The Dow Jones Industrial Average
ETF (Symbol: DIA)
A Benjamin Graham Analysis of the Dow 30

FinTrust Brokerage Services
Equity Research
December 3, 2019

Industry: Diversified
Tracking ETF: SPDR Dow Jones Industrial ETF (DIA)

Index Overview: Two-thirds of the DJIA's 30 component companies are manufacturers of industrial and consumer goods while the others represent diverse industries. When Charles H. Dow first unveiled his industrial stock average on May 26, 1896, the stock market was not highly regarded. Prudent investors bought bonds, which paid predictable amounts of interest and were backed by real machinery, factory buildings and other hard assets. Today, stocks are widely accepted as investment vehicles, even by conservative investors. The 30 stocks now in the Dow Jones Industrial Average are all major factors in their industries, and their stocks are widely held by individuals and institutional investors. Besides longevity, two other factors play a role in its widespread popularity: It is understandable to most people, and it reliably indicates the market's basic trend. **Source:DJAverages.com**

Analyst Notes:
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Are Stocks Too High To Buy?
A Benjamin Graham Analysis of the Dow Jones Industrial Average

- FinTrust is maintaining its BUY rating for the Dow Jones Industrial Average exchange traded fund (ETF symbol: DIA), as the market is currently just above the midpoint of our 2020 estimated price range (Dow Dupont has undergone a complicated series of spin-offs since our last report).

- **The current analysis suggests levels below 27,397 on the Dow Jones Average would be considered below average, while a level closer to 21,767 would represent low prices, while an index level of 33,036 would be considered rich** in relation to past sales, earnings, book value, dividends and forward analyst estimates. As a result of our updated analysis, we are increasing the low end, the high end, and midpoint of our estimated price range.

- **We are decreasing our recommended equities asset allocation** as the data suggest an allocation for defensive investors of 48/52 v. the previous 55/45. Equities are currently 2% above the midpoint of our estimated valuation range. **Should equities continue to trade higher from here toward the top of our estimated price range, we would recommend investors proportionately decrease their equity allocations. Conversely, should equities trade lower from here, we believe investors should proportionately increase their equity allocations.**

- As in our previous reports, the data suggests that for the "defensive investor" reasonable allocations, toward the common stocks of the Dow Jones Industrial Average levels appear appropriate and reasonable. For fixed income investors, we continue to recommend inflation protected, tax-free, floating rate and high-quality

Fintrust Recommendation

Fintrust Rating:	**BUY**
Target Price:	**$330.26**
Current Share Price	**$280.95**
Expected Return	**17.55%**
52 Week Price Range	**$233.2-269.28**

Fintrust Brokerage Services, LLC rates companies a BUY, HOLD, SELL, or SHORT.

- A BUY rating is given when the security is expected to outperform the broad equity market as measured by the S&P 500 on a risk adjusted basis over the next year.
- A HOLD rating is given when the security is expected to perform in line with the broad equity market as measured by the S&P 500 on a risk adjusted basis over the next year.
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- A SELL SHORT is given when the security is expected to decline in value over the next year.

The distribution of ratings across Fintrust's entire company universe is 64.20% Buy, 28.57% Hold, 7.14%Sell, and 0% Short

Key Figures (Dow 30 @ 11/29/2019)
Key figures pricing data reflects previous trading day's closing price. Other applicable data are trailing 12-months unless otherwise specified.

R.O.A.E	**21.3%**
Earn $	**$1,354.19**
Divs $	**$621.80**
Book Value $	**$6,512.92**

Valuation (Dow 30 @ 11/29/2019)

P/E (Actual)	**20.71x**
Earns Yield %	**4.83%**
Divs Yield %	**2.22%**
P/B	**4.31x**

Please see pages 8 and 9 of this publication for important certification and disclosure information

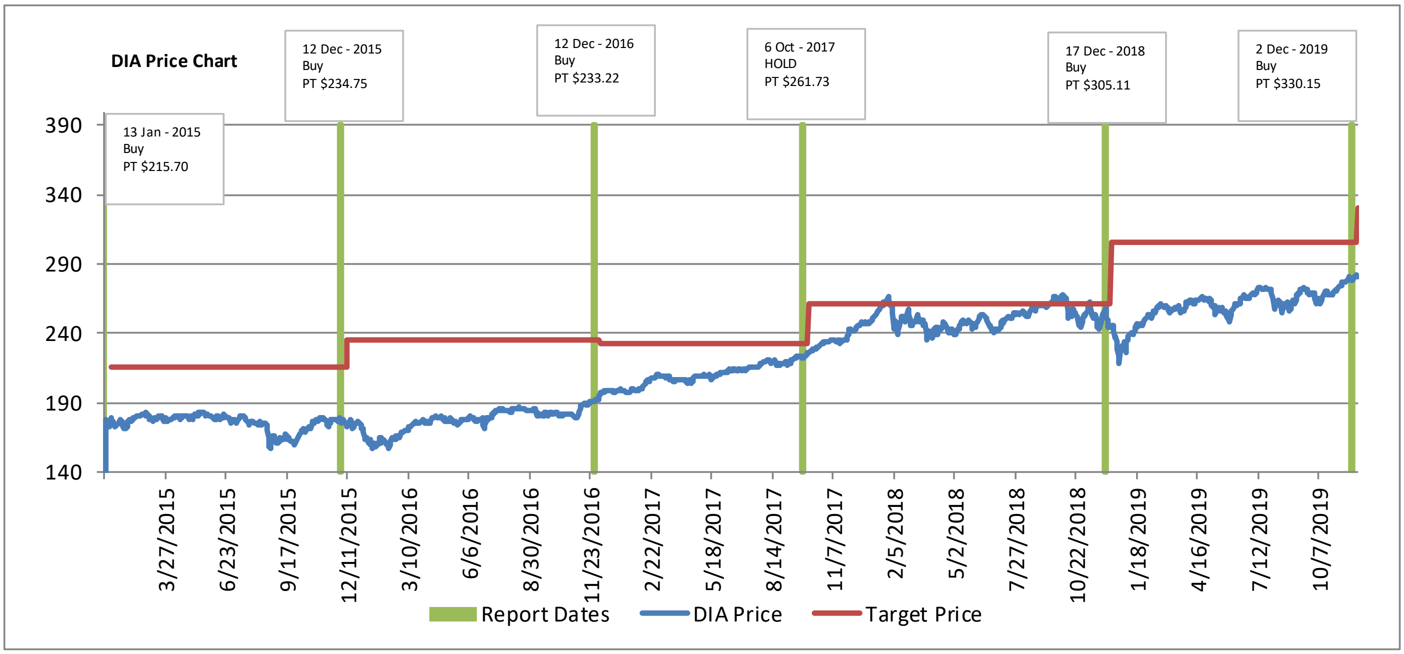
Analyst's Notes.... Continued

bonds, while for aggressive investors we recommend gold equities, gold, and cryptocurrency in place of short-term fixed income and money market holdings.

Risks to the Recommendation:

- Risks include, but are not limited to, (1) Unanticipated changes in inflation, interest rates and industrial production (2) credit risk (3) regulatory, governmental, and tax law changes (4) product and business risks (5) the mere fact the future is uncertain (6) political risks (7) and all other risks normally associated with investments in common equities.

Price Chart



Source: Bloomberg

Analyst's Notes.... Continued

A Benjamin Graham Analysis of the Dow Jones Industrial Average

In his investment classic*, The Intelligent Investor*, the father of security analysis Benjamin Graham endeavored to answer the following question:

"Is the stock market too high for conservative purchase?"

Graham recommends methods by which a defensive investor might determine the appropriate portfolio level asset allocation and simple methods by which to value securities in order to develop long term return expectations. He defined a defensive investor as one that is "interested chiefly in safety plus freedom from bother."

Graham also defined an "investor" and a "speculator" with his famous statement that "an investment operation is one which, upon thorough analysis promises safety of principal and an adequate return. Operations not meeting these requirements are speculative." He argued for a 50/50 split of funds between stocks and bonds for defensive investors, unless the weight of the evidence suggested a tilt toward a 75/25 or 25/75 mix.

In this analysis, I seek to logically implement his recommendations by analyzing the Dow 30 by using data from *Value Line, Market Smith, Bloomberg, and Barron's*.

What We Said in December 2018

Last December, in conducting this analysis, I wrote the following:

"It must be evident to the reader that we continue to find the stocks of the Dow Jones Industrial Average at today's prices look better on average than taxable bonds. **We are more confident now in the analysis given that interest rates have in fact risen, the index membership has changed, and because the tax cuts have helped to alleviate much of the overvaluation in equities**. Despite the improved picture, the case for equities at today's prices is still not so compelling when compared to high quality bonds, **given that earnings may be at a peak**, as to lead a defensive investor to completely abandon balanced asset allocations in the search of a little more growth and income."

I continued with the following:

"Our analysis suggests levels below 25,376 on the Dow Jones Industrial Average would be below the 10-year average, and levels closer to 20,241 would represent low prices relative to the average results, while an index level of 30,511 would be considered rich in relation to past sales, earnings, book value, dividends and forward analyst estimates. The data suggest that for the "defensive investor" reasonable allocations toward common stocks at today's levels appear appropriate and reasonable. **Given the components of the Dow 30 collectively appear to trade at slightly below average levels (24,100 v. 25,376 or 94.97% of average), portfolio policy for the "defensive investor" should lean toward above average equity allocations (so if one normally splits funds in a 50/50 ratio, the analysis suggests a 55/45 ratio)**."

I then concluded:

"We are increasing our recommended equities asset allocation as the data suggest an allocation for defensive investors of 55/45 v. the previous 45/55, as we estimate equities are currently 5% below the midpoint of our valuation range. **Should equities continue to trade lower from here toward the bottom of our estimated price range, we would recommend investors proportionately increase their equity allocations."**

Analyst's Notes.... Continued

What Has Happened Since December 2018?

We published our report on December 17, 2018 while the Dow Jones Industrial Index was in the middle of a waterfall decline. Investors were concerned that the Federal Reserve would raise interest rates two more times in 2019 to the 3.0% level. In our 2018 report, we had projected a potential low of 20,241. The Dow Jones Industrial Index found its low slightly above our low-price estimate just 7 days after our report at 21,712. The Dow Jones Industrial Index has since recovered to surpass 28,174 this November, as the Federal Reserve not only has failed to raise interest rates, but in fact, has cut interest rates 3 times during 2019.

Since last year, earnings have advanced, as we expected, due to interest rate declines, tax rate reductions, and corporate buyback activity which improves earnings per share measures. **The recovery in equities, however, has been greater than the rise in earnings due in part to the Federal Reserve's systematic destruction of bond markets**. Since the time of our last report, the yield on the DJ Equal Weight US Corp Bond Index has declined from a reasonable 4.41% yield to 2.89%, while the yield on high quality tax-free bonds as measured by the Bond Buyer 20 Bond Index has fallen from 4.18% from 2.79%. This 24% decline in interest rates has been matched almost point for point by an increase in equity prices as the Dow Jones Industrial Average has risen 29.7% since last Christmas Eve's low.

What Policy Now? – A Top Down Look

"Much like last year's analysis, the current low levels of dividend and earnings yields and interest rates suggest a fair degree of caution. For the 52 weeks ending November 25, 2019 Barron's reports the 12-month trailing earnings for the Dow 30 components at $1,354.19 v. $1,201.11 for the prior year and paid dividends of $621.80, while equity book value rose slightly from $6,201.99 to $6,512.92. Based on an earnings retention rate of 54.08% and a return on average equity of 21.3%, the implied expected book value growth for 2020 would be a solid 11.52%, which when added to an initial 2.22% dividend yield would lead to **an expected 13.74% total return under average conditions**. While impressive and consistent with historical ranges, **I continue to point out that this may represent near peak conditions."**

In expanding this analysis to the broader S&P 500 index, using data for book value, return on equity, dividends and earnings returns, one finds that earnings rose to $135.27 from $122.48. Like the Dow stocks, the S&P 500 companies experienced an earnings increase year over year, and dividends increased to $59.72 v. the prior year's $55.02. Average equity for the S&P 500 was $839.07 this past year, which when combined with the 55.85% earnings retention rate yields an expectation for book value growth of 9.0%. **This 9.0% growth when added to the initial 1.92% yield leads to a total return expectation of 10.92% for 2020.**

Given that our interest is in determining portfolio policy for the defensive investor, we have previously suggested a few modifications to Mr. Graham's methods. First, we have suggested deflating current profits by 1/3 for a normalization of interest rates in order to stress test the analysis. Secondly, we also suggested adjusting the return expectations by the one-year probability of a down year in stocks (35.65% for the 115 years from 1901-2016).

What portfolio policy then for the "defensive" investor?

It must be evident to the reader that we continue to find the stocks of the Dow Jones Industrial Average at today's prices look better on average than taxable bond give the spread between the expected total return on equities (13.74% and 10.92% for the Dow and S&P) versus the (2.89%) yield on taxable bonds. **We are less confident in the analysis now, however, given the suppressed nature of global interest rates, as both equities and bonds may be mispriced.** Despite trading near the

Analyst's Notes.... Continued

midpoint of our estimated range, the case for equities at today's prices is still not so compelling when compared to high quality bonds, given that earnings may be at a peak and interest rates artificially depressed, as to lead a defensive investor to completely abandon balanced asset allocations in the search of a little more growth and income.

Portfolio Policy – A Bottom's Up Look

In discussing common stock selection for the defensive investor, Graham suggests the following:

1. Adequate though not excessive diversification, meaning a minimum of ten to a maximum of about 30 stocks.
2. Limit selections to large prominent and conservatively financed corporations.
3. Each company should have a long record of continuous dividends.
4. An investor should place a limit on the price he will pay in relation to average earnings over say the past 7 years.

Later, in *The Intelligent Investor*, Graham figures that estimates for a group of equities are likely to be a good deal more dependable than those for individual companies and he uses data from *Value Line* to illustrate his point. The outcome of this effort, in 1965, found that while earnings estimates proved to be high, and many wrong, the use of low multipliers on earnings led reasonable results for a portfolio of equities over the following five years.

In an effort to produce an analysis similar to Prof. Graham, I once again took the Dow 30 Components, a diverse set of 30 prominent and conservatively financed corporations. I then calculated the average ratios of price to sales, price to earnings, dividend yields, and price to book value for at least the previous 12 years (2007-2019), if available, in order to capture the period both before and after the great recession, and possibly the prior recession as well. Then using both the annual high and annual low for the stock price, I calculated the corresponding price to sales, price to book, price to earnings and dividend yields and averaged these for each security across various trailing time periods. I further applied these average ratios to the forward estimates for each respective variable from *Value Line* and *MarketSmith* and FinTrust estimates to develop price range estimates for each of Dow Components.

What portfolio policy then for the "defensive" investor?

As Mr. Graham cautions, the valuations reached by the method above are unlikely to prove sufficiently dependable, particularly on an individual company level, so an investor must endeavor to pay a low-prices in relation to average earnings. This suggests prices below 27,397 on the Dow Jones Industrial Average would appear reasonable, while prices above 33,026 would appear to be too high for the defensive investor. **Prices close to 21,760 would be low in relation to past multiples.**

Nominal v. Real Prices

One of the difficulties for the modern analyst is the degree of monetary deformation wrought by modern central banks and central planners over the last ten years. We are forced to analyze assets based upon nominal price fixing arrangements across a large number of assets, including stocks and bonds. Fortunately, the universe has now provided the modern analyst additional tools for measuring real prices, a roll historically reserved for the reserve asset of gold. We believe any real price

Analyst's Notes.... Continued

estimates should be converted into gold for tangible assets and bitcoin for the goodwill and intangible assets associated with technology and service businesses. Thus, we would add this final comment to our analysis. If the tangible book value of the Dow sits at $6,512 and our low-price estimate rests at $21,762 then the bitcoin value would be the delta, as **we think the value of one gold coin plus one bitcoin will approximate the value of one Dow share over time**. **This implies a bitcoin target price of $21,532 and a gold price of $6,512.**

Recommendation:

Our analysis suggests levels below 27,390 on the Dow Jones Industrial Average would be below the 10-year average, and levels closer to 21,767 would represent low prices relative to the average results, while an index level of 33,026 would be considered rich in relation to past sales, earnings, book value, dividends and forward analyst estimates. The data suggest that for the "defensive investor" reasonable allocations toward common stocks at today's levels appear appropriate and reasonable. **Given the components of the Dow 30 collectively appear to trade at slightly above average levels (28,051 v. 27,397 or 102.39% of average), portfolio policy for the "defensive investor" should lean toward average equity allocations (so if one normally splits funds in a 50/50 ratio, the analysis suggests a 48/52 ratio)**.

Risks to the Recommendation:

With the benefit of hindsight, Mr. Graham recognized in later editions that he underestimated the risks associated with bonds in 1965, as future inflation proved quite devastating to bond portfolios in the 1970s. Interestingly, today's data points certainly still look similar to those of Mr. Graham's 1965 edition. No one, in 1965, anticipated the high inflation rate of the 1970s and the impact it was to have on both the earnings power of corporations and bond portfolios. **We believe, however, that the next large inflation could be digital in nature, as millennial investors may prefer uploading excess money to non-fiat currencies in the cloud with their phones verse the complications associated with investing in gold, real estate, and other fixed or tangible assets**. In addition to unanticipated inflation, other risks to the recommendation include, but are not limit to, regulatory, governmental, and tax law changes, political risks, the mere fact the future is uncertain, and all other risks normally associated with investments in common equities.

Analyst's Notes.... Continued

The table below contains the range estimates for the individual securities in the Dow Jones Industrial Index.

Stock	Symbol	AveLowEst	AveHighEst	Last_Price 11/29/2019
Apple	AAPL	149.23	220.63	267.25
American Express Company	AXP	93.49	175.45	120.12
The Boeing Company	BA	304.11	478.36	366.18
Caterpillar Inc.	CAT	102.93	179.47	144.73
Cisco Systems, Inc.	CSCO	36.54	50.17	45.31
Chevron Corporation	CVX	95.25	135.24	117.13
Dow Inc.	DOW	74.63	109.08	53.37
The Walt Disney Company	DIS	109.51	158.88	151.58
Walgreens Boots Alliance Inc.	WBA	72.77	108.51	59.6
The Goldman Sachs Group, Inc.	GS	188.9	364.46	221.35
The Home Depot, Inc.	HD	162.72	246.94	220.51
International Business Machines	IBM	166.05	236.06	134.45
Intel Corporation	INTC	45.2	76.14	58.05
Johnson & Johnson	JNJ	115.94	150.82	137.49
JPMorgan Chase & Co.	JPM	91.97	154.83	131.76
The Coca-Cola Company	KO	43.44	57.97	53.4
McDonald's Corp.	MCD	122.66	165.66	194.48
3M Company	MMM	155.65	216.28	169.77
Merck & Co. Inc.	MRK	55.48	85.22	87.18
Microsoft Corporation	MSFT	90.94	129.48	151.38
Nike, Inc.	NKE	55.38	80.21	93.49
Pfizer Inc.	PFE	33.08	46.28	38.52
The Proctor & Gamble Company	PG	87.1	109.75	122.06
The Travelers Companies, Inc.	TRV	113.25	160.45	136.72
UnitedHealth Group Incorporated	UNH	216.64	329.73	279.87
United Technologies Corporation	UTX	121.48	170.57	148.34
Visa Inc.	V	102.41	201.07	184.51
Verizon Communications Inc.	VZ	46.54	64.43	60.24
Wal-Mart Stores Inc.	WMT	79.51	104.24	119.09
Exxon Mobil Corporation	XOM	76.72	103.27	68.13
	Total	3209.52	4869.65	4136.06
	DowDivisor	0.147445684	0.147445684	0.147445684
	Index Est.	21767.47	33026.74	28051.41

Source: *Value Line, MarketSmith,* and FinTrust estimates

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