Three Minutes of Your Time for 2020
Market Forecasts

Legendary investor and former manager of Fidelity’s Magellan Fund Peter Lynch said, “If you spend more than 13 minutes analyzing economic and market forecasts, you’ve wasted 10 minutes.”

Lynch believes in the power of investing in the best companies. These companies will outperform regardless of macroeconomic or analyst reports. By focusing on such companies, an investor can largely ignore unpredictable economic cycles and find investing success over the long term, through both the ups and the downs.

The Dividend Investing (DI) portfolio uses a bottom-up investment approach, so we generally agree with Lynch’s thoughts on analyzing economic and market forecasts. Despite Lynch’s sound advice, with 22 of the 24 holdings (92% of the DI portfolio) included in the S&P 500 index, we think it is worthwhile to check in with leading market strategists from time to time especially if it helps us assess potential impacts to specific DI holdings.

With the end of the year and decade fast-approaching, Wall Street strategists have begun to publish their expectations for 2020. The next year will bring a myriad of market-moving events, including the 2020 U.S. elections and the next phases in U.S.-China trade negotiations. We look at a few of the analysts’ ideas for how these and other catalysts will shape equity markets in 2020. The commentary below is a sampling from a longer compilation from Yahoo Finance reporter Emily McCormick.

So according to Lynch, you have a total of three minutes to read this piece on broader economic activity, and then move on to more useful analysis.


Stocks will stabilize and appreciate slightly in 2020 after more than a year’s worth of choppy equity trading, which had been driven by gyrating interest rates and an ongoing U.S.-China trade war, according to Jefferies.

“If 2018 was a year of policy over-tightening then 2019 was a year of unwinding policy mistakes,” equity strategist Sean Darby said. “Hence, 2020 looks to be the year of normalization as a number of macro factors recede.

“[The year] 2020 ought to see some normalization as earnings growth moves back in tandem with GDP [gross domestic product]. In summary, equity investors are likely to be focused on the traditional drivers for U.S. markets, namely earnings growth.”

Darby conceded that the 2020 elections could generate some idiosyncratic risks for sectors like health care, financials and technology, depending on the prevailing policies of newly elected officials. His base case, however, is that neither party will win both the House and the Senate, creating a hurdle for politicians trying to implement policies that could impact any of these companies’ operations.

“Heading into 2020, sector leadership will likely be driven by cyclicals, assuming the recent upturn in global economic data carries through next year,” Darby said.
Portfolio Alerts This Month

December Portfolio Additions

<table>
<thead>
<tr>
<th>Company (Ticker)</th>
<th>Latest Price</th>
<th>Dividend Yield</th>
<th>Sector: Industry</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
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</tr>
</tbody>
</table>

no portfolio additions for December

Credit Suisse upgraded “economically sensitive groups” including financials, industrials and materials from market weight to overweight, and upgraded energy from underweight to market weight.

Morgan Stanley upgraded “economically sensitive sectors” including staples, utilities and real estate investment trusts (REITs) from market weight to overweight, and upgraded communications from overweight to market weight.

Cyclical stocks will lead next year’s market rally, according to Credit Suisse’s chief U.S. equity strategist, Jonathan Golub. The firm’s S&P 500 price target of 3,425 implies a 9.3% gain from December 10 closing prices.

The upbeat outlook assumes that S&P 500 revenues will grow in line with nominal GDP, margin headwinds will recede and become “substantially less onerous” and buybacks will remain robust.

Next year’s reacceleration in economic growth will drive a rotation to cyclical stocks, Golub added. The Federal Reserve’s actions appear to support the analyst’s forecast. The Fed has been aggressively cutting interest rates—cutting them in October for the third time in four months.

“Our expect earnings to accelerate back to trend of circa 10%, real interest rates to remain negative alongside a steep yield curve,” Darby said.

Jeffreies is bullish on the consumer discretionary, energy, financials, industrial and materials sectors heading into 2020. The firm is bearish on consumer staples, real estate and utilities.

Jeffreies 2020 S&P 500 target of 3,300 implies a 5.4% increase from December 10.

Credit Suisse (2020 S&P 500 target: 3,425): ‘Cyclical leadership’

Morgan Stanley (2020 S&P 500 target: 3,000): ‘U.S. remains our least preferred region’

U.S. equities may underperform their global counterparts next year, according to Morgan Stanley. The firm set its base case S&P 500 target at 3,000, implying a 4.2% decline from closing prices on December 10.

“Our expect earnings growth to remain under pressure as our earnings model projects another year of flat to modestly down earnings as margin pressures continue to mount,” strategists Andrew Sheets and Michael Wilson said. “The forecasts from our economics team, which have slow growth and accelerating wage gains, are likely to amplify these margin pressures and weigh on the outlook for earnings further, which should translate into better earnings growth outside the

Market Forecasts: Implications for the DI Portfolio

The DI portfolio holds several stocks in the sectors mentioned by Jefferies and Credit Suisse. Both firms are bullish on economically sensitive sectors, including financials, consumer cycicals, industrials and materials. They are bearish on consumer staples, real estate and utilities.

If the market forecasts by Jefferies and Credit Suisse are accurate, they could favor some DI holdings: Comerica Inc. (CMA) and Huntington Bancshares Inc. (HBAN) in financials; Royal Caribbean Cruises Ltd. (RCL) and Williams-Sonoma Inc. (WSM) in consumer cycicals; and Eaton Corp. (ETN) and Snap-on Incorporated (SNA) in industrials, to name a few.

Conversely, DI holdings in non-cyclicals such as PepsiCo Inc. (PEP), Tyson Foods Inc. (TSN) and Walgreens Boots Alliance


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“With many valuations across major equity markets already having rebounded to slightly above five-year averages, we don’t think it prudent to rely on more multiple expansion in what is still a fairly tepid growth environment. This means that forward returns at this point need to be driven by a realization of the earnings growth that is already in the price.

“The U.S. remains our least preferred region, given limited scope for multiple rerating or incremental flows, and earnings expectations that look materially too high to us,” the analysts said.

Morgan Stanley didn’t highlight bullish or bearish sectors in this report.

Our three minutes are up.
(WBA) could be in for a rough year, if you believe the strategists.

We will need to wait until the end of 2020 to see how these forecasts fared. In the meantime, the DI portfolio will continue to rely on the three pillars of dividend investing when decisions are made.

Bottom-Up Investing

Bottom-up investing is an approach that focuses on the analysis of individual stocks and with less emphasis placed on the significance of macroeconomic and market cycles. In bottom-up investing, the investor focuses their attention on a specific company and its fundamentals, rather than on the industry in which that company operates or on the greater economy overall. This approach assumes individual companies can do well even in an industry that is not performing, at least on a relative basis.

With a top-down approach, investors instead look at the broad performance of the economy, and then seek industries that are performing well, investing in the best opportunities within that industry. The market forecasts from Jefferies, Credit Suisse and Morgan Stanley are examples of top-down investing.

Bottom-up investors typically follow a long-term, buy-and-hold strategy based on fundamental analysis of a company. Bottom-up investing enables an investor to gain a deep understanding of a company’s long-term growth potential. Top-down investors, on the other hand, can be more opportunistic in their investment strategy, and may seek to enter and exit positions quickly to make profits off short-term market movement.

As mentioned earlier, the DI portfolio uses a bottom-up investment approach. We look at dividend investing through the lens of the three pillars: a firm’s growth trends, financial strength/quality and valuation. Successful dividend-paying stocks must possess good business models, strong balance sheets, growth in sales and earnings, positive free cash flow, attractive valuations and a history of rising dividend payments.

November DI Performance

The DI tracking portfolio increased 3.7% for the month of November and is up 25.9% for the year through the close on Tuesday, December 10. The Dow Jones U.S. Index ETF (IYY) grew 3.8% for the month and through December 10 is up 26.8% from the start of the year.

The DI tracking portfolio’s monthly gain of 3.7% was composed of 3.5% price appreciation and 0.2% income return. The Dow Jones U.S. Index fund’s 3.8% increase during the month was composed of a 3.8% price rise and no distributed income return.

Over the life of the DI portfolio, it has provided a total return of 150.9%, with dividend income contributing 53.3% to the total return. The Dow Jones U.S. Index fund’s 3.8% increase during the month was composed of a 3.8% price rise and no distributed income return.

The average dividend yield of the stocks in the DI portfolio is 3.0%, in line with the previous month. The Dow Jones U.S. Index fund has a dividend yield of 1.8%, also in line with the previous month.

Portfolio Alerts

There are no portfolio additions or deletions for the DI portfolio this month.

Portfolio Watch: Medtronic PLC (MDT)
Medtronic PLC (MDT) is being watched due to valuation. The company’s dividend yield of 1.9% is in line with its five-year average low. When a stock’s dividend yield goes below its historical average low, an investor is paying more (higher stock price) for a given level of anticipated annual dividends. Medtronic’s stock price has outpaced its dividend growth, which has driven the dividend yield down. If Medtronic’s dividend yield goes below its five-year average low yield and a suitable replacement is identified, it will be deleted from the DI portfolio.

UnitedHealth Group is being watched because its dividend yield of 1.5% is approaching a level considered to be too low for the portfolio. If a stock’s yield is less than 75% of the IYY’s average yield, then a stock may be deleted from the portfolio. So, if UnitedHealth’s dividend yield goes below 1.33% (IYY’s current yield 1.77% × 0.75), it is a candidate for deletion. UnitedHealth’s yield has decreased because its stock price has appreciated significantly over the last two months.

DI Portfolio Versus DI Ideas Quant Screen

There may be some DI subscribers wondering why only six companies in the DI portfolio currently pass the DI Ideas quantitative screen. We look at this question on page 16, and the results may surprise you.

To be sure, for the other 18 companies in the DI portfolio, they all passed the filter when they were added to the portfolio.

Dividend News

Ten stocks in the DI portfolio declared dividends during November, of which nine were in line with the previous quarter’s payment: BlackRock Inc. (BLK), Comerica, Cracker Barrel (CBRL), Home Depot Inc. (HD), Occidental Petroleum (OXY), PepsiCo, Tyson Foods, Union Pacific Corp. (UNP) and UnitedHealth Group.

Snap-on also declared a dividend in November, raising its quarterly cash dividend by 13.7%, from $0.95 per share to $1.08. Snap-on’s current dividend yield of 2.6% is above its five-year average of 1.7%. The company has paid a dividend since 1939 and has increased it for 10 consecutive years.

Portfolio News

Strongest Stocks During November

UnitedHealth Group Inc. (UNH) was up 10.8% during November, making it the top-performing stock in the DI portfolio for the second consecutive month. UnitedHealth continued its solid performance in November, building on the momentum it gained in October.
after its stronger-than-expected third-quarter earnings.

UnitedHealth’s November performance might be considered counter-intuitive in light of the Trump administration’s proposed rules for increasing health price transparency, which is expected to empower patients and increase competition among all hospitals, group health plans and health insurance issuers. The new rules would require hospitals to disclose their standard charges for services, negotiated prices with insurers and the discounted price the institution is willing to accept from a patient.

A coalition of hospital industry groups and some individual hospital operators intend to file a lawsuit challenging the new rule. The rule is expected to be enacted in 2021, if upheld.

During November, UnitedHealth declared a quarterly cash dividend of $1.08 per share, in line with the previous dividend. The company’s current dividend yield of 1.5% compares to its five-year average high of 1.9% and its five-year average low of 1.3%.

Royal Caribbean Cruises Ltd. (RCL) was the second-best-performing stock in the DI portfolio for the month of November with a gain of 10.3%. Shares recovered after the company reported marginally disappointing third-quarter 2019 earnings in late October. Royal Caribbean’s adjusted earnings per share of $4.27 missed the I/B/E/S consensus estimate of $4.31.

CEO Richard D. Fain stated, “Our business continues to thrive and exceed our expectations. While Hurricane Dorian had a negative impact, stronger demand for our brands and our key itineraries exceeded our expectations. Excluding the hurricane impact, we are not only able to maintain our yield and earnings guidance, but to raise both slightly as a result of particularly strong performance in the U.S. and China.”

The company expects full-year 2019 adjusted earnings to be in the range of $9.50 to $9.55 per share.

The company is experiencing strong early booking trends for 2020. Rates are higher than the same time last year in all four quarters and booked load factors are ahead of last year on a like-for-like basis.

Royal Caribbean’s dividend yield of 2.6% compares to its five-year average high of 2.5% and its five-year average low of 1.6%.

Amgen Inc. (AMGN) gained 10.1% in the month of November, making it the third-strongest-performer in the DI portfolio for the second consecutive month.

The company announced financial results that beat analyst expectations on October 29. Amgen’s adjusted earnings per share of $3.66 for the third quarter fell marginally year over year, though it beat the I/B/E/S consensus estimate of $3.53 by 3.8%. Total quarterly revenue also saw a 3% decline from last year, facing headwinds such as a 4% decrease in net selling prices and increased competition. Despite the decline in revenue and earnings per share, Amgen generated $3.2 billion of free cash flow in the third quarter, which represented a 3.2% increase from last year.

On November 22, the company announced the completion of its acquisition of worldwide rights to psoriasis drug Otezla for $13.4 billion in cash. With the closing of the acquisition, Amgen also updated its overall guidance for 2019. For the full year, Amgen now expects total revenues in the range of $23.1 billion to $23.3 billion and earnings per share in the range of $14.50 to $14.70. Previously, the company expected total revenues in the range of $22.8 billion to $23.0 billion and earnings per share in the range of $14.20 to $14.45.

The company’s dividend yield of 2.5% compares to its five-year average high of 2.8% and its five-year average low of 2.1%.

For more on Amgen, see pages 8 and 9.

Weakest Stocks During November

Home Depot Inc. (HD) was the worst-performing stock in the DI portfolio for November, down 6.0%. The company’s underperformance is largely attributed to impacts from tariffs, declining lumber prices and issues relating to its multi-year investment plan.

During the month, Home Depot reported third-quarter 2019 net earnings of $2.8 billion, or $2.53 per diluted share, compared to net earnings of $2.9 billion, or $2.51 per diluted share, in the prior-year quarter. Earnings per diluted share were largely in line with the I/B/E/S consensus estimate. Sales for the quarter were $27.2 billion, up 3.5% year over year.

Last year, the company outlined an ambitious One Home Depot digital transformation strategy to improve its physical store and online connectedness/experience. The project is delivering returns slower than expected and will cut into near-term sales growth.

The company estimated that fiscal-2019 sales will grow by about 1.8% compared to previous guidance of 2.3%. The company also predicts that comparable-store sales will increase by about 3.5% compared to previous guidance of 4.0%.

Despite these lower forecasts, the home improvement market remains robust. Millennials are increasingly entering the housing market, and spending by baby boomers on home improvement continues to increase.

Home Depot declared a regular quarterly dividend of $1.36 per share on
Dividend Payments

<table>
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<tr>
<th>Ticker</th>
<th>Company</th>
<th>Dividend Paid</th>
<th>Ex-Dividend Date</th>
<th>Date Payable</th>
<th>Payment Amount</th>
<th>Ind Div</th>
<th>Div Yield</th>
<th>Direct Invest</th>
<th>DRIP Plan</th>
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<tbody>
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<td>AMGN</td>
<td>Amgen, Inc.</td>
<td>3, 6, 9, 12</td>
<td>Thu Nov 14, 2019</td>
<td>Fri Dec 6, 2019</td>
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<td>BLK</td>
<td>BlackRock, Inc.</td>
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<td>Mon Dec 23, 2019</td>
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<td>Cracker Barrel</td>
<td>2, 5, 8, 11</td>
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<td>Wed Feb 5, 2020</td>
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<td>Eastman Chemical Co.</td>
<td>1, 4, 7, 10</td>
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<td>Huntington Bancshares</td>
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<td>International Paper Co.</td>
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<td>Mon Dec 16, 2019</td>
<td>$0.5125</td>
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<td>MDT</td>
<td>Medtronic PLC</td>
<td>1, 4, 7, 10</td>
<td>Thu Dec 26, 2019</td>
<td>Fri Jan 17, 2020</td>
<td>$0.5400</td>
<td>$2.16</td>
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<td>Occidental Petroleum</td>
<td>1, 4, 7, 10</td>
<td>Mon Dec 9, 2019</td>
<td>Wed Jan 15, 2020</td>
<td>$0.7900</td>
<td>$3.16</td>
<td>8.4%</td>
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<td>PEP</td>
<td>PepsiCo, Inc.</td>
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<td>Thu Dec 5, 2019</td>
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<td>$0.9550</td>
<td>$3.82</td>
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<td>PII</td>
<td>Polaris Inc.</td>
<td>3, 6, 9, 12</td>
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<td>Mon Dec 16, 2019</td>
<td>$0.6100</td>
<td>$2.44</td>
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<td>PFG</td>
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<td>Royal Caribbean Cruises L.1</td>
<td>4, 7, 10</td>
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<td>Mon Jun 6, 2020</td>
<td>$0.7800</td>
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<td>Texas Instruments</td>
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<td>Thu Feb 27, 2020</td>
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<td>3.1%</td>
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<td>WSM</td>
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<td>Fri Nov 29, 2019</td>
<td>$0.4800</td>
<td>$1.92</td>
<td>2.8%</td>
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</table>

Data as of 12/10/2019.

November 21, in line with the previous declaration. The company’s dividend yield of 2.5% compares to its five-year average high of 2.6% and its five-year average low of 1.9%.

**Occidental Petroleum (OXY)** was the second worst-performing stock in the DI portfolio for November, down 4.8%. Occidental reported adjusted earnings per diluted share of $0.11, which missed the I/B/E/S consensus estimate of $0.37 and declined year over year from $1.77. Total revenue declined 5% year over year to $5.86 billion.

Headwinds of more than $1 billion included transaction costs and debt financing fees related to the Anadarko Petroleum merger and oil and gas impairment charges. CEO Vicki Hollub commented that reducing debt remains a primary target in the coming quarters. Occidental plans to slash capital spending by 40%, cutting oil and gas production growth to 2% from the previous target of 5% in order to meet its priorities.

To this end, Occidental opened solicitation of bids for its oil and gas properties in Wyoming and Colorado acquired as parts of Anadarko, valued at as much as $700 million. The company also affirmed the sale of a 49% stake of Anadarko properties in west Texas for as much as $700 million. The company expects to explain the price decline. The company faces headwinds across its tools group division and has been adversely impacted by foreign currency translations.

Publicly opposed to the Anadarko acquisition, activist investor Carl Icahn cut his $1.6 billion stake in Occidental to $900 million but vowed to launch a proxy fight against the board next year.

Occidental declared a regular quarterly dividend of $0.79 per share during the month, in line with the previous declaration. Occidental has paid a dividend for 17 consecutive years. The company’s dividend yield of 8.4% compares to its five-year average high of 4.9% and five-year average low of 3.6%.

**Snap-on Incorporated (SNA)** was the third worst-performing stock in November, down 1.4% for the month. There was no company-specific news to explain the price decline. The company faces headwinds across its tools group division and has been adversely impacted by foreign currency translations.

There was weak manufacturing data released at the end of the month that may provide some insight into the stock’s performance. The Institute for Supply Management (ISM) Manufacturing index fell to 48.1 in November. The number missed expectations and represented the fourth consecutive month of contraction, as trade remained the most significant challenge across industries.
Dividend Analysis

<table>
<thead>
<tr>
<th>Ticker</th>
<th>P/E Ratio (TTM)</th>
<th>Dividend Yield</th>
<th>EPS Growth Rate (3-5 Yr)</th>
<th>Div Growth Rate (5 Yr)</th>
<th>First Year Div Paid</th>
<th>Consecutive Years Div Raised</th>
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Data as of 12/10/2019.

Definitions of Terms Used in Tables

Ann’l Ind Div: The total dollar amount of cash dividends forecast to be paid over the next 12 months.

Consecutive Years Div Raised: The number of consecutive years the company has increased the annual dollar amount of the dividend.

Date Payable: The date a company will distribute (or has distributed) the most recent quarterly dividend.

DI Purchase Price: The average cost basis per share of the stocks purchased for the real DI tracking portfolio. The average cost basis includes any commissions incurred for the purchase and is adjusted for stock splits and spin-offs, if appropriate.

Direct Invest: Denotes companies that offer a direct investment program, which allows investors to buy their initial shares directly from a company, without having to go through a broker.

Div Growth Rate (5 Yr): The compound annual percentage change in dividends per share over the past five years. Positive numbers show an increase in the dollar amount of dividends paid.

Div Yield (or Current Dividend Yield): Projected dividend payments for the next 12 months divided by the current stock price. This number shows, in percentage form, how much income can be expected relative to the current stock price.

Dividend Yield—1 Year Ago: The stock’s dividend yield (dividends divided by price) from one year ago. 5 Year Averages: The stock’s average and average high and low dividend yields over the past five years.

DRIP Plan: Denotes companies that offer a dividend reinvestment plan, which allows shareholders to use cash dividends to acquire additional shares of stocks, including partial amounts.

Est EPS Growth Rate (3-5 Yr): The forecast annual growth rate in earnings per share for the next three to five years.

Ex-Dividend Date: The date used by the exchanges to determine who owns shares of a company. This is one trading day before the record date. Investors must purchase shares prior to the ex-dividend date to receive the dividend.

First Year Dividend Paid: The first year a company paid its dividends. If a dividend was suspended, the date is the first year the dividend was reinstated.

Liab to Assets: Total liabilities divided by total assets. A measure of balance sheet strength, lower percentages signal a lower proportionate amount of debt.

Market Cap (Mil): A measure of company size, this is the current share price multiplied by the number of shares outstanding, expressed in millions of dollars.

Months Dividends Paid: The calendar months the company has typically paid dividends to shareholders (1 = January, 2 = February, 3 = March, etc.).

Payout Ratio: EPS—12 Month: The percentage of earnings paid out as dividends over the latest 12-month period. 5 Year Average: The average payout ratio for the previous five years. A payout ratio of 100% means the dollar amount of dividends paid equals the dollar amount of profits earned.

Payout Ratio: FCFPS (12 Month): The percentage of free cash flow per share paid out as dividends over the latest 12-month period. Free cash flow is cash flow from operating activities less capital expenditures. A measure of a company’s ability to both pay dividends and increase its cash balance.

P/E Ratio (TTM): The price-earnings ratio (price divided by earnings) based on reported earnings per share for the previous 12 months (trailing 12 months).

Total Return Since Purchase—Stock: The change in a stock’s price plus the value of all dividends received during the holding period divided by the commission-adjusted purchase price. Index: The total return of the benchmark index since the stock was added to the DI tracking portfolio, expressed as a percentage.
Amgen Inc. is a biotechnology company that discovers, develops, manufactures and delivers various human therapeutics.

Some of Amgen’s main products include: Enbrel, which treats moderate-to-severe active rheumatoid arthritis and chronic plaque psoriasis (23% of third-quarter 2019 revenue); Neulasta, which helps boost the immune system (12%); Prolia, which increases bone mass in osteoporosis patients (11%); XGEVA, which aids in the prevention of skeletal-related events in patients with bone metastases from solid tumors (8%); and Aranesp, which treats anemia caused by specific disorders (8%). The company recently acquired worldwide rights to Otezla, a treatment for plaque psoriasis and psoriatic arthritis that generated sales of $1.6 billion in 2018. Based on current estimates, Otezla will be Amgen’s best-selling product in 2020.

**Growth Trends**

Amgen has continued to grow despite steady regulatory and competitive headwinds. In aggregate, the company reported that portfolio volume has grown for seven consecutive years. The catalyst for the company’s future growth depends on it rapidly advancing its oncology portfolio.

Revenue for Amgen has increased at a 4.9% annual rate of growth over the last five years but has slowed to 3.1% over the last three years.

Net income is much stronger, with a five-year compound annual growth rate (CAGR) of 10.6% and three-year CAGR of 6.6%.

Gross profit margins currently at 82.1% are robust but may experience a slight decline going forward, reflecting the impact of biosimilar and generic competition against key products. By comparison, the industry average is 65.8%.

Analysts expect adjusted earnings per share to increase by 16.3% this fiscal year to $14.69 and expand 8.6% to $15.95 per share for 2020. The I/B/E/S consensus estimate calls for an annual dividend of $5.80 per share, above the five-year average of 2.4%.

Amgen has been paying a dividend since 2011 and has seen a positive trend in free cash flow per share over the last five years. Over the last five years, the dividend has increased at an annualized rate of 22.9%.

**Financial Strength**

Amgen is a well-diversified, financially sound biotechnology company with a healthy pipeline. While the industry is very competitive, Amgen has managed to maintain its competitive edge by introducing new drugs and acquiring other companies that strategically fit its portfolio.

The ratio of total liabilities to total assets has worsened over the last five years from 62.6% to 81.6%, with a large spike in 2018 mainly due to its $10 billion modified Dutch auction tender offer. The current industry median is 48.6%.

Amgen’s current earnings payout ratio is 43.3% and its free-cash-flow payout ratio is 37.0%, which is above its five-year average of 29.2%.

Amgen’s strong operating and free cash flows should allow it to continue returning capital to investors. Amgen generated operating cash flow of $9.8 billion over the last four quarters and has seen a positive trend in free cash flow per share over the last five years.

In the third quarter of 2019, Amgen returned $1.2 billion to shareholders through stock repurchases and $900 million in dividends paid.

**Valuation**

Amgen shares currently yield 2.5%, based on an indicated annual dividend of $5.80 per share, above the five-year average yield of 2.4%.

Amgen is trading with a trailing price-earnings ratio of 17.9, above the five-year average of 16.7, and well below the pharmaceuticals industry median of 20.9. The forward price-earnings ratio is 15.9 times expected 2019 earnings and 14.7 times consensus 2020 earnings.

**Risks**

The biotechnology industry is very competitive, and Amgen faces significant competition on many fronts. Biosimilars have a large impact on Amgen’s business model. Two of Amgen’s key products already face biosimilar competition in Europe, and the U.S. Food and Drug Administration (FDA) is beginning to approve biosimilars in the U.S.

As patents expire on current drugs, new products need to be ready to help support revenue and earnings growth. Regulatory and reimbursement changes, including Medicare dialysis reimbursement cuts, may continue to harm Amgen’s Aranesp and EpoGen drug products.

Before the Otezla acquisition, Amgen’s two largest products as a percentage of revenue (Enbrel and Neulasta) had seen declining demand and subsequent declining sales. Sales growth has declined as the company works on launching new products to mitigate the loss of revenue from legacy products. This is illustrated by Amgen’s third-quarter revenue results: Newer brands like Prolia, Repatha and Aimovig delivered double-digit growth year over year, but total portfolio revenue was flat.

**Bullish Factors**

- Worldwide rights to blockbuster psoriasis drug Otezla strengthen its inflammatory drugs portfolio
- Robust pipeline, including branded biosimilars and recent launch of potential blockbuster cholesterol drug Repatha and migraine drug Aimovig
- Strong dividend growth

**Bearish Factors**

- Legacy products facing headwinds
- Strong competition, particularly with biosimilars
- Pipeline drugs could fail to become marketable
**Addition Alert Date:** 10/27/2017  
**Price at Alert:** $175.28  
**Risk Index:** 1.74  
**Market Cap (Mil):** $138,337.8  
**Avg Daily Dollar Volume (Mil):** $558.7  
**Primary Sector:** Healthcare  
**Primary Industry:** Pharmaceuticals

Amgen Inc. is a biotechnology company that discovers, develops, manufactures and delivers various human therapeutics for the treatment of serious illness in the areas of oncology/hematology, cardiovascular disease and neuroscience. Amgen's products portfolio includes Enbrel for inflammatory diseases; immune system boosters Neulasta and Neupogen; and bone-strengthening drug Prolia. Recent drug launches include Repatha (cholesterol-lowering) and Aimovig (migraine). The company completed its $13.4 billion acquisition of worldwide rights to Otezla, a treatment for plaque psoriasis and psoriatic arthritis in November 2019.

### Dividend Data

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### Growth

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### Est Surprise

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### EPS (Qtr)

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### Sources:

AII Stock Investor Pro, Thomson Reuters and I/B/E/S.
Eastman Chemical Co. (EMN)

Eastman Chemical Co. was originally founded in 1920 to produce chemicals for Eastman Kodak (KODK). Since then, the company has evolved into a global producer of specialty chemicals. Eastman’s products have a wide variety of end uses and the company ranks either number one or two in terms of market share for the markets that it serves. Significant revenues are realized in North America, Asia Pacific, Europe, the Middle East and Africa.

Eastman has four business reporting segments: additives & functional products (36% of year-to-date 2019 revenues), advanced materials (29%), chemical intermediates (26%) and fibers (9%). The additives & functional products segment manufactures chemicals for a variety of end uses including tires, coatings, consumables and feed additives. The chemical intermediates segment manufactures products used for industrial chemicals and processing, building and construction, health and wellness and agrochemicals. The advanced materials segment produces specialty plastics, interlayers and films. The fibers segment produces acetate products.

Growth Trends

Eastman has sought growth through both existing products and strategic acquisitions. Since the $2.8 billion acquisition of Taminco Corp. in 2014, most of the acquisitions have been relatively small. The company has referred to these purchases as “bolt-ons,” a reference to the fact that they have added to existing business segments instead of having a substantial impact on revenues and earnings.

Sales have grown at a 1.7% annualized pace over the past five years. The company’s streak of annual sales growth was interrupted in 2016 and has been inconsistent since. Revenues this year are on track to decline for the second time in four years.

Earnings per share could decline by 4.3% this year. Eastman lowered its full-year adjusted earnings forecast in October from a range of $7.50 and $8.00 per share to $7.00 to $7.20 per share. Global trade issues were cited as the key reason for the change. If the company’s guidance proves to be correct, it would be the first annual decrease since 2014.

Growth is expected to resume next year, with earnings per share expected to rebound to $7.86 per share. This forecast is down from the $8.57 per share analysts were expecting three months ago.

Eastman raised its dividend near the start of the month by 6.5%. The 10th consecutive annual increase raised the quarterly dividend to $0.66 per share. On an absolute basis, the $0.04 hike was the smallest since 2012.

Financial Strength

Eastman has both the financial ability and the stated intent to keep growing its dividend. Its payout is reasonable at 43.5% of earnings and 29.6% of free cash flow. The company has routinely been free-cash-flow positive. Eastman continues to expect positive free cash flow to approach $1.1 billion this year.

The priorities for cash flow include paying down debt and supporting the dividend. Remaining free cash will be used for acquisitions and repurchasing stocks. Retiring CFO Curtis Espeland recently told attendees at an investor conference to expect the company to continue looking for bolt-on acquisitions.

Eastman’s debt has been decreasing relative to its assets. The company’s liabilities-to-assets ratio of 62.7% is below the basic materials industry average of 71.1%.

Valuation

Shares of Eastman yield 3.5%. This is well above the five-year average range of 2.0% to 2.8%. The yield also ranks Eastman among the 20% highest-yielding members of the S&P 500 and the 15% highest-yielding stocks overall.

Eastman’s price-earnings ratio of 14.3 also implies that the stock is cheap. It ranks in the approximate bottom third of all exchange-traded stocks. The current price-earnings ratio compares to a five-year average of 13.0.

Risks

Eastman’s global reach exposes it to variations in global growth as well as trade issues. Slowing growth in China and tough economic conditions in other countries have adversely impacted revenues. At the same time trade disputes have affected end-market demand for the products that Eastman’s products are used in, such as tires.

Because Eastman’s revenues are realized in foreign countries, the company is exposed to currency risk. The combination of weaker international economies and a stronger dollar have been headwinds for Eastman’s attempt to grow.

High multiples have prevented the company from making an acquisition of significant size in recent years.

Because the company’s products are often used in the production and manufacture of other products, Eastman lacks control over the end products and end-market demand.

Bullish Factors

- Yield ranks among the highest 20% of all S&P 500 members
- Has grown its dividend for 10 consecutive years and has the cash flow to continue raising it
- Sells to a variety of markets, and is a leader in many of the product categories it targets

Bearish Factors

- Earnings are projected to decline this year, the second such decline in four years
- Economic headwinds in foreign markets and trade issues have adversely impacted revenues
- High valuations have kept acquisitions from being large enough to drive revenue and earnings growth
Eastman Chemical Co. is a global specialty chemical company that produces a broad range of advanced materials, chemicals and fibers. Eastman Chemical's businesses are divided into four reporting segments: additives & functional products (coatings, resin, tire industry, animal nutrition and crop protection), advanced materials (specialty plastics, interlayers and films), chemical intermediates (chemical intermediates, amines, specialty fluids and plasticizers) and fibers (acetate products). The company operates globally, selling to customers in more than 100 countries. Eastman Chemical's stated objective is to be an outperforming specialty chemical company with consistent earnings growth and strong cash flow.

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Indicated Annual Dividend: $2.64
Current Dividend Increase: Date Dec 5, 2019
Latest Dividend Increase: % 6.5%
Dividend Yield: Current 3.5%
Dividend Yield: 5-Year Avg (High-Low) 2.3% - 2.0%
Dividend Paid Since: 1994
Number of Years of Div Increases: 10
Direct Invest Option: Yes
DRIP Plan: Yes

Declared Ex-Div Date Payable Amount
Dec 5, 2019 Dec 16, 2019 Jan 3, 2020 $0.6600
Aug 1, 2019 Oct 4, 2019 Sep 16, 2019 $0.6200
May 2, 2019 Jun 14, 2019 Jul 5, 2019 $0.6200
Feb 14, 2019 Mar 14, 2019 Apr 5, 2019 $0.6200
Dec 7, 2018 Dec 14, 2018 Jan 4, 2019 $0.6200
Aug 3, 2018 Sep 13, 2018 Oct 5, 2018 $0.5600

Stock Growth Rel Strength Rank
4 Week (6%) 0.92 23
13 Week 4% 0.99 60
26 Week 6% 0.98 62
52 Week 6% 0.89 55

Growth TTM 3 Year 5 Year
Dividends 10.5% 11.9% 13.3%
Sales (8.8%) 1.7% 1.7%
Net Income (50.1%) 8.4% (1.5%)
EPS Basic (48.5%) 10.3% 0.2%
EPS Dil Cont (36.0%) 9.4% (0.1%)

Est Surprise EPS % Surp SUE Score
Oct 24, 2019 $1.94 (2.1%) (0.80)
Jul 25, 2019 $1.99 (4.8%) (1.60)

EPS Estimates Quarterly Annual Annual
# of Estimates 17 13 13
Current $1.39 $7.10 $7.86
Month Ago $1.41 $7.11 $7.89
# Rev Up 0 0 0
# Rev Down 3 3 4
Three Mos. Ago $1.91 $7.68 $8.57
Year/Year Chg 1862.0% (4.3%) 10.7%

EPS ($Q) 2019 2018 3Q/19 1Q/19 2018 Total
TTM $1.93 $1.86 $1.49 $0.07 $5.35
Year Ago $2.99 $2.32 $2.00 $1.05 $8.36

Sales/Sh ($Q) 2019 2018 3Q/19 1Q/19 2018 Total
TTM $17.00 $17.15 $17.12 $17.01 $68.27
Year Ago $18.12 $18.47 $18.26 $16.45 $71.29

Sources: AII, Stock Investor Pro, Thomson Reuters and I/B/E/S.

December 2019

$76.25 ($86.18 - $61.22)
Medtronic PLC (MDT)

Medtronic PLC is one of the world’s leading and largest medical technology companies. Founded in 1949, the company develops, manufactures and markets its medical devices and technologies to hospitals, physicians, clinicians and patients in more than 150 countries. The company operates in four segments: cardiac and vascular group (37% of revenues; includes cardiac rhythm and heart failure, coronary and structural heart and aortic and peripheral vascular), minimally invasive technologies group (28% of revenues; includes surgical solutions, patient monitoring and recovery & renal care solutions), restorative therapies group (27% of revenues; includes spine, brain therapies, specialty therapies & pain therapies) and diabetes group (8% of revenues; includes intensive insulin management, non-intensive diabetes therapies and diabetes services and solutions).

Roughly 46% of the company’s revenues come from outside the U.S., with 16% of revenue from emerging markets.

Growth Trends

Medtronic offers an attractive portfolio of medical products. Medtronic is the largest medical equipment maker, with roughly 50% market share in its core heart devices. The company also has market-leading positions in spinal products, insulin pumps and neuromodulation for chronic pain treatment. Medtronic continues to launch new products and expand its global footprint.

Sales have grown at an annual rate of 12.4% over the last five fiscal years, while bottom line net income has increased at an 8.6% annual rate.

Fully diluted continuing earnings per share have increased at a 2.5% annual rate over the last five fiscal years. The lower long-term growth rate in earnings per share reflects the increased share count from the Covidien merger.

Earnings are expected to grow at an annual rate of 7.6% over the next three to five years. Six analysts provided long-term earnings estimates that range from a low of 6.6% to a high of 8.8%.

Medtronic has been paying a dividend since 1977 and its annual dividend payment has increased each year. Over the last five years, the company has been increasing dividends 12.3% annually. The company announced an 8.0% dividend increase in June 2019.

Medtronic has established tax residence in Ireland. As such, dividends are considered Irish source income, and Irish dividend withholding tax (DWT) rules apply. Residents of the U.S. are entitled to an exemption from DWT.

Financial Strength

Operating margin over the last four quarters is 17.6%, below the company’s five-year average of 19.4%. However, net margin has been expanding and was 15.1% over the last four quarters, above its 12.9% five-year average. Overall, operating cash flow has been strong and growing over the years, and the company is committed to returning cash to shareholders through its dividend and share buyback programs.

Medtronic is paying out 59.8% of its earnings as dividends and 44.3% of free cash flow.

Medtronic’s ratio of total liabilities to assets is 44.5%, below the industry median of 46.1%.

Medtronic’s interest coverage ratio was 6.9 over the last four quarters.

Valuation

Medtronic’s strong and consistent growth—protected by difficult barriers to entry—and merger-related expenses have elevated the firm’s price-earnings level, but the firm still trades at a discount to its industry. Medtronic’s trailing price-earnings ratio is 32.5, above its 25.5 average over the last five years. The forward price-earnings ratio is 19.8 times projected 2020 earnings for the fiscal year ending in April and 18.4 times projected 2021 earnings. These ratios are attractive relative to the industry median price-earnings ratio, which has averaged 36.6 over the last five years.

Medtronic’s relatively strong price action has also pushed down the current yield to 1.9%, based on an indicated annual dividend of $2.16 per common share. The dividend yield is below the 2.2% average yield over the last five years.

Risks

As a medical device manufacturer, Medtronic faces litigation and regulatory risk. Occasional voluntary recalls of products have impacted short-term performance and hurt the reputation of the firm with doctors and patients. Medtronic recalled an insulin pump this year due to cybersecurity problems that can’t be updated or patched.

Medtronic’s products are subject to FDA approval and oversight, and delays in the approval of new products can impact sales. Even early FDA approval of a product can negatively impact short-term sales, as doctors hold off using an older product line until the new and improved product is widely available.

Lastly, the company operates in a highly competitive marketplace and faces pricing pressures from its competitors.
**MDT**

**Addition Alert Date:** 1/6/2017  
**Price at Alert:** $72.87  
**Risk Index:** 1.25  
**Market Cap (Million):** $148,956.2  
**Avg Daily Dollar Volume (Million):** $482.9

Primary Sector: Healthcare  
Primary Industry: Medical Equipment, Supplies & Distribution

Medtronic PLC is a medical technology and services company. The company develops, manufactures and markets its medical devices and technologies to hospitals, physicians, clinicians and patients in approximately 160 countries and operates in four segments: Cardiac and vascular group, minimally invasive technologies group, restorative therapies group and diabetes group.

<table>
<thead>
<tr>
<th>Stock Price</th>
<th>$111.04 ($114.46 - $81.66)</th>
</tr>
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<tbody>
<tr>
<td>Dividend Yield: (%)</td>
<td>Avg 1.9% 2.3 2.3 2.1 2.3 1.9 2.3</td>
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<tr>
<td>Price/Sales</td>
<td>4.8 3.9 3.6 3.7 3.3 3.5</td>
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<tr>
<td>Price/Growth</td>
<td>106.5% 108.1% 106.1% 105.1% 103.8% 102.5%</td>
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<tr>
<td>EPS Dil Cont</td>
<td>1.8% 11.3% 2.4% 2.4% 2.4% 2.5%</td>
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<tr>
<td>EPS Basic</td>
<td>108.1% 11.1% 2.4% 2.4% 2.4% 2.5%</td>
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<tr>
<td>EPS Diluted Extra ($M)</td>
<td>1.776 1.342 (92) 950 699 791</td>
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<td>Payout Ratio: EPS (%)</td>
<td>59.8 58.1 80.4 58.9 60.6 50.0</td>
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<tr>
<td>Operating Margin (%)</td>
<td>17.6 18.9 22.0 18.1 18.6 19.6</td>
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<tr>
<td>Current Ratio</td>
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<tr>
<td>Gross Margin (%)</td>
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<tr>
<td>Net Margin (%)</td>
<td>15.1 15.2 10.4 13.6 12.3 13.2</td>
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<td># of Estimates</td>
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<tr>
<td>Current</td>
<td>$1.39</td>
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<tr>
<td>Month Ago</td>
<td>$1.39</td>
</tr>
<tr>
<td># Rev Up</td>
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</tr>
<tr>
<td># Rev Down</td>
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</tr>
<tr>
<td>Three Mos. Ago</td>
<td>$1.39</td>
</tr>
<tr>
<td>Year/Year Chg</td>
<td>49.1% 63.8% 7.6%</td>
</tr>
<tr>
<td>EPS (Qtr)</td>
<td>10/2019</td>
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<tr>
<td>TTM</td>
<td>$1.01</td>
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<tr>
<td>Year Ago</td>
<td>$0.86</td>
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<tr>
<td>Sales/Sh ($) (Qtr)</td>
<td>10/2019</td>
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<tr>
<td>TTM</td>
<td>$5.54</td>
</tr>
<tr>
<td>Year Ago</td>
<td>$5.54</td>
</tr>
</tbody>
</table>

Sources: AAII Stock Investor Pro, Thomson Reuters and I/B/E/S.

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December 2019
Walgreens Boots Alliance (WBA)

Walgreens Boots Alliance is a global pharmacy-led health and well-being company with fiscal-2019 sales of $136.9 billion. The company operates through three segments: retail pharmacy USA (76.7% of sales), retail pharmacy international (8.0%) and pharmaceutical wholesale (16.9%). Its operations consist of retail drugstores, care clinics, specialty pharmacy services, optical practices and related contract manufacturing.

Its portfolio of retail and business brands includes Walgreens, Duane Reade, Boots and Alliance HealthCare.

From the first store on the South Side of Chicago in 1909, the company now operates or has an equity interest in 18,750 stores in 25 countries and is the largest retail pharmacy, health and daily living destination across the U.S. and Europe. It has also built one of the largest global pharmaceutical wholesale and distribution networks, with more than 390 distribution centers delivering to more than 230,000 pharmacies, doctors, health centers and hospitals each year in more than 20 countries. In addition, Walgreens is one of the world’s largest purchasers of prescription drugs and many other health and well-being products.

Growth Trends

Despite reimbursement pricing pressure and increasing competition from mass merchants and internet retailers for consumer commodity products, Walgreens has demonstrated solid growth due to its scale, transformational acquisitions and strategic partnerships focused on increasing store utilization with clinical partners.

Revenue for Walgreens has increased at a 12.4% annual rate of growth over the last five years but has slowed to 5.3% over the last three years. While the industry is hyper-competitive, Walgreens has maintained an edge through two transformational acquisitions that expanded its global footprint: U.K.’s Boots Alliance in 2014 and 1,932 Rite Aid stores in 2018.

Due to reimbursement pricing pressure and the increased competition mentioned above, Walgreens’ gross profit margins have decreased over the seven years from 29.2% to 22.0%, basically in line with the industry at 22.7%. Its net margin of 2.9% is below the five-year average of 3.6.

However, the typical company in the drug retailers industry is not profitable.

The I/B/E/S consensus estimate calls for earnings per share to grow 2.3% over the next three to five years, based on a poll of four analysts. Analysts expect earnings to decline 1.1% to $5.94 per share for the current fiscal year ending August 2020 and then increase 3.9% and 3.6% over the following two years.

Walgreens has been paying a dividend since 1933 and has increased its annual dividend in each of the last 44 years. In July 2019, the company announced a 4.0% increase in its quarterly dividend, down from the 10% increase the year before. Over the last five years, the dividend has increased at an annualized rate of 6.9%.

Financial Strength

The ratio of total liabilities to total assets has increased over the last five years from 55.1% to 65.2% but is well below the industry median of 89.0%. The company’s ability to pay interest is strong, as measured by the times interest earned ratio of 7.4.

Walgreens’ current earnings payout ratio is 40.8% and its free-cash-flow payout ratio is 40.7%, which is above its five-year average of 29.6%.

The company’s long-term capital policy is to maintain a strong balance sheet and financial flexibility, including returning surplus cash flow to stockholders in the form of dividends and share repurchases over the long term. For fiscal 2019, Walgreens returned $4.2 billion to shareholders through stock repurchases and $1.64 billion in dividends paid.

Valuation

Shares currently yield 3.1%, based on an indicated dividend of $1.83 per share. This yield is above the five-year average yield of 2.0%.

The company is trading with a trailing price-earnings ratio of 13.6, well below the five-year average of 18.7, and below the industry median of 15.7. The forward price-earnings ratio is 9.9 times forecasted earnings for 2020. The stock is trading at historically low valuation levels.

Risks

The landscape across retail (drugs) is very competitive, and Walgreens faces significant headwinds from mass merchants and internet retailers for consumer commodity products.

Regulatory and reimbursement changes will likely continue to impact gross margins, but Walgreens should be able to offset this decline as the company improves its cost structure and accelerates cost savings initiatives. The company is in the midst of a multi-faceted cost management program that is expected to deliver in excess of $1.8 billion of annual cost savings by fiscal 2022.

Weak U.K. market conditions and continued uncertainty surrounding Brexit are playing a role limiting near-term earnings per share growth.

<table>
<thead>
<tr>
<th>Bullish Factors</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Stock trading at historically low valuation levels, with dividend yield above its historical average high</td>
</tr>
<tr>
<td>• Acquisition of Rite Aid stores driving sales growth</td>
</tr>
<tr>
<td>• Emphasis on strategic partnerships and joint ventures</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Bearish Factors</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Increasing competition, particularly with consumer commodity products</td>
</tr>
<tr>
<td>• Reimbursement pressures and pricing transparency will likely lead to stock volatility</td>
</tr>
<tr>
<td>• Weak U.K. market and continued Brexit confusion</td>
</tr>
</tbody>
</table>

December 2019
Boots pharmaceutical wholesaling and distribution businesses.
Why DI Holdings May Not Pass the DI Ideas Quant Screen Today

DI Ideas is a list of Dividend Investing stock ideas that pass our initial quantitative filters for consideration for the model DI portfolio. To get to the DI Ideas screening strategy, login to the DI website (www.aaiidividendinvesting.com) and click the “DI Ideas” tab. AAII introduced the DI Ideas tool to enhance the DI subscriber experience and to deliver more meaningful content. We believe this tool will help you find additional stock candidates to meet your income investing needs.

The DI Ideas area is updated daily with stocks that currently meet the initial screening criteria used for inclusion in the actual DI portfolio. Note that these top DI Ideas may not be in the actual DI tracking portfolio and may never be added to it, but they meet the criteria used when making additions to the DI portfolio.

Of the 34 companies that passed the DI Ideas screen using data as of December 10, the actual DI portfolio held six of them: BlackRock Inc. (BLK), Comerica Inc. (CMA), Cummins Inc. (CMI), Royal Caribbean Cruises Ltd. (RCL), Snap-on Incorporated (SNA) and Walgreens Boots Alliance (WBA). There may be some DI subscribers wondering why only six companies in the DI portfolio currently pass the DI Ideas quantitative filters. We will address this concern in a moment but, rest assured, the other 18 companies in the DI portfolio all passed the quantitative filters when they were added to the portfolio.

Quantitative Filters Behind DI Ideas

The quantitative filters behind DI Ideas seeks to identify the best dividend investment opportunities by focusing on a select universe of well-financed companies that have a long history of earnings and dividend growth, positive free cash flow, reasonable valuations and a solid outlook for both price appreciation and higher dividends in the future. There are over 40 characteristics that are used to create the DI Ideas screen. Three of them are: 1) current dividend yield greater than its five-year average yield, which seeks out companies whose dividends have increased faster than increases in share price, or whose current share price has declined recently; 2) five-year dividend growth rate greater than 3%; and 3) paid a dividend for each of the last seven years and has never reduced it during this period.

Still Solid Rising-Dividend Payers

Some of the DI holdings do not currently pass the filter because they simply do not meet one or two of its qualifying requirements. The characteristics that eliminate the most DI holdings from passing the DI Ideas screen are the requirements that the ratio of long-term debt to capital be less than or equal to 50% and five-year sales growth be greater than 3%; eight DI portfolio companies do not currently meet the long-term-debt-to-capital requirement and nine DI holdings do not currently meet the sales growth requirement. Although some DI holdings do not pass the quantitative filters, it does not mean that they aren’t attractive rising-dividend payers.

The portfolio addition alert date for Texas Instruments (TXN) was April 5, 2013. On that date, Texas Instruments passed the quantitative filters for inclusion in the DI portfolio. Texas Instruments was added to the portfolio, and it has been one of the strongest performers since the DI portfolio’s inception. However, the company does not currently pass the DI Ideas screen.

Texas Instruments meets all the characteristics looked for in a company to add to the DI portfolio, except one. As of December 10, the company does not meet the payout ratio characteristic. The DI approach looks for companies with a 12-month payout ratio that is less than or equal to 50%. Texas Instruments’ payout ratio is 56.2%, so it does not pass the filter. However, it has continued to be held in the portfolio because all its other fundamentals are strong.

Home Depot Inc. (HD) is another good example of a fundamentally strong company that does not currently pass the screen because its payout and long-term-debt-to-capital ratios are too high. The DI portfolio seeks companies with long-term-debt-to-capital ratios for the most recent quarter that are less than or equal to 50%. Home Depot’s ratio is 104.2%. Heavy debt spending on buybacks has skewed total liabilities high relative to assets, resulting in negative shareholder equity.

The Home Depot example reminds us that screening is only the first stage in the process to identify the best dividend opportunities, and it involves scanning a group of securities to find those that merit further in-depth analysis. Home Depot’s financial leverage ratio is extremely high, but with further research an investor understands that it borrowed money at attractive rates to buy back shares while simultaneously its interest coverage ratio continued to improve.

IBM Corp. (IBM) and International Paper Co. (IP) are holdings that do not pass the DI Ideas screen due to the same four characteristics: payout ratios greater than 50%, long-term-debt-to-capital ratios for the most recent quarter greater than or equal to 50%, five-year sales growth less than 3% and five-year adjusted earnings per share growth less than 3%.

One of the reasons why Eastman Chemical Co. (EMN), Medtronic PLC (MDT), PepsiCo Inc. (PEP) and UnitedHealth Group Inc. (UNH) do not pass the DI Ideas screen is that their current dividend yields are less than their five-year average yields.

Huntington Bancshares Inc. (HBAN) does not meet two of the filter requirements. The DI portfolio seeks companies with operating margins for the last 12 months and the previous year greater than or equal to its industry operating margins. Huntington’s operating margins are above 70% but are below the comparable banking industry figures.