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# DOW THEORY FORECASTS®

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Stock Market Trends & Securities Reports Since 1946

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## What, me worry?

We imagine many of you are sick of hearing the *Forecasts* commingle these words:

- *Inflation.*
- *Interest rates.*
- *Corporate profits.*

We refer to this triumvirate so often, however, because the threesome *matters* to stock-market returns. Indeed, inflation, interest rates, and corporate profits are the three most important engines of sustained market moves.

Looking at these three factors, the one with perhaps the most worrisome profile today is inflation, which in recent months has reached levels not seen in years. The Consumer Price Index jumped 5.4% year-over-year in July, the highest in 13 years. And trillions of dollars in stimulus money, not to mention the specter of trillions more in proposed government spending, are fueling inflationary concerns.

Should investors be concerned about inflation? Absolutely. Given inflation's impact on investment portfolios, investors should *always* worry about inflation. Inflation matters to stock prices because it devalues growth. Said differently, higher inflation tends to mean lower price/earnings ratios, which

*Continued on page 2*

# What to do as inflation rises

**SPECIAL REPORT**

U.S. inflation has accelerated this summer after more than a decade of historically low price gains in the wake of the financial meltdown. Growth in the Consumer Price Index (CPI) reached 5.4% for both June and July, up from 1.7% in April and its highest reading since August 2008.

A proxy for inflation, CPI measures the average price that urban households pay for a fixed basket of consumer goods and services. The index is weighted more heavily toward things that make up a larger portion of a consumer's budget, such as housing, transportation, and food. Core CPI, which excludes food and fuel, tends to be less volatile and is the preferred inflation metric for many analysts and economists.

Year-over-year CPI growth has averaged 2.8% since 1920. It steadily declined in each of the past four decades, and has experienced fewer wild swings since the 1980s. From 2010 to 2019, inflation was lower than any decade since the 1930s, when deflation was common.

In July, year-over-year prices rose highest for energy (up 24% from a year earlier), transportation services (up 6%) and automobiles, both new (up 6%) and used (up 42%). Many Americans stayed close to home during the pandemic last summer, lowering demand in the above categories. That pressured prices, which explains the current snap-back. Supply shortages and high shipping costs are also pushing up prices this year — food rose 3% and apparel 4%

*Continued on page 4*

### CPI ON THE RISE


The Consumer Price Index rose 5.4% year-over-year in June and July, the highest inflation since 2008.

## Economic Review

# What, me worry?

*Continued from page 1*

tends to mean lower stock prices. Inflation is especially punishing to stocks sporting the highest expected growth profiles and premium valuations. You can review evidence of the punitive impact of inflation on the highest expected growers in the table at the bottom of page 4. Two groups that have historically performed the worst during high inflationary periods are communications and technology, sectors typically sporting high-P/E, high-growth stocks.

A sustained rise in inflation could be trouble. However, while ingredients exist that could make inflation problematic for investment portfolios, the *Forecasts*, at least for now, doesn't see inflation as a market killer, for the following reasons:

➤ **The Fed's argument that inflation should be transitory seems reasonable, at least for now.** While siding with government economists makes us a bit, well, queasy, a lot of the explanations for the recent spike in inflation spring from demand-supply challenges. Following the atypical, Covid-induced recession, pent-up demand exploded into a supply-challenged marketplace, driving prices significantly higher.

But such demand-supply imbalances have a way of working themselves out in time. We already see declines in certain commodity prices, such as lumber (down approximately 70% from its May high), crude oil (down 9% from its July peak) and copper (down 8% from the May peak).

➤ **Wages, though up, have yet to reach levels that should drive sustained inflationary pressures — yet.** Average hourly wages for all private-sector employees rose 4.0% in July 2021. That's up from the 3.1% average year-over-year growth rate in 2019. However, several factors that have contributed to higher wages, especially the tight labor market, may loosen a bit as we move toward the end of the year. The expiration of enhanced unemployment benefits, scheduled to end nationwide Sept. 6, could boost the supply of new workers, as could the reopening of schools. Median salary increase budgets for 2022, according to the Conference Board's long-running Salary Increase Budget Survey, should be about 3%, consistent with the previous 10 years.

The *Forecasts* will become much more concerned about inflation and its impact on the market if wage inflation starts running consistently above 4.5% to 5%. Thus, the next few months will be important in gauging the inflation threat.

➤ **Inflation-sensitive sectors don't yet reflect heightened inflation numbers.** As mentioned earlier, growth stocks should be most sensitive to inflation. However, the S&P 1500 Growth Index has outperformed the S&P 1500 Value Index by 13% in the last three months. Furthermore, the Nasdaq Composite — home to many growth stocks, including some of the more crazily valued — has been making a series of new highs. Stocks are forward-looking, which means they constantly discount future expectations, including inflation. At this point, the market seems reasonably comfortable with the inflation outlook.

➤ **Interest rates don't tell an inflationary story.** Conventional wisdom says that the higher the inflation rate, the more likely interest rates will rise. Higher rates reflect lenders' demand for compensation to offset the decrease in purchase power of money they will receive in the future. Interestingly, current interest rates across every part of the yield curve are flat to lower than they were at the beginning of July.

**Bottom line:** The inflation story, while difficult to assign to the bullish side of the ledger, seems only modestly negative or neutral at this time. And the other two engines of sustained market performance — interest rates and corporate profits — tilt in the bullish direction. Combine that with the Dow Theory still telling a bullish story, and equities remain the most attractive asset class. For now, we expect stocks to maintain their upward bias, albeit at rates likely more moderate than the gains posted up to this point.



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# MARKET COMMENTARY

## Don't exit market on bubble concerns

Is the stock market massively overvalued? Should you exit the stock market?

Even if the answer to the first question is yes, it may not follow that the answer to the second question is yes.

Many of the skeptics calling the U.S. stock market a bubble rely on a single yardstick to measure its valuation, the price/earnings ratio of the capitalization-weighted S&P 500 Index. This index, which comprises about 80% of the market's total value, trades at 21 times expected year-ahead earnings — more than 30% above the 10-year norm of 16. While there's no denying that the stock market's total value is unusually high relative to total earnings, several factors argue against selling all your stocks.

First, the last major signal under the Dow Theory was a reconfirmation of the bullish primary trend, and the final speculative phase of a bull market can be quite lucrative for investors.

Second, while the S&P 500 Index may be overvalued relative to its own history, it's unusually cheap relative to bond yields. Yields on 10-year Treasury bonds could surge as the Federal Reserve dials back its highly stimulative policy, but yields could also be mired in the 1.35% to 3.25% range that prevailed in the eight years ended December 2019.

Third, a handful of giant companies skews the S&P 500 Index's valuation, as does the unusually large number of companies with little or no earnings. Excluding stocks with P/E ratios above 75 or below 0, the median S&P 500 stock trades at 21.6 times trailing earnings, about 17% above the norm since 1994 of 18.5. In other words, one-half of S&P 500 stocks trade at less than 21.6 times trailing earnings.

For the S&P 1500, which also includes small and midcap stocks, the median P/E is 18.8, about 3% above the norm of 18.3 since 1994. Today's median P/E translates into an earnings yield (earnings/price ratio) of 5.3%, or more than four percentage points above the 10-year Treasury yield. That is more than double the average spread since 1994. The spread is also unusually wide based on average earnings yield, as shown below.

### MEDIAN P/E OF S&P 1500 SECTORS

| | *Recent Median Trailing P/E Ratio* | *Norm Since 1994* | *Recent As % Of Norm* | *% Of Month-Ends Lower Since 1994* |
|---|---|---|---|---|
| All S&P 1500 stocks | 18.8 | 18.3 | **103%** | 57% |
| Financials | 11.8 | 14.8 | **79** | 7 |
| Cons. Discretionary | 15.5 | 17.2 | **90** | 20 |
| Energy | 16.3 | 17.9 | **91** | 39 |
| Technology | 22.0 | 24.1 | **91** | 32 |
| Consumer Staples | 18.3 | 19.7 | **93** | 33 |
| Health Care | 23.3 | 22.8 | **102** | 49 |
| Materials | 18.7 | 17.5 | **107** | 65 |
| Communications | 21.6 | 19.7 | **110** | 76 |
| Utilities | 18.8 | 16.2 | **116** | 83 |
| Industrials | 22.5 | 18.6 | **121** | 92 |
| Real Estate * | 40.1 | 30.4 | **132** | 94 |

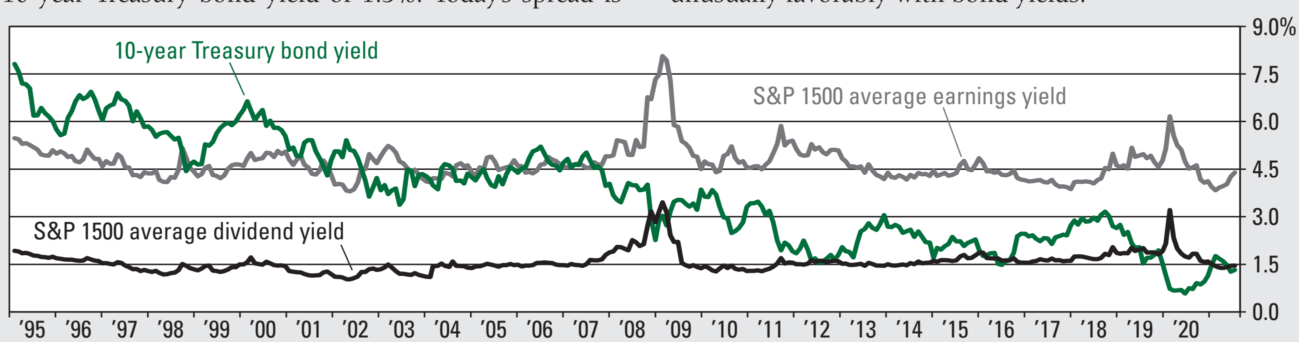
** Data since 2001.*

### Conclusion

Big stocks are expensive, and we recommend several of these names because of their stellar growth prospects. But the typical stock is not outrageously valued, especially if compared to what's available in the bond market. For now, our buy lists have about 93% in stocks.

### BOND YIELDS VERSUS EARNINGS AND DIVIDEND YIELDS

Excluding stocks with price/earnings ratios above 75 or below 0, the average S&P 1500 stock has an earnings yield of 4.4%, about three percentage points above the 10-year Treasury bond yield of 1.3%. Today's spread is more than three times the average spread since 1994, and higher than 90% of month-end observations since 1994. Similarly, today's average dividend yield of 1.4% compares unusually favorably with bond yields.



# What to do as inflation rises

*Continued from page 1*

last month.

Since 1990, sectors that tend to perform best when inflation is low or moderate include consumer discretionary, financials, health care, industrials, materials, and technology. The energy and utilities sectors tend to fare well when inflation is moderate to higher. In a high-inflation environment, consumer staples and health care have historically performed best. See the table below for more details.

Below, we review four high-potential stocks from sectors with histories of performing well during periods of higher inflation.

A provider of research animals and drug-safety testing, **Charles River Laboratories International** *($444; CRL)* boasts strong operating momentum and should remain an attractive play for growth in the drug-development market in coming years. Charles River has performed work on more than 80% of drugs approved by the U.S. Food and Drug Administration (FDA) over the past three years. Investment in new drugs is steadily increasing, with funding for a single FDA-approved drug requiring up to $2.5 billion over 10 to 15 years of development.

Charles River is raising prices aggressively and expanding capacity. In the first half of 2021, Charles River increased earnings per share 50%, revenue 25%, cash from operations 55%, and free cash flow 58%. The company is seeing growth across all business segments and geographic markets. Management has already raised its 2021 guidance twice this year, most recently projecting 20.5% to 22.5% revenue growth, with 13% to 15% of that growth being organic. Looking out over the next three years, Charles River expects annual organic revenue to grow by low-double digits and seems confident that operating profit margins will expand further. *Charles River is a Focus List Buy and a Long-Term Buy.*

**Danaher** *($328; DHR)* shares look timely considering health care has been the top-performing sector in the S&P 1500 Index during periods of high inflation since 1990, as shown in the table below. Danaher shares have produced a 34% total return over the past three months and returned 48% in 2021. Danaher shares aren't cheap at 37 times trailing earnings and 35 times estimated 2021 profits, but they remain cheaper than the rest of the S&P 1500 Index's health-equipment industry, which has a median trailing P/E of 39 and current-year P/E of 37.

Raising its full-year guidance in July, Danaher is increasingly bullish on demand for coronavirus testing, projecting only a small drop-off in testing volume next year. Management now expects $2 billion in revenue from coronavirus vaccines and therapeutics this year, with a backlog of $1.5 billion carrying into 2022. That guidance did not include any benefit from booster shots or vaccine approval for children under the age of 12, leaving room for upside. Danaher is projected to increase 2021 earnings per share 50% on revenue growth of

## INFLATION'S DECLINE

Entering 2020, inflation had steadily declined over the past four decades, based on average monthly readings for the Consumer Price Index (CPI). Between 2010 and 2019, inflation was the lowest since the 1920s and 1930s. The past decade's monthly high of 3.9%, occuring in September 2011, was lower than that of any other decade. Inflation reached 5.4% in both June and July.

| *Decade* | *Average* | *High* | *Low* |
|---|---|---|---|
| 1920 to 1929 | 0.2% | 23.7% | -15.8% |
| 1930 to 1939 | -1.9 | 5.6 | -10.7 |
| 1940 to 1949 | 5.7 | 19.7 | -2.9 |
| 1950 to 1959 | 2.1 | 9.4 | -2.1 |
| 1960 to 1969 | 2.3 | 6.2 | 0.7 |
| 1970 to 1979 | 7.1 | 13.3 | 2.7 |
| 1980 to 1989 | 5.6 | 14.8 | 1.1 |
| 1990 to 1999 | 3.0 | 6.3 | 1.4 |
| 2000 to 2009 | 2.6 | 5.6 | -2.1 |
| 2010 to 2019 | 1.8 | 3.9 | -0.2 |
| **Since 2020** | **2.1** | **5.4** | **0.1** |
| **Total** | **2.8** | **23.7** | **-15.8** |

*Source: U.S. inflation calculator.*

## HOW INFLATION AFFECTS SECTOR PERFORMANCE

We show below how sectors in the S&P 500 Index have performed in different inflation environments since 1990. The consumer-staples and health-care sectors have performed best in high-inflation environments, based on rolling 12-month periods where the Consumer Price Index (CPI) averaged 4.0% or higher. We excluded the real estate sector, launched in 2015, due to a lack of historical data.

| | | *Average 12-Month Return* | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| *Inflation Level* | *Number Of Periods* | *S&P 500 Index* | *Communications* | *Consumer Discretion.* | *Consumer Staples* | *Energy* | *Financials* | *Health Care* | *Industrials* | *Materials* | *Tech* | *Utilities* |
| Deflation (below 0%) | 5 | 15% | 0% | 29% | 8% | 4% | 10% | 11% | 10% | 27% | 40% | -1% |
| Low (0% to 1.9%) | 122 | 12 | 9 | 18 | 9 | -2 | 11 | 13 | 11 | 8 | 20 | 4 |
| Moderate (2.0% to 2.9%) | 137 | 13 | 8 | 12 | 9 | 12 | 12 | 14 | 13 | 11 | 25 | 4 |
| Higher (3.0% to 3.9%) | 85 | 2 | 0 | 3 | 6 | 11 | 7 | 2 | 5 | 3 | -2 | 11 |
| High (4.0% and higher) | 18 | 4 | -10 | 6 | 21 | -1 | 3 | 22 | 1 | 4 | -3 | 1 |
| **All periods** | **367** | **10** | **6** | **12** | **9** | **6** | **10** | **11** | **10** | **8** | **16** | **5** |

29%. *Danaher is a Focus List Buy and a Long-Term Buy.*

**MDU Resources Group** *($32; MDU)* shares have climbed 1% in the past month and 25% in 2021, despite a somewhat disappointing June-quarter report, where both per-share profits and sales missed consensus estimates. Still, MDU's utility business saw sales volumes rise 7% last quarter, as growth from industrial and commercial companies overcame lower residential demand. Its construction business has offset rising raw-materials costs with its own price hikes and appears positioned to benefit from the U.S. infrastructure legislation winding through Congress. The proposed $1 trillion bill, spread out over five years, includes $65 billion to update the nation's electric grid by building new power lines and expanding renewable energy.

Like the rest of the utilities sector, MDU shares tend to perform best during periods of higher inflation. In rolling 12-month periods since 1990, when monthly readings for the Consumer Price Index averaged 3.0% to 3.9%, MDU shares averaged a total return of 16%, exceeding its 9% return for all 12-month periods. The S&P 1500 Index utilities sector averaged a 12-month return of 11% for similar higher inflationary periods, versus 5% for all periods. *MDU is a Buy and a Long-Term Buy.*

Three factors are driving **Thermo Fisher Scientific's** *($562; TMO)* growth: the life-sciences industry's robust fundamentals, strong global economic activity, and the company's role in the pandemic response. Management's decision in July to curtail 2021 expectations for coronavirus tests could prove overly cautious, given the pandemic's recent resurgence. Thermo Fisher expects a very strong market for coronavirus therapies and vaccines in 2022. Moreover, the company's work on mRNA vaccines for the coronavirus could spur next-generation vaccines for other diseases in the coming years. The consensus 2022 estimate of 10% lower profits on flat sales seems conservative.

The stock has rallied 26% over the past three months yet still looks attractively valued. At 22 times trailing earnings, Thermo Fisher's stock trades below its own five-year median of 34 and industry median of 44 for life-sciences stocks in the S&P 1500 Index. Since 1990, Thermo Fisher shares have averaged 12-month returns of 22% during periods when the Consumer Price Index rose by at least 4.0%. That compares to the stock's average return of 18% for all 12-month periods during that stretch. *Thermo Fisher is a Focus List Buy and a Long-Term Buy.*

## TOP PLAYS FOR HIGHER INFLATION

We screened for A-rated stocks in consumer staples, energy, health care, and utilities. Those sectors have historically performed better in environments of higher inflation. Stocks in **bold** are on our Buy lists.

| | 12-Month Change | | | Total Return | | Quadrix Scores | | | |
|---|---|---|---|---|---|---|---|---|---|
| *Company (Price; Ticker)* | *Earnings Per Share* | *Sales* | *Trailing P/E Ratio* | *Past 3 Months* | *Year-To-Date* | *Momentum* | *Value* | *Overall* | *Sector* |
| AbbVie *($112; ABBV)* | 27% | 48% | 10 | 1% | 8% | 57 | 70 | 79 | Health care |
| Anthem *($369; ANTM)* | -15 | 14 | 18 | -6 | 16 | 22 | 67 | 52 | Health care |
| **Charles River Labs.** *($444; CRL)* | 38 | 19 | 45 | 33 | 78 | 79 | 15 | 72 | Health care |
| Cigna *($211; CI)* | -8 | 11 | 12 | -18 | 2 | 5 | 91 | 50 | Health care |
| Costco Wholesale *($457; COST)* | 15 | 16 | 45 | 21 | 22 | 79 | 25 | 75 | Consumer staples |
| CVS Health *($86; CVS)* | -9 | 6 | 12 | 0 | 28 | 12 | 76 | 47 | Health care |
| **Danaher** *($328; DHR)* | 78 | 37 | 37 | 34 | 48 | 91 | 28 | 83 | Health care |
| Enterprise Products *($22; EPD)* | 5 | 12 | 10 | -5 | 22 | 37 | 77 | 53 | Energy |
| EOG Resources *($66; EOG)* | 60 | -10 | 15 | -20 | 37 | 95 | 86 | 95 | Energy |
| **Fortis** *($46; FTS)* | 12 | 3 | 22 | 3 | 16 | 9 | 52 | 31 | Utilities |
| HCA Holdings *($253; HCA)* | 59 | 12 | 17 | 17 | 54 | 94 | 48 | 84 | Health care |
| Johnson & Johnson *($174; JNJ)* | 15 | 11 | 19 | 6 | 12 | 45 | 51 | 65 | Health care |
| Kinder Morgan *($16; KMI)* | 47 | 18 | 12 | -11 | 25 | 76 | 85 | 81 | Energy |
| Kroger *($46; KR)* | 27 | 4 | 13 | 24 | 47 | 45 | 61 | 59 | Consumer staples |
| **LabCorp Of America** *($305; LH)* | 217 | 43 | 9 | 15 | 49 | 88 | 79 | 96 | Health care |
| **MDU Resources** *($32; MDU)* | 17 | -23 | 15 | -4 | 24 | 42 | 67 | 65 | Utilities |
| Novartis *($89; NVS)* | NA | NA | NA | 27 | 240 | 17 | 64 | 47 | Health care |
| **PerkinElmer** *($188; PKI)* | 171 | 63 | 15 | 30 | 29 | 75 | 61 | 90 | Health care |
| Pfizer *($46; PFE)* | 9 | 17 | 15 | 21 | 29 | 92 | 70 | 91 | Health care |
| Philip Morris Int'l *($104; PM)* | 13 | 3 | 18 | 8 | 28 | 35 | 49 | 60 | Consumer staples |
| Stryker *($277; SYK)* | 33 | 15 | 30 | 9 | 14 | 81 | 29 | 75 | Health care |
| **Thermo Fisher Scient.** *($562; TMO)* | 92 | 46 | 22 | 24 | 19 | 43 | 50 | 74 | Health care |
| **UnitedHealth Group** *($417; UNH)* | -14 | 10 | 26 | 3 | 20 | 32 | 45 | 57 | Health care |
| Walmart *($148; WMT)* | 17 | 4 | 24 | 5 | 4 | 65 | 47 | 62 | Consumer staples |

*Note: Quadrix scores are percentile ranks, with 100 the highest. NA Not available.*

# Top 15 Utilities adjustments

We are tweaking our Top 15 Utilities portfolio by adding **OGE Energy** *($36; OGE)*, which replaces **Algonquin Power & Utilities** *($16; AQN)*.

■ OGE delivered an impressive June quarter, with earnings per share rising 10% and sales 15%; both metrics comfortably topped expectations. Per-share profits are projected to climb 6% this year on sales growth of 18%, with analyst estimates steadily drifting higher over the past 90 days. In February, OGE announced the sale of its stake in Enable Midstream Partners *($8; ENBL)*, which is merging with Energy Transfer *($9; ET)*. The divestment should help stabilize OGE's operating momentum and allow the company to focus exclusively on its electric utility in Oklahoma and Arkansas.

## RANK CHANGES

No changes are being made to our recommended lists. For the Top 15 Utilities Portfolio, **OGE Energy** *($36; OGE)* is replacing **Algonquin Power & Utilities** *($16; AQN)*.

* * * * *

Check for rank changes and market updates on our twice-weekly hotlines, updated Wednesdays after the market's close and Fridays around noon Central time. Go to **www.DowTheory.com** or call (800) 931-2295. **For September, the passcode for the telephone hotline is 416.**

OGE shares have returned 6% including dividends in the past month and 24% over the past six months. Yet the stock trades at a reasonable 17 times trailing earnings, below the median of 20 for electric utilities in the S&P 1500 Index. Although OGE earns a modest Quadrix® Overall score of 51, both of its sector-specific scores exceed 80. Yielding 4.5%, OGE has grown its dividend at an annualized rate of 8% over the past five years.

■ Algonquin, a diversified utility, has seen its Quadrix Overall score slip to 37, hurt by subpar ranks for Momentum, Value, Earnings Estimates, and Performance. Algonquin's per-share profits and revenue topped consensus estimates for the June-quarter. But earnings quality seemed to deteriorate, while operating cash flow fell 28% and is now down in three of the past four quarters. The stock's performance has also been discouraging, retreating 12% since we first recommended Algonquin in February. *Now rated B in our Utility Update, Algonquin should be sold.*

### Technology update

◆ **Lam Research** *($600; LRCX)* raised

## Apple navigates App Store challenges, product rollouts, new deal

South Korea passed a new law forcing **Apple** *($153; AAPL)* and **Alphabet** *($2,904; GOOGL)* to allow other payment systems in their application stores. The new law lets users pay through different methods, paving the way for application developers to bypass commissions charged by the app stores. Other countries could follow South Korea's lead, potentially breaking up a highly lucrative business for Apple and Alphabet. Google Play, Alphabet's mobile application store, generated $11.2 billion in revenue in 2019. The South Korean law could go into effect as early as September.

In the U.S., Apple settled a class-action lawsuit with application makers that includes a $100 million payment. The company also revised its advertising policy, allowing developers to promote alternative pricing plans outside of the App Store, preventing Apple from taking a cut. But developers can only promote these outside pricing plans through external means, such as email, rather than within the applications themselves. The settlement also doesn't alter Apple's collection of fees on subscriptions or in-app purchases. Analysts generally viewed the settlement as a positive development for Apple since it avoids major changes to the App Store that some developers and lawmakers had sought. With that in mind, Apple may still be subjected to more scrutiny.

Separately, Apple reportedly plans to unveil on Sept. 14 its next iPhone, slated to launch on Sept. 24. Rumors are circulating that the new iPhone will boast satellite capabilities, allowing users to contact first responders in emergency situations where cellular coverage is unavailable. This feature could help the iPhone further stand out from rival devices, especially with recent natural disasters fresh in consumers' minds.

The forthcoming Apple Watch has suffered production delays as suppliers and manufacturers struggle to adjust to the redesigned device, featuring a larger screen and faster processor. Apple is expected to unveil a new line of its watch in coming weeks. The company is working on new health features that can track users' blood pressure and temperature, which could be included in Apple Watch models next year. Apple hopes its smartwatch will eventually be capable of detecting sleep apnea, low blood oxygen levels, and diabetes.

Finally, Apple acquired Primephonic, a streaming service for classical music. The deal's terms were not announced. Apple says Primephonic will be the backbone for a classical music application expected to launch next year. *Alphabet is a Focus List Buy and a Long-Term Buy. Apple is a Buy and a Long-Term Buy.*

its quarterly dividend 15% to $1.50 per share, payable Oct. 13. Lam has raised its dividend every year since its 2014 initiation. This most recent dividend hike exceeds Lam's 13% increase last year and 5% bump in 2019. *Lam is a Focus List Buy and a Long-Term Buy.*

◆ **Microsoft** *($302; MSFT)* warned its cloud-computing customers that a security flaw left their main databases exposed to intruders. Microsoft insisted that it found no evidence that the flaw had been exploited. In other news, Microsoft says its new Windows 11 operating system will launch on Oct. 5. *Microsoft is a Focus List Buy and a Long-Term Buy.*

◆ Taiwan Semiconductor Manufacturing *($120; TSM)*, the largest semiconductor maker in the world, announced broad prices hikes that will take effect later this year or next year. Taiwan Semiconductor plans to raise prices for its most advanced chips, such as those used by **Apple** *($153; AAPL)*, by roughly 10%. Prices for its less-advanced semiconductors, such as those used by automakers, are expected to climb about 20%.

Seeking to address the global semiconductor shortage, TSMC aims to spend $100 billion over the next three years on new facilities, equipment, and research and development. **Applied Materials** *($133; AMAT)* and Lam stand to benefit from those spending plans. *Applied Materials is a Focus List Buy and a Long-Term Buy. Apple is a Buy and a Long-Term Buy.*

## BUYS AND LONG-TERM BUYS

The Buy List represents our top choices for 12-month gains. Focus List stocks, listed in **bold**, represent the best picks among that group. Long-Term Buys are our top choices for 24- to 48-month gains.

If you want your equity portfolio to track the Buy List or Long-Term Buy List, purchase each of the stocks below in the proportion suggested by the target weight. To represent the cash portion of your equity portfolio, hold 6.8% (Buy List) or 6.6% (Long-Term Buy List) in the **Vanguard Short-Term Corporate Bond** *($83; VCSH)* exchange-traded fund.

If you are copying the Focus List, hold a 6.8% fund position and put the rest into equal-dollar positions in the Focus List stocks.

| | – Target Weight – | | | | | Quadrix | | |
|---|---|---|---|---|---|---|---|---|
| Company (Price; Ticker) | Buy List | LT Buy List | Div. | Div. Yield | Trailing P/E Ratio | — Scores — Value | Overall | 52-Wk. Range |
| 3M *($193; MMM)* | 3.1% | 2.9% | $5.92 | 3.1% | 19 | 56 | 71 | $209 - $156 |
| • Adobe *($666; ADBE)* | 3.1 | 2.9 | 0.00 | 0.0 | 58 | 17 | 80 | 669 - 421 |
| **Ally Financial** *($52; ALLY)* | 3.5 | 3.3 | 1.00 | 1.9 | 7 | 86 | 97 | 57 - 23 |
| • **Alphabet** *($2,904; GOOGL)* | 3.5 | 3.3 | 0.00 | 0.0 | 31 | 30 | 89 | 2,925 -1,402 |
| • Apple *($153; AAPL)* | 3.1 | 2.9 | 0.88 | 0.6 | 30 | 25 | 71 | 155 - 103 |
| • **Applied Materials** *($133; AMAT)* | 3.5 | 3.3 | 0.96 | 0.7 | 22 | 41 | 88 | 146 - 54 |
| **Charles River Labs.** *($444; CRL)* | 3.5 | 3.3 | 0.00 | 0.0 | 45 | 15 | 72 | 447 - 197 |
| Chubb *($183; CB)* | 3.1 | 2.9 | 3.20 | 1.7 | 16 | 82 | 99 | 188 - 112 |
| • Comcast *($61; CMCSa)* | 3.1 | 2.9 | 1.00 | 1.6 | 22 | 53 | 60 | 62 - 41 |
| **Danaher** *($328; DHR)* | 3.5 | 3.3 | 0.84 | 0.3 | 37 | 28 | 83 | 329 - 193 |
| **Dover** *($174; DOV)* | 3.5 | 3.3 | 2.00 | 1.2 | 25 | 39 | 79 | 176 - 105 |
| • **Facebook** *($382; FB)* | 3.5 | 3.3 | 0.00 | 0.0 | 29 | 40 | 93 | 384 - 244 |
| **FedEx** *($266; FDX)* | 3.5 | 3.3 | 3.00 | 1.1 | 15 | 85 | 86 | 320 - 217 |
| Fortis *($46; FTS)* | | 2.9 | 1.68 | 3.7 | 22 | 52 | 31 | 47 - 38 |
| • **Garmin** *($176; GRMN)* | 3.5 | 3.3 | 2.68 | 1.5 | 28 | 24 | 62 | 179 - 92 |
| J.P. Morgan Chase *($160; JPM)* | 3.1 | 2.9 | 3.60 | 2.3 | 11 | 67 | 72 | 167 - 91 |
| LabCorp Of America *($305; LH)* | 3.1 | 2.9 | 0.00 | 0.0 | 9 | 79 | 96 | 308 - 171 |
| • **Lam Research** *($600; LRCX)* | 3.5 | 3.3 | 6.00 | 1.0 | 22 | 42 | 78 | 674 - 292 |
| Lennar *($88; LENb)* | 3.1 | 2.9 | 1.00 | 1.1 | 9 | 83 | 88 | 90 - 56 |
| • **LKQ** *($52; LKQ)* | 3.5 | 3.3 | 0.00 | 0.0 | 15 | 67 | 96 | 53 - 27 |
| MDU Resources *($32; MDU)* | 3.1 | 2.9 | 0.85 | 2.6 | 16 | 67 | 65 | 35 - 21 |
| • **Microsoft** *($302; MSFT)* | 3.5 | 3.3 | 2.24 | 0.7 | 38 | 22 | 87 | 306 - 196 |
| **Parker-Hannifin** *($294; PH)* | 3.5 | 3.3 | 4.12 | 1.4 | 20 | 52 | 48 | 325 - 192 |
| PerkinElmer *($188; PKI)* | | 2.9 | 0.28 | 0.1 | 15 | 61 | 90 | 189 - 112 |
| • **Qorvo** *($186; QRVO)* | 3.5 | 3.3 | 0.00 | 0.0 | 17 | 61 | 90 | 202 - 112 |
| **Quanta Services** *($102; PWR)* | 3.5 | 3.3 | 0.24 | 0.2 | 23 | 39 | 80 | 104 - 49 |
| • Signature Bank *($259; SBNY)* | 3.1 | 2.9 | 2.24 | 0.9 | 20 | 42 | 78 | 268 - 71 |
| Target *($246; TGT)* | 3.1 | 2.9 | 3.60 | 1.5 | 19 | 51 | 83 | 267 - 143 |
| **Thermo Fisher Scient.** *($562; TMO)* | 3.5 | 3.3 | 1.04 | 0.2 | 22 | 50 | 74 | 563 - 401 |
| UnitedHealth *($417; UNH)* | 3.1 | 2.9 | 5.80 | 1.4 | 26 | 45 | 57 | 431 - 290 |

*• Nasdaq Stock Exchange. Notes: Quadrix scores are percentile ranks, with 100 the best.*

## Entergy in the eye of Ida

Hurricane Ida, which made landfall on Sept. 29, has left more than one million people without power in Louisiana; another 60,000 in Mississippi lack electricity. The storm forced the closure of the region's ports, plants, and railways at a time when supplies were already tight. Oil, gas, and chemical companies were also forced to halt production in the area. Some parts of New Orleans could be without power for three weeks, complicating recovery efforts.

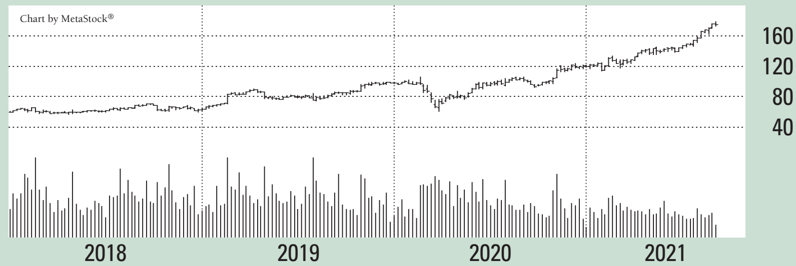
Shares of **Entergy** *($113; ETR)*, Louisiana's largest utility company, fell on news of the extensive outages. Entergy had recently spent $100 million upgrading the area's electrical grid, boasting it was a model of "storm resiliency." But Ida knocked out all eight transmission lines that connect to Entergy's power plants in New Orleans. A massive Entergy transmission tower, which had passed recent inspections, fell into the Mississippi River. The New Orleans City Council plans to investigate Entergy's role in the outages. Entergy provides power to 3 million customers in the Gulf region. *Entergy's stock has recovered much of the ground it initially lost and remains a member of our Top 15 Utilities portfolio.*

# ANALYSTS' CHOICE

| Recent Price | Dividend | Yield | P/E Ratio | Shares (Millions) | Long-Term Debt as % of Capital | 52-Week Price Range |
|---|---|---|---|---|---|---|
| $176 | $2.68 | 1.5% | 28 | 193 | 1% | $178.81 - $91.84 |

## Garmin's gadgets locate profits

### GARMIN




| Quarter | Per-Share Earnings* | Sales Change | Quarterly Price Range | P/E Ratio Range |
|---|---|---|---|---|
| Jun '21 | $1.68 vs $0.91 | 53% | $145.20 - $127.78 | 27 - 24 |
| Mar '21 | 1.18 vs 0.91 | 25 | 133.43 - 113.59 | 26 - 22 |
| Dec '20 | 1.73 vs 1.29 | 23 | 123.55 - 93.74 | 26 - 20 |
| Sep '20 | 1.58 vs 1.27 | 19 | 106.00 - 91.84 | 24 - 21 |

| Year (Dec.) | Sales (Bil.) | Per-Share Earnings* | Per-Share Dividend | 52-Week Price Range | P/E Ratio Range |
|---|---|---|---|---|---|
| 2020 | $4.2 | $5.14 | $2.40 | $123.55 - $61.04 | 24 - 12 |
| 2019 | 3.8 | 4.45 | 2.24 | 99.26 - 61.18 | 22 - 14 |
| 2018 | 3.3 | 3.69 | 2.04 | 70.77 - 57.01 | 19 - 15 |
| 2017 | 3.1 | 2.94 | 2.04 | 63.15 - 47.03 | 21 - 16 |

** Earnings exclude special items. † Quadrix scores are percentile ranks.*

| Quadrix Scores† | |
|---|---|
| Overall | 62 |
| Momentum | 45 |
| Value | 24 |
| Quality | 93 |
| Fin'l Strength | 95 |
| Earnings Ests. | 48 |
| Performance | 95 |
| Reversion | 5 |

**Garmin** *($176; GRMN)* taps into consumers' love for digital gadgets. The company makes GPS-enabled products used by athletes, hikers, boaters, pilots, drivers, and even dog trainers. These devices tend to be geared toward activities that accommodate social distancing, which has helped boost demand during the pandemic. But even as the pandemic eases, Garmin should continue to benefit from consumers gaining more disposable income as the global economy expands.

The stock's Overall score has fallen to 62 from 84 in January, hurt by the prospect of weaker operating momentum and a rising valuation. Operating growth could prove elusive in the second half of 2021, due to challenging year-over year comparisons from historically strong demand during the depths of the coronavirus pandemic. But analyst estimates for 2022 are rising, with the consensus projecting 11% profit growth on 8% higher sales. Garmin is a Focus List Buy and a Long-Term Buy.

### No gimmicks about this growth

Garmin shares have surged 12% in the past month, after the company comfortably topped June-quarter consensus profit and sales estimates, while also raising its full-year guidance. Management sees all five product categories — fitness, outdoor, aviation, marine, and auto — growing revenue by double-digits this year. Although higher supply-chain costs cut into profitability, Garmin's operating profit margin expanded to 28% last quarter, a threshold reached in just four quarters since 2009. Its operating margin in the year-ago quarter was 22%.

Garmin boasts strong cash-flow trends, with operating cash flow surging 54% for the 12 months ended June and free cash flow up 66% to $608 million. Cash and marketable securities on Garmin's balance sheet have risen 19% in the past year to $3.2 billion, while long-term debt remains zero.

Management views paying an attractive dividend as its top priority for excess cash, followed by acquisitions, then reinvestment in its business. Earlier this year, Garmin raised its quarterly dividend 10% to $0.67 per share, its biggest annual hike since 2011. Garmin devotes just 43% of earnings to its dividend, leaving plenty of flexibility for more growth in coming years.

Entering the September quarter, production of Garmin's devices was running near full capacity. But Garmin appears well-positioned to support future growth, with a new facility to open this fall set to double capacity in Taiwan. Garmin also recently completed two new plants in Europe. Aiming to catch the airline industry's rebound, in May Garmin acquired AeroData, a software company that provides performance data to commercial airplanes.

For six pages of statistical reports on Garmin, visit **www.DowTheory.com/Go/Page8**.

### Conclusion

The stock has now rallied 47% in 2021, dragging down its Value score to 24. At 28 times trailing earnings, the stock trades well above the median of 28 for consumer-electronics stocks in the S&P 1500 Index. Backing out net cash of $16 per share lowers Garmin's trailing P/E ratio to a more tolerable 26. The stock yields 1.5%.

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