The Stress Capital Buffer is a capital hurdle set by regulators on banks to withstand periods of financial duress.										
**Global banks deemed systemically significant by the Financial Stability Board in Basel, Switzerland are charged with meeting additional capital requirements										
***Tier 1 Common Equity is considered the highest quality of regulatory capital and includes common equity, stock surplus, retained earnings & other comprehensive income										
Not analyzed										
SYF	SYNCHRONY FINANCIAL	$14,884,187,821								
CMA	COMERICA INC	$9,705,029,986						9.9		
NYCB	NEW YORK COMMUNITY BANCORP	$4,329,446,190						9.5		
ONB	OLD NATIONAL BANCORP	$4,423,680,900						10.0		
OZK	BANK OZK	$4,546,424,854						13.2		

The capital requirements are designed to set a floor on how much capital banks are allowed to return to shareholders through buybacks and dividends. Though we expect higher net interest margins to help their cause, a few top banks (JPM, **Bank of America** (BAC – $31.79) & C) fell just shy of their CET1 targets, but these ratios are dynamic and management teams can scale up equity or reduce leverage to meet their requirements before they are set to take effect October 1. We also note that Goldman was in this situation after the 2020 stress test. Although the investment bank kept its dividend flat that year and payments were interrupted, but it is on pace to double its per-share payout in the two years since.

On top of the Stress Capital Buffer, several larger banks deemed Systemically Important are subject to another (G-SIB) capital charge, which is expected to also increase in the coming years. Such regulations force banks to build and hold higher levels of equity capital than they might otherwise owing to their being interconnected to other global financial systems. Citi and JPM appear most impacted on that front, with JPMorgan CEO Jamie Dimon grumbling about the subject in his latest annual shareholder letter:

The U.S. implementation of G-SIB requirements does not enable a level playing field — plain and simple. Not only have American rules made the G-SIB designation worse for American banks (if JPMorgan Chase could operate on the same basis as large European banks, our Tier 1

capital requirements would be reduced by $30 billion), but the rules have not been adjusted as the framework allows. G-SIB capital requirements were supposed to be modified to account for the increasing size of the global economy and the smaller size of banks in relation to that global economy — this simply has not happened. So JPMorgan Chase will be required to hold 2% more common equity Tier 1 capital as a consequence. We have always said that the G-SIB calculation is nonsensical as it is not risk-based at all. It drives absurd behavior, such as favoring various acquisitions that may be imprudent but don't require G-SIB capital or encouraging very risky loans that require no more G-SIB capital than risk-free loans. Being a large, diversified company, with strong revenue and profit streams, is normally a source of strength in troubled times, but this is a negative in regard to G-SIB capital.

As we mentioned two weeks ago, given our tempered expectations for large repurchase plans and dividend hikes, we are delighted with the raises that were announced. This is especially true as recession seems to be on the tip of everyone's tongue of late, but we aren't so convinced that the economy is in such dire straits. And even should a recession occur, the stress test results offer some evidence that the country's banks will weather the storm. The valuation discount of the banking sector (as judged by the P/E on the KBW Index) relative to the S&P 500 remains greater than 40% and we think the E portion of the P/E could expand in a swift manner should net interest margins start to resemble anything close to pre-financial-crisis levels.

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