Jack Adamo's Insiders Plus

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Dear Friend & Client,

Thanks for joining me.

We had a bad week. Most of the drag in the Main Portfolio came from precious metals, but Teva, which we'll discuss later, was also a big factor. Gold only crept down 0.7%, but it has fallen five of the last seven weeks, so that would certainly affect the market's sentiment toward the metal and its miners. The earnings reports from miners so far have not been bad, but more may have been expected from them. The gold "trade" is notoriously skittish, and traders, not investors, set the price in the short term.

The High Income Portfolio slid just 0.1%, due to a slight erosion in preferred stocks. The dollar has pulled back a bit from its recent rise, which should normally boost preferreds, so I don't know if the pullback is related to the dollar or not. Maybe the coming week will reveal something more tangible.

There were a ton of quarterly reports in our portfolios this week. I've fully analyzed eight of them, but two of them require deeper looks. I'm going to post the letter with the eight, so that you may have time to think about them today. If I finish the two others this afternoon, I'll send an updated version of the letter tonight. If now, I'll send it Monday or Tuesday, assuming I can get all my questions answered.

I'll also look at **iShares MSCI Colombia Capped ETF** (NYSE:ICOL), which has not kept up with other emerging market investments. If I see something significant, I may treat that too. If not, I should have something to say about it next weekend.

Okay, let's get down to specifics.

PORTFOLIO UPDATES

Our first preferred today will be **Texas Capital Bancshares 6.50% Non-Cumulative Perpetual Preferred, Series A** (NASDAQ: TCBIP). I was a little worried about Texas Capital a while back, so we lightened up our position, but although the bank isn't the best capitalized holding we have, its reserves are adequate and it has weathered what is probably the worst of the energy sector restructuring. Its Q3 earnings report is outstanding. It grew diluted EPS 28.7%, but the number we most care about is its preferred dividend coverage. That was an excellent 24-times net income. The company continues to operate very cost effectively with an efficiency ratio of 51.4%, and its Common Equity Tier 1 Ratio is good at 8.4%. Those numbers make me smile. Hold Texas Capital Bancshares 6.50% Preferred.

We also had an excellent report for our **Cullen/Frost Bankers 5.375% Perpetual Preferred Series A** (NYSE:CFR-A). Cullen/Frost Net income was up 16.5%; its Basel III Common Equity Tier 1 Ratio was 12.4%, and it covered its preferred dividends 46 times. As Steve Jobs would say, that's insanely great. Hold Cullen/Frost Bankers 5.375% Perpetual Preferred.

Generally recognized to be the strongest bank in America, M&T continues its excellent performance. Our **M&T Bank Corp. Fixed Rate Cumulative Perpetual Preferred Stock, Series C** (MTB-C) had its dividends covered 18-times over. Average annualized return on assets was very good at 1.18%. At 8.89%, return on common equity wasn't great, as usual, because the bank doesn't take on as much debt as most large banks. But its Basel III Common Equity Tier 1 Ratio is very strong, due to the same factor. M&T Bank Fixed Rate Cumulative Perpetual Preferred Stock, Series C is a buy on pullbacks below $1000. Take a 4% position in the Main Portfolio.

Our dividend coverage is the lowest on our **Public Storage 5.40% Cumulative Preferred Share of Beneficial Interest, Series B** (NYSE: PSA-B). It was down in Q3 to 6.7 from 7.6 in Q3 2016. But this is fine. This is a very solid, low-risk business.

We have an 8.3% total return for the seven months we've owned the stock. I've raised the buy range a little. Public Storage 5.40% Cumulative Preferred Series B is a buy on pullbacks below $24.85. Take a 2% position in the High Income Portfolio.

Our best showing among the miners so far is **Newmont Mining Corp.** (NYSE: NEM). Sales rose 4.9%, but profits were further boosted by Newmont's typical excellent expense control. That's why it was among the first miners to return to profitability after the big pullback in gold, and why it's growing its earnings along with the best of them.

At $1,276 per ounce, Newmont's average realized gold price was 4% percent lower than Q3 2016, but all-in sustaining costs were just $943/oz., and its average realized price for copper rose 50% to $3.06 per pound, helping to boost Q3 EPS to $0.38 from a $0.67 loss last year. Year-to-date EPS are $0.80, so the earnings growth trend may be accelerating, since Q3 almost equals the first and second quarters combined.

Newmont continues to do the right thing by its balance sheet too. The company reduced net debt to $1.1 billion, ending the quarter with $3.0 billion cash on hand, and an industry-leading, investment-grade credit profile. It also increased the Q3 dividend 50% from the prior year's quarter to $0.075 per share.

Newmont Mining Corp. is a buy on pullbacks below $35. Take a 3% position in the Main Portfolio.

We got a pretty complicated, but good, earnings report from **Conoco-Phillips** (NYSE: COP). Sales revenue was up 4.3%, but help from earnings in affiliates; much lower impairments of assets, and large reductions in operating and administrative expenses, turned EPS around from an $0.84 loss last year to a $0.21 gain this year. That number excludes the effect of asset sales, which added another $0.13 to the bottom line.

Note that earnings from affiliates don't actually come into Conoco as cash. They are just like stock you or I would earn. The money is still in the affiliated company, but our net worth goes up because we own a piece of it.

Operating cash flow was more than double net earnings, and Conoco further strengthened its balance sheet with almost $3 billion in asset sales (The $0.21/share gain on asset sales mentioned above is just the *profit* on the sales, not the entire sale amount.) The cash was well utilized. The company paid down $2.5 billion in debt and repurchased $970 million in stock. I'm okay with stock buyback here. The press release and SEC filing didn't indicate the average price paid, but it will probably prove to be a bargain in coming years.

My only qualm about the report is that the dividend continues to be higher than the actual earnings from operations, but like other companies in the industry, I guess it felt it had to provide dividend stability to bolster investor confidence through the recent very rough patch in earnings. In the final analysis, it won't hurt the company's long-term health, so I guess it's a valid tactic.

Hold Conoco-Phillips. Over the next month or so, I'll try to get a deeper and broader view of the state of the petro-energy sector and decide whether it's safe to go back in the water.

At first glance, the earnings report from **Ensco plc.** (NYSE: ESV) looked awful, but closer examination revealed a much more optimistic picture. The market reacted accordingly, boosting the shares 1.8% this week.

Revenues fell 16% while reductions in expenses were unable to make up the difference. As a result, the company posted an $0.08 per share loss.

It may seem frightening that, as the price of oil is recovering, Ensco's revenue fell so steeply. Keep in mind, however, that work is contracted a year or more in advance, with a specified number of drilling days and rates. So, 2016 still had revenues from contracts initiated before the huge oil glut and price collapse. It was only when those contracts expired that the true weight of the downturn was felt. Other drillers were affected the same way.

We may now have seen the trough of that trend, at least for Ensco. Ensco has closed on more new contracts than any offshore driller year to date. I've mentioned before that ESV has year after year gotten the highest customer ratings in the industry for safety and satisfaction. The new contracts show that Ensco remains the driller of choice among customers. It now has $3.2 billion in contracted backlog, excluding possible extensions.

Meanwhile, with a net debt to capital ratio of just 30%, the company's balance sheet is probably the strongest in the industry. It has no debt maturities until Q2 2019, and less than $1.0 billion maturing before 2024. It currently holds almost a billion in cash and cash equivalents. This, along with its safety and satisfaction record, will undoubtedly provide the confidence customers need to continue to choose Ensco.

Getting back to earnings for a moment, it should be noted that Ensco's loss this quarter would have been almost breakeven were it not for major tax differences from last year. It seems illogical that the company posted a $4.6 million pre-tax loss this quarter, yet taxes were $23 million, while last year's pre-tax profit was $85 million and it got a $4 million tax rebate. But, as I've said many times before, tax accounting and financial accounting have significant differences, and they've really stuck out like a sore thumb this period. Let's hope they treat us more kindly next year.

With the Atwood merger completed, one overhang is behind us; I'm now satisfied that the worst is over for Ensco, although there is still end-of-year tax selling that may be a further drag. What is more on my mind is the overall economy. At the moment, I don't see any large cracks, but some people wiser than I am about such matters are very leery of 2018. Given ESV's growing contract backlog and strong balance sheet, I think it's unlikely that money put into the stock at this time will not be a good investment, hence I'm taking the hold off Ensco. I may recommend rebuying the position we recently closed, but not yet. I want to at least get a few weeks into November to see if tax-loss selling becomes a significant factor. Ensco plc. is a buy up to $5.50. Take a 2% position in the High Income Portfolio. *This is not a new position, just a change in advice on the current 2% position*.

Shares of **Briggs & Stratton Corp.** (NYSE: BGG) did well this week. The company reported a 14.7% rise in sales and reported gross profit up 26.2%, due to lower cost-of-goods-sold. Engineering, selling, and general & administrative expenses -- a large part of overall expenses, pulled back 20.3%, as the company continues to optimize its operations.

Calendar quarters three and four always show losses for the company, due to the highly seasonal nature of its business, but the loss was within normal lines at 36¢ versus 34¢ last year. Briggs & Stratton is expanding its product base to bolster year-end profitability. We should have some idea by next year how that effort is going.

Briggs is up 14.7% in the six weeks we've owned it. I'm removing the "speculative" designation from the stock and raising its buy limit a little. Briggs & Stratton Corp. is a buy on pullbacks below $22.50. Take a 2% position in the Main Portfolio.

Shares of **Teva Pharmaceutical**, **Ltd.** (NASDAQ: TEVA) dropped 10.6% this week. The only saving grace in evidence is that volume was very low -- about half of normal -- or less, for the whole week. In fact, you have to go back to October fourth and fifth to see any above-average selling volume. That may indicate that selling is nearly dried up, except for short-sellers.

Despite a lack of negative news in Teva, short-interest in the stock has ballooned by more than 50% over the last two weeks. The third-quarter earnings report of Novartis, which knocked down its shares more than 7%, set the tone for the whole generic pharmaceutical industry. Short-interest is up almost across the board, but none so much as Teva's. If this is smart money, the report expected on Thursday will not be good. The question now is whether this week's drop has the bad news fully priced in or not.

A recent report from Cantor Fitzgerald says that consolidation of generic drug manufactures has not been enough to offset the leverage of the three largest buying consortiums (Red Oak, WBAD and ClarusOne), which have squeezed generic drug prices hard in the last year. An analyst for Cantor said that, based on their work, they think there is still room for consortiums and wholesalers to put further downward pressure on prices. I don't know how insightful that assessment is, but Teva's Q3 report may shed some light, particularly on the conference call.

I've said several times that I think Teva's stock is unlikely to go lower, but I've been dead wrong. Whether the drop in valuation is justified is not clear to me. The only thing that is clear is that the future of the generic drug industry is troubled. Whether the survivors thrive or just hang on by their fingernails remains to be seen.

I'm going to wait for Teva's Q3 earnings report to come out before I make a decision about this holding. My guess is the stock will probably drop some more, then rebound due short covering. The low selling volume we've seen is at least a small positive indicator. Depending on the projected P/E, price to book value, et cetera, and how solid management's assessment of the outlook is, I'll recommend selling, holding or buying, although that last option is unlikely at this juncture. For now, we'll stand pat and see what Thursday brings. Hold Teva Pharmaceutical, Ltd.

You can view all of our holdings with their current advice by going to:
http://www.jackadamo.com/main.asp?fn=portfolio_view.asp

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That's it for today.

I'll forego my usual closing remarks, so that I can get back to those last two earnings reports.

I'll talk with you again later or within a day or two.

Jack

Questions? Write to Jack at: jack@jackadamo.com