THE MONTHLY RESEARCH CONFERENCE CALL
SECTOR OUTLOOKS:
RISKS AND OPPORTUNITIES

Wednesday, April 1, 2020
11:00 a.m. ET

MODERATORS

Jim Kelleher, CFA
Director of Research

John M. Eade
Argus President

&

Argus Senior Analysts

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WHAT’S NEW AT ARGUS
APRIL 2020

Argus Revises Economic & Market Assumptions
- New podcast on the Argus website
- Argus now looks for mid-2020 recession
- Revised outlook for Interest rates and fed policy
- Revised earnings estimates, fair value, and S&P 500 target
- Find it on the site: Homepage, left column, Podcasts

Argus Quick Notes
- Quick Note: Healthcare on the Front Lines
- Quick Note: Clean Balance sheets, Low Beta, Dividends
- Quick Note: Min Vol Stocks
- Special Note on the Fed’s policy response, from Kevin Heal
- Find it on the site: Homepage, center column, Quick Notes

Argus Quality Study Shows Market-Beating Performance
- Argus published its semi-annual quality study in February
- Consistent #1 rating on Investars broker performance platform
- Argus BUY-rated stocks consistently beat market, lead peer group
- Bloomberg BARR: senior analysts in top ranks
- Model Portfolios: 3 of 4 MPs beat S&P 500 benchmark on trailing 3-years
- Portfolio Selector-Focus List: 220 bps premium to benchmark
- Argus will remain focused on delivering high-value research
MACRO FORECASTS

REAL GDP W/FORECASTS (%)

Source: Bureau of Economic Analysis, Argus Research Corp.

TREASURY YIELD CURVE (%)

MARKET SECTOR DISTRIBUTION - PERCENT OF S&P 500

Sectors in Green are Recommended Overweight; Blue are Marketweight; Red are Underweight
MARKET PERFORMANCE
DATA AS MARCH 26, 2020

MAJOR INDEX

- Lehman US Aggregate Bond Index
- Growth Stocks (Wilshire Large Growth)
- Nasdaq Composite
- S&P 500
- DJIA
- Value Stocks (Wilshire Large Value)
- Russell 2000

SECTOR

- Financials
- Health Care
- Communication Services
- Industrials
- Consumer Staples
- Materials
- Real Estate
- Utilities
- Technology
- Consumer Discretionary
- Energy

GLOBAL EQUITY MARKETS

- China
- Japan
- DJ World Index
- Mexico
- US
- Canada
- UK
- Euro Zone
- India
- Brazil
- Russia
FINANCIAL SERVICES: THIS IS NOT 2008/09

- Banks not holding toxic securities, little exposure to leveraged loans
- Largest 7 banks have suspended share buybacks, saving $40 billion in capital
- Vastly better capital levels built over the 10 years since the financial crisis
- All banks subjects to stress tests passed for the 2019/20 planning year. Severe adverse scenario included:
  - Recession where U.S. unemployment rate rises to 10%
  - U.S. GDP falls 8% from the pre-recession peak
  - Consumer price inflation declines to 1.25%
  - Short-term interest rates fall to near zero
  - Equity prices fall 50%
  - Home prices drop 25%
- Banks still able to lend under above scenarios
FINANCIAL SERVICES: CORONAVIRUS IS IMPACTING BANKS LARGE AND SMALL

- Lower interest rates will hurt net interest margins (asset sensitivity)
- Reduced loan growth as consumers and businesses pull back spending
- Credit quality is historically closely correlated to unemployment
- Reduced level of capital market activities (M&A, IPOs, underwriting)
- The Positives:
  - Better trading revenues and expected cost reductions
  - S&P has indicated no change in bank credit ratings if economy rebounds in 2H
Focus on banks with strong capital, a diverse business mix, and good credit quality going into the downturn

- JPMorgan Chase (JPM)
- Bank of America (BAC)
- Truist Financial (TFC)
- PNC Financial Services (PNC)
SECTOR OUTLOOK ENERGY: RISKS & OPPORTUNITIES

Defensive Posture Recommended: Focus on Quality & Balance Sheet

- Energy markets have been in bearish territory for the past few years, further exacerbated in 2020 by global oversupply, COVID 19 and OPEC’s policy pivot.

- We officially cut our oil price deck (March 11) by 36% to $35 per barrel West Texas Intermediate (WTI) and remain open to cutting it again in the near term.

- We project oversupply of 3.5 million bbl/per day in 2020, likely keeping WTI oil below $30 per barrel for the next few months. Only + near-term catalyst? Resolution between OPEC/Russia.

- With this commodity backdrop, a firm’s b/s strength and position on the cost curve is critical; Our preference is for more defensive and cash generative stocks that are well positioned.

- Heading into 1Q20, we expect nearly all of our energy companies to cut dividends (except CVX and COP) and capex, reflecting reduced drilling activity.

- Many companies have already started: OXY, MRO, DVN, APA, CVX, RDSA, PSX
RECOMMENDED STOCK PICKS IN ENERGY

■ OIL SERVICES, DRILLING & EQUIPMENT (OFS)
  • Schlumberger (SLB)

■ INTEGRATED OIL COMPANIES (OIC’S)
  • Chevron (CVX)

■ OIL & GAS E&P
  • EOG Resources (EOG), ConocoPhillips (COP) and Noble Energy (NBL)

■ REFINING
  • Valero Energy (VLO) and Phillips 66 (PSX)

■ MIDSTREAM
  • Oneok (OKE)
OUR CONSUMER HIT LIST

■ Holiday
  • The consumer stocks that perform well during and after the crisis may be the ones that were performing well before the crisis.
  • The competitive Holiday season often shows us who is winning.

■ Innovation
  • Companies must do something unique and useful to earn above average returns on capital.

■ Traffic
  • Traffic is a key indicator of which companies are relevant to their customers.
  • It will be hard to drive profits without sales growth.
  • It will be hard to drive sales without traffic.
Stocks in our healthcare coverage that are working on solutions in combating the Covid-19 virus.

- These companies are working on drugs to vaccinate against or to treat Covid-19:
  - Johnson & Johnson (JNJ: BUY)
  - Gilead Sciences Inc. (GILD: HOLD)
  - AbbVie Inc. (ABBV: HOLD)

- These companies are developing and scaling up diagnostics tests:
  - Danaher Corp. (DHR: BUY), featured in our Growth, Dividend Growth, and Institutional model portfolios
  - Thermo Fisher Scientific Inc. (TMO: BUY), featured in our Institutional model portfolio
  - Hologic Inc. (HOLX: BUY)
  - Becton, Dickinson& Co. (BDX: BUY), featured in our Growth & Income and Institutional model portfolios
  - Abbott (ABT: BUY)

- Scaling up production of ventilators:
  - Medtronic Plc. (MDT: BUY), featured in our Growth & Income model portfolio
INDUSTRIAL SECTOR UPDATE

■ CURRENT RECOMMENDATION: OVER WEIGHT

■ SECTOR WEIGHT OF S&P 500: +8%

■ COMPANIES TIED TO DEFENSE SECTOR
  • LMT, NOC, GD, RTN/UTX, LHX, LDOS, BA

■ LOW-COST TRANSPORTATION COMPANIES FOR THE SUPPLY CHAIN
  • ODFL, UNP, CP, UPS

■ STRONG BALANCE SHEETS
  • CMI, HON, ITW, ROP

■ DOUBLE-DIGIT DIVIDEND GROWERS
  • GD, FAST, HRS, HON, ITW, LMT, NOC, NSC, ODFL, RTN, ROP, UNP

■ ESG LEADERS
  • LMT, RTN, NOC, DE, UPS, GE, UNP, ODFL, ITW, LHX, WM
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