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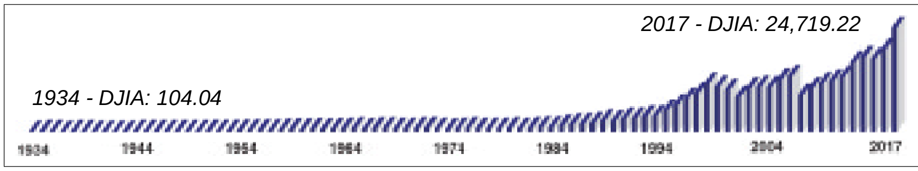
MARKET DIGEST



THURSDAY, JUNE 7, 2018

JUNE 6 DJIA 25,146.39
UP 346.41

Good Morning. This is the Market Digest for Thursday, June 7, 2018, with analysis of the financial markets and comments on **WellCare Health Plans Inc., BlackRock Inc., Boston Scientific Corp. and Consolidated Edison Inc.**

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MARKET REVIEW:

Risk-On Back On: Our Monthly Survey of the Economy, Interest Rates, and Markets

The stock market did not make much of the first-quarter 2018 earnings season, even though it blew away already high expectations. We believe investors may have had a hard time sorting the tax cut benefit from organic growth and so moved cautiously to the sidelines.

In addition to benefiting from the Tax Cut & Jobs Act, first-quarter earnings reflected broad-based global growth a revenue-repatriation benefit from weak dollar (the dollar bounce-back in April and May could mean that factor is fading). Although overall earnings were good, several companies were slammed after reporting their strongest growth in years, mainly because they were cautious on the look ahead.

With earnings season behind, however, stocks now appear to be doing a bit better. And stocks are having a strong start to June, usually one of the worst stock-performance months. The technology sector was an underperformer in mid-winter. But given the secular transitions underway as the global economy goes digital, technology is seemingly never down for long. As of the May 2018 month-end, the technology sector was at an all-time high 26% sector weighting within the S&P 500. That was up 280 bps year-over-year and up 110 bps just in the past month, as technology bulls aggressively bought the very modest end-of-April dip.

The fact that technology is in a seemingly constant uptrend is contributing to the turmoil in other sectors, as formerly safe market share is disrupted by cloud, big data, mobile enterprise, AI and other transitions and evolutions. The consumer staples giants have seen their markets upended by upstarts with non-traditional models and distribution. Staples has lost 270 bps of market weight in the past year.

While the market goes its unpredictable way, economic fundamentals remain solid. The rapid winter run-up in interest rates has now given way to some retracement, though that is not likely to last. And sector performance is showing unusual dispersion, as the gulf between winners and losers widens.

The Economy, Interest Rates, and Earnings

Despite a modest downward revision, first-quarter 2018 GDP growth of 2.2% was the strongest first-quarter performance since the economy registered 3.7% growth in 1Q10. Between 2013 and 2017, first-quarter GDP averaged growth of less than half a percentage point.

First-quarter growth declined from 2.9% in 4Q17, and despite slipping from a 2.3% advance reading showed the economy in solid shape. The first quarter featured balanced growth across consumers, businesses and government. Personal consumption expenditures (PCE) rose just 1.0%, pulled down by a 2.6% drop in consumers' durable goods spending. While that is the first decline in this category since 1Q17, we look for this measure to bounce back in coming quarters as the fall new car buying season kicks off. Consumer services spending remained positive, rising 1.8%.

Within GPD, we define core demand as including PCE, spending on intellectual property and IT, exports, housing, and government expenditures. Core demand represented 61.4% of 1Q18 GDP, above the 10-year average of 60.8%.

Non-residential fixed investment, a proxy for capital spending, was up a very strong 9.2%, as companies plow back tax savings into their infrastructure. Investments into intellectual property were up 10.9%. Exports advanced 4.2%, undercut by 2.8% growth in imports, which are subtractive of GDP. Overall government spending grew more than 1%, as both federal and state & local government spending picked up.

For all of 2018, and factoring in positive drivers including global growth, domestic deregulation and the tax act, we forecast GDP growth in the 2.4%-3.0% range. Given the stronger than expected start to the year, we are now shading our expectations to the high end of that range at around 2.9%. Our growth target remains dependent on consumer spending recovering from a soft first quarter. Our forecast also implies continued investment by businesses. One factor that is fading from the picture is government infrastructure investment; however, tax cuts and the budget-busting spending bill are providing fiscal stimulus in its place.

As the Fed continues pushing rates gradually higher, we expect some negative impacts on economic activity in the current year but particularly in 2019. Our first GDP forecast for 2019 is 2.4%; while down from 2018's projected growth, our 2019 estimate has moved up from the low 2% range. GDP performance for 2019 is dependent on how 2018 plays out.

The huge volatility in yields across March through May has now moderated. Interest rates, like any measurement tied to an asset class, move in waves. We have lately seen long yields roll back from mid-spring peaks. We do expect higher levels for rates going forward, particularly now that strong jobs data and a multi-decade low in unemployment practically forces further action on the Fed.

May nonfarm payrolls rose a robust 223,000, reflecting across-the-board gains in business services, healthcare, construction, manufacturing and elsewhere. Annual wage growth accelerated to 2.7%. The headline number was 3.8% unemployment, a level not seen since April 200.

As a reminder, in March, the Federal Reserve under new Fed Chairman Jerome Powell raised the Fed funds rate for a sixth time in this cycle, to a target of 1.5%-1.75%. The FOMC meets again in mid-June 2018, and investors are nearly unanimous in expecting the second rate hike of 2018. Futures contracts on three-month Treasury debt suggest that more investors are anticipating a third and fourth hike. The fourth hike in particular is far from a sure thing, and will depend on job gains, wage growth, and the unemployment rate in the second half of 2018. Dollar weakness that pushes up commodity prices could be another factor in the Fed's calculus.

We are not looking for the Fed to raise rates during the Federal Open Market Committee meeting that concludes on May 2, 2018. But we do expect the Fed to remain in restrictive mode across 2018 and in fact across the next two years. The Fed's dot plot for 2018 signals no change from three hikes for all of 2018, yet an increasing number of investors think it is possible the Fed could hike four times in 2018.

As of early June, the three-month Treasury bill yield stood at 1.92%, up from 1.83% a month ago and 0.77% in May 2017. Both the two-year yield and the five-year yield, however, have backed down slightly from levels at April month-end. The two-year is now at 2.47%, vs. 2.49% a month ago; and the five-year is at 2.74% vs. 2.80% last month. The 10-year Treasury yield, which briefly lifted above 3% late in March for the first time since late 2013, is now down to 2.89% from 2.96% a month ago.

Although the yield curve has flattened slightly, we continue to see limited recession risks ahead in a growing and well-balanced economy. The risks of inflation are clearly elevated, and the Fed may step up its vigilance and activity. At the same time, we believe the equity market can withstand several more Fed rate hikes as long as they are measured and predictable.

Market strategists and individual analysts now anticipate full-year 2018 EPS growth in the high teens to low 20% range. Unfortunately, that may not be good enough for this skeptical market. As occurred during 1Q18 reporting season, investors' difficulty in discerning tax-cut-driven growth from organic growth may prevent stocks from rallying on EPS beats. And, also as in 1Q18 EPS season, companies that "only" deliver low to mid-teens EPS growth are at risk of severe stock selloffs.

Our 2018 EPS forecast remains $160.20, and continues to imply 20% EPS growth. Despite the 1Q18 beat against expectations, we have not raised our 2018 EPS projection given the worsening uncertainty on the trade war front.

Our 2019 earnings growth forecast of $179 implies further 11% growth. The earnings year 2019 will be up against tough comparisons, and the one-time tax-related boost will be gone. Nonetheless, we look for continued growth in domestic and international economic activity to fuel double-digit EPS growth. Again, the biggest single wild card in the deck at this point would be implementation of tariffs here and abroad, which would be bad for everyone.

Domestic and Global Markets

Sentiment remains mixed at best, and skepticism is rampant. Maybe this wall of worry is what the bull has been waiting for. A strong bid has returned to the stock market over the past month, and leadership is clearly with risk-on names. The Nasdaq composite, for example, advanced about 5% during May from the end of April; and Nasdaq is up a further 2% just in the June month to date.

Nasdaq now leads year-to-date with a gain of 10%. Growth stocks are close behind with a 9% edge. While small-caps were left behind in 2017, the Russell 2000 is up nearly 8% year-to-date.

Among Blue Chip indexes, the performance increment month-over-month is much more modest. The S&P 500 is up about 4%, while the DJIA is up just 2%. Hurt by weakness in staples, utilities, and telecom, Wilshire Large Cap Value is negative so far this year.

Despite some snap-back in bonds over the past month, the Lehman US Aggregate Bond Index remains down about 2% year-to-date.

As the market has increasingly gravitated toward risk-on and away from defensive and high-income, the dispersion in returns between winning sectors and losing sectors has intensified. While a handful of favored sectors are at or approaching double-digit positive returns for the year, out of favor sectors are in some cases down in double digits.

Technology is leading year-to-date, with a gain approaching 14%. Consumer Discretionary is another favored sector, currently up 9%. And Energy is up 7%, although some sector investors are now taking money off the table.

A handful of sectors are treading water with a market-like performance. These include Financial Services, Healthcare, Industrials and Materials. At the bottom of the pack are so-called defensive sectors that are not putting up much of a defense this year. Consumer Staples is down nearly 12%, Telecom is down about 10%, and Utilities are off by 5%.

The ongoing sector turmoil creates opportunities, and our recommended sector weightings for the third quarter of 2018 reflect significant relative shifts in opportunities and valuations. We have made six shifts in recommended sector allocation for the summer quarter, representing a nearly unprecedented amount of movement amid dizzying change.

We have raised Financial Services to recommended Over-Weight from Market-Weight. The pace of Fed tightening is picking up, with an increasing likelihood of four rate hikes in 2018. That should continue to widen net interest margins for banks, which are already in strong financial shape based on reserve levels and other financial safeguards designed to protect against worse-case scenarios.

We have lowered Energy to recommended Market-Weight from Over-Weight. Investors loved this sector in the second quarter of 2018, after years of mistrust. But with Russia, Saudi Arabia and OPEC now wavering on promised production discipline, investors are abandoning the sector once again. Blow-out earnings comps are also running off, and we look for more normal sector EPS growth going forward.

We've raised Industrials to recommended Over-Weight from Market-Weight. Dollar strength has scared some investors away from this sector. Underlying fundamentals are strong, however. And no sector outside technology is embracing the digital economy as fully and quickly as industrial, where sensors, connectivity, and AI-based automation are transforming the modern factory.

We have lowered Healthcare to recommended Market-Weight from Over-Weight. Despite Republican efforts to dismantle the Affordable Care Act, it is still upright. But the end of the individual mandate and other actions have blunted ACA. Domestically, the percentage of citizens with health insurance is now declining, after years of growth. That's a big headwind for a sector already hurt by lack of new blockbusters and rising costs for drug development. Given its year-to-date outperformance, Healthcare now warrants a Market-Weight.

We have raised Consumer Staples to recommended Market Weight from Under-Weight. At one time not long ago, Staples accounted for 11% of S&P 500 sector weight; that is now down to 6.7%. Consumers are spending more than ever on food, beverages, healthcare and consumer goods; they are just not spending as much on brand names from P&G, General Mills and other sector giants. We expect these companies over time to use their cash to consolidate the sector, acquiring fast-growing companies that better match with millennials' evolving wants and needs.

Finally, we have lowered Telecom Services to recommended Under-Weight from Market-Weight. Telecom is another sector where embattled giants continue to struggle from aggressive pricing and new strategies by upstarts. Unlike in Staples, however, where the giants can buy small start-ups, Verizon and AT&T likely could not get regulatory approval to buy the companies that are hurting them, such as Sprint and T-Mobile. As long as ruinous price wars rule the sector, no one is winning.

A handful of global stock markets turned up slightly in May, though not as much as U.S. leadership sectors. And mature and Americas markets generally retreated in May. Our global composite is up 1.5% as of end-of-May, vs. up 3.5% year-to-date as of end of April.

BRIC markets are up an average 3.5% year-to-date, no better than the stodgy S&P 500. Commodity and resource based markets are up about 2%. After that, performance degrades further. Mature markets are up about 1.5%. And Americas in aggregate are down slightly year-to-date. The mature economies that have been our longest running trade partners are feeling the impact of tariff threats and counter-threats, while emerging and commodity markets appear to be rising above the fray.

Conclusion

The longer-term trend is still working against defensive and income-oriented sectors. The across-the-board rise in interest rates since the mid-March FOMC meeting has hit traditional income areas such as utilities, while relentless price wars continue to hurt telecom services.

We expect continued leadership by economically sensitive stocks in a still-rising economy. Further gains in risk-on and economy-sensitive stocks are likely to come at the expense of defensive and income-oriented sectors.

Argus also believes that exceptional earnings growth will supersede any near-term negative impact from rising rates as well as the other factors cited above. Even if the Fed ends up moving four times in 2018, the stock market should be able to handle a higher rate environment. The key to stock market stability and expansion is the Fed, which needs to move steadily and predictably. (Jim Kelleher, Director of Research)

WELLCARE HEALTH PLANS INC. (NYSE: WCG, $229.23)... BUY

WCC: Launching coverage with a BUY rating and $265 target

* We believe that WellCare is well positioned to benefit from continued strong growth in the Medicaid, Medicare Advantage and Medicare Part D (prescription drug) markets, as well as from acquisitions and geographic expansion.
* Management sees particularly strong prospects in the Medicare Advantage market, driven by current demographic trends and the sale of more private health plans to Medicare members.
* WCG trades at 22-times our 2018 EPS estimate of $10.70, above the average multiple of 17 for other health insurers.
* However, we believe that the stock merits a premium valuation based on the company's strong earnings growth prospects and contributions from the Universal American acquisition.

ANALYSIS

INVESTMENT THESIS

We are initiating coverage of WellCare Health Plans Inc. (NYSE: WCG), a managed care company, with a BUY rating and a target price of $265. The company is well-positioned to benefit from continued strong growth in the Medicaid, Medicare Advantage and Medicare Part D (prescription drug) markets, as well as from acquisitions and geographic expansion. It sees particularly strong prospects in the Medicare Advantage market, driven by current demographic trends and the sale of more private health plans to Medicare members. In 2017, it acquired Universal American Corp. to help expand its presence in the Medicare Advantage segment. Management also expects earnings to benefit from a lower effective tax rate of 34.5%-36.0%, down from a prior 51.0%-53.0%.

WCG trades at 22-times our 2018 EPS estimate of $10.70, above the average multiple of 17 for other health insurers. However, we believe that the stock merits a premium valuation based on the company's strong earnings growth prospects and contributions from the Universal American acquisition. We also note that WCG may be an attractive acquisition target for a larger insurer.

RECENT DEVELOPMENTS

On May 1, 2018, WCG reported better-than expected 1Q18 earnings, driven by strength in the company's Medicare business. Adjusted EPS rose to $2.47 from $1.61 in the prior-year period and topped the consensus estimate of $1.99. The strong earnings reflected a lower-than-expected Medical Loss Ratio (MLR), i.e., the company's expenses and claims paid as a percentage of premiums. The improvement reflected lower MLRs in the Medicare and Medicare Part D programs, offset in part by a higher MLR in the Medicaid business. The overall company MLR fell to 87.5% from 88.8% a year earlier, despite the impact of a severe flu season. Management looks for further improvement in the MLR in all segments except for Medicare Part D, which is currently operating at its minimum legal MLR. Total revenue rose to $4.65 billion from $3.95 billion in 1Q17.

For all of 2017, revenue rose to $17.0 billion from $14.2 billion in 2016. EPS rose to $8.52 from $5.96 in 2016.

During the 1Q conference call, management raised its adjusted EPS guidance to $10.00-$10.30 from $9.55-$9.85. It also narrowed its Medicaid MLR guidance to 88.4%-89.0% from 88.2%-89.2%, and lowered its Medicare MLR forecast to 84.6%-85.4% from 84.6%-85.6%, down 20 basis points at the high end of the range. It also lowered its Medicare Part D MLR to 79.5%-81.0% from 80.0%-82.0%. It raised its investment and other income forecast to $72-$78 million from $63-$73 million, and reiterated its forecast for adjusted premium revenue of $17.9-18.4 billion.

EARNINGS & GROWTH ANALYSIS

Based on our expectations for growth in existing markets and contributions from acquired businesses, we expect revenue to increase 10% to $18.7 billion in 2018. The company now has more than half a million Medicare Advantage members and 1.2 million Medicare Part D members in all 50 states, as well as 2.7 million Medicaid members. Management expects revenue growth to be driven by the expansion of the Medicare Advantage business, and looks for membership growth following the launch of the company's Medicaid business in Arizona and Nebraska, and the statewide expansion of Medicaid in Missouri. On the negative side, it expects competition from a new insurer to hurt the Medicare business in Georgia.

We project a 2018 operating margin of 3.9%, up 50 basis points from 2017, and above the average of 2.8% for other Medicaid-focused insurers. Our EPS estimates are $10.70 for 2018 and $12.00 for 2019. Our long-term earnings growth rate estimate is 15%.

FINANCIAL STRENGTH & DIVIDEND

Our financial strength rating on WellCare is Medium-High. At the end of 1Q18, cash and cash equivalents totaled $4.8 billion, up from $4.2 billion a year earlier. The long-term debt/capital ratio was 32.1%, below the industry average of 34.0%. Operating income covered 1Q interest expense by a factor of 10.5, well above the ratio of 5.0 that we view as healthy coverage. The 1Q ROE was 17.9%, above the industry average of 15.2%.

WellCare does not pay a dividend and we do not expect it to initiate one given management's preference for acquisitions.

MANAGEMENT & RISKS

Ken Burdick became the company's CEO in January 2015 after previously serving as president and COO, and as president of the company's national health plans. Before joining WellCare in 2014, he spent 14 years in senior management positions at UnitedHealth Group.

Risks to our rating and target price include cuts to Medicaid funding, medical costs that rise faster than premiums, new competition in the Medicaid market, and an inability to win new business. Aggressive pricing by competitors could lead to market share losses in the company's core Medicaid and Medicare businesses. The company may also fail to generate the expected revenue and cost synergies from acquired businesses.

COMPANY DESCRIPTION

WellCare Health Plans Inc. is a managed care company. It focuses on government sponsored managed care services, primarily through the provision of Medicaid, Medicare Advantage (MA) and Medicare Prescription Drug Plans (PDP) to families, children, seniors and individuals. WellCare Health Plans consists of three divisions: Medicaid Health Plans, Medicare Health Plans, and Medicare PDPs. With 2017 revenue of $17 billion and a $9 billion market cap, WCG is much smaller than other large health insurers and has more room to grow.

INDUSTRY

We have lowered our rating on the Healthcare sector to Market-Weight from Over-Weight. Despite Republican efforts to dismantle the Affordable Care Act, it is still upright. But the end of the individual mandate and other actions have nonetheless diminished its impact. The percentage of U.S. citizens with health insurance is now declining after years of growth. That's a big headwind for a sector already hurt by a lack of new blockbusters and rising costs for drug development.

The sector accounts for 13.9% of the S&P 500, and includes companies in the pharmaceuticals, medical devices, healthcare services, and insurance industries. The sector is slightly underperforming the market in 2018, after gaining 20.0% in 2017 and losing 4.4% in 2016.

VALUATION

WCG shares have outperformed over the last five years, with a gain of 260%, reflecting the company's more consistent earnings, accretive acquisitions, and expanded geographic presence in both the Medicaid and Medicare markets. The company has also benefited from an aging population and from recent favorable trends in medical costs. Given the rapid growth in Medicaid and Medicare enrollment, and the company's positive earnings surprises in 13 of the past 14 quarters, we believe that WCG merits a premium multiple. Our target price of $265 implies a multiple of 25-times our 2018 EPS estimate, above the industry average of 17, and a potential return of 16% from current levels.

On June 6, BUY-rated WCG closed at $229.23, up $1.30. (John Staszak, CFA, 6/6/18)

BLACKROCK INC. (NYSE: BLK, $551.86).. BUY

BLK: Highlights from Investor Day

* On June 5, we attended the company's fourth Investor Day in New York, where management outlined its growth strategy.
* BlackRock is focused on maintaining or improving its market position in high-growth markets and on leveraging its scale and technology.
* Management sees "illiquid alternatives," though currently just 1% of AUM, as a potential new growth driver. It also expects strong growth in its cash management business.
* On valuation, we believe that BLK should trade at a premium to large-cap financial stocks given the company's above-average operating margins, stable long-term asset inflows, and history of product innovation. Our target of $620 assumes a multiple of 21.7-times our 2018 EPS estimate.

ANALYSIS

INVESTMENT THESIS

We are maintaining our BUY rating on BlackRock Inc. (NYSE: BLK) following the company's June 5 Investor Day. As management discussed at the meeting, BlackRock has a two-prong strategy. First, it is focused on maintaining or improving its market position in high-growth markets (including iShares, factor-based investing, retirement products, illiquid alternatives, and "Emerging Asia"). Second, it is working to extend its value proposition by leveraging its scale and technology, with a focus on portfolio construction and asset allocation, artificial intelligence, and its Aladdin risk analytics platform.

We believe that BlackRock, which marked its 30th anniversary in March, has strong growth opportunities. The company continues to see strong growth in AUM (up 17% in 1Q18), driven by both asset inflows and market appreciation. It has also adapted well to unpredictable market events (such as Brexit, trade disputes, and interest rate volatility), reflecting its wide range of products and services, and been able to retain a high proportion of assets across the investment cycle. This was particularly evident during the market turbulence of 1Q18, and during the substantial shifts between equities and bonds in 2016. We also expect BlackRock to benefit from the accelerating "retirement-income gap," the growth in fee-based assets, and the changing needs of financial advisors, who increasingly wish to spend more time with clients and less time on administrative work.

Management sees "illiquid alternatives," though currently just 1% of AUM, as a potential new growth driver. It expects continued strong fundraising momentum, and believes that Blackrock differentiates itself in this business through strong technology and the success of its global platform. The cash management business is also starting to have an impact. Though currently accounting for just 7% of assets under management, this segment is gaining scale and market share through its partnership with Kyriba, the purchase of Cachematrix, and the development of the Aladdin platform. Management has emphasized that Blackrock offers more than standard cash management, which typically treats cash like a commodity, and that it is focused on helping investors with active cash management investments.

Like those of other active equity managers, Blackrock's actively managed equity funds have been underperforming the broad market. In 1Q17, the company announced that it would take a more data-driven approach to active management. New active product categories include Core Alpha, High Conviction Alpha, Outcome-Oriented, and Country and Sector Specialty. We believe that the move also reflects the increase in fund flows into passive index funds, driven by the better performance and low cost of these products.

With some $1.8 trillion in ETF assets under management, BlackRock's franchise is the largest ETF provider, well ahead of second-place Vanguard. The iShares franchise has allowed the company to dominate the ETF market, with 70% organic growth over the past five years. The company is also the largest investment-only defined-contribution provider. This large scale has helped the company to boost its operating margin from 39.3% in 2010 to 44.1% in 2017.

Turning to recent results, we view the company's 19% year-over-year revenue growth in 1Q18 as very healthy. Revenue benefited from AUM growth and market appreciation, and margins expanded. We expect continued growth in AUM in the coming quarters, aided by a broad product suite, new product introductions, market share gains, and further market appreciation.

On valuation, we believe that BLK should trade at a premium to large-cap financial stocks, as well as to the broad market given the company's above-average operating margins, stable long-term asset inflows, and history of product innovation. Our target price of $620 implies a multiple of 21.7-times our 2018 EPS estimate.

RECENT DEVELOPMENTS

BLK shares have risen 32% over the past year, compared to a 13% increase for the broad market.

On April 12, BlackRock reported adjusted 1Q18 earnings of $6.70 per share, up from $5.23 a year earlier and above the $6.39 consensus. Revenues rose 16%, to $3.58 billion, aided by growth in investment advisory and distribution fees. As of March 31, 2018, AUM totaled $6.32 trillion, up 17% from the prior year.

Compensation and benefits expense, which accounted for 51% of operating costs, rose 9.8%, and operating income rose 20%. The adjusted operating margin was 44.1% in 1Q18, up from 42.6% a year earlier.

In the first quarter, BlackRock had $54.6 billion of long-term net inflows, with 49% attributed to equities, 49% to fixed income, and the balance to multi-asset and alternatives. Market depreciation lowered assets by $77.1 billion, while positive foreign currency adjustments contributed $46.9 billion. Long-term assets under management totaled $5.91 trillion as of March 31, 2018, with 58% in equities, 32% in fixed-income, 8% in multi-asset, and 2% in alternatives.

EARNINGS & GROWTH ANALYSIS

BlackRock's three main segments are retail, iShares, and institutional. Management expects the retail segment to grow with help from new products, additional sales channels, favorable market conditions, and strong long-term net inflows.

iShares, historically the fastest-growing segment, should also benefit from product expansion and market share gains. In 1Q18, iShares ETFs saw inflows of $35 billion and $246 billion in new net business (NNB). Management projects growth of 20%-30% over the next five years. In 2017, iShares captured the largest share of industry flows in the U.S. and Europe, and in both equity and fixed income. We believe the increase of $105 billion in cumulative iShares assets in 2017 highlights the segment's growth potential. BlackRock expects the ETF market to double in size by 2023, helped by growth in fee-based wealth management and the use of ETFs to generate alpha.

In the institutional segment, drivers include an enhanced "solutions-oriented" approach and expanding client relationships. Institutional net inflows were $3.3 billion in 1Q, led by fixed-income products. The institutional segment is divided between active and index. Active includes equity, fixed income, multi-asset, and alternatives, with growth driven mainly by fixed-income and multi-asset. The institutional index segment is divided into the same categories, with equity as the main driver.

The company is targeting long-term AUM growth of 5% annually, a figure that it reiterated at the 2018 Investor Day. It fell short of this target in 2016 with 4.2% growth, reflecting challenging global market performance; however, AUM recovered in 2017, rising 23%. BlackRock is also targeting double-digit EPS growth, reflecting both the increasing scale of the business and the impact of share buybacks. The company's operating margin improved from 39.3% in 2010 to 44.1% in 2017. We look for additional modest improvement, driven by economies of scale.

BlackRock experienced positive long-term inflows in all four quarters of 2017, with $80 billion in 1Q17, $94 billion in 2Q17, $76 billion in 3Q17 and $103 billion in 4Q17. This was followed by inflows of $55 billion in 1Q18. We believe that these positive inflows reflect the company's strong diversification across product lines. Although BlackRock has occasionally experienced outflows, these have been of the lower-margin institutional variety and thus less harmful to margins. In 1Q17, BlackRock began to restructure its active equity product group, using a more data-driven approach in an effort to boost performance.

The blended fee rate, or advisory fees divided by assets under management, which had been in decline since late 2015, stabilized in 2017 and in the first quarter of 2018. We expect stable fee rates going forward as higher fees on emerging market assets are offset by lower fees on passively managed products.

We are maintaining our 2018 EPS estimate of $28.56 and our 2019 forecast of $31.75.

FINANCIAL STRENGTH & DIVIDEND

Our financial strength rating on BlackRock is Medium-High, the second-highest rank on our five-point scale.

Long-term borrowings of $5.0 billion at March 31, 2018 were modest compared to shareholders' equity of $32.0 billion. The company also maintains a healthy operating margin in the mid-40s.

Dividends grew at a compound annual rate of 18% between 2010 and 2014, but slowed to 13% growth in 2015 and 5% in 2016. BLK raised the dividend by 9% in the first quarter of 2017 and by 15% in the first quarter of 2018, to $2.88 per share, or $11.52 annually. The payout ratio was 44% in 2017; we expect it to remain in the 40-50% range going forward. Our dividend estimates are $11.52 for 2018 and $12.52 (raised from $12.40) for 2019.

The company has an active share buyback program, repurchasing $1.1 billion of its stock in 2017 at a consistent pace of $275 million per quarter. This was expanded to $335 million in the first quarter of 2018, as the company took advantage of savings from a lower tax rate. We expect share repurchases of $300 million per quarter for the balance of 2018, resulting in a 1%-2% decline in average shares outstanding.

MANAGEMENT & RISKS

BlackRock has been led by chairman and CEO Laurence D. Fink since its formation in 1998. Mr. Fink owns about 1.6 million shares (1%) of BlackRock common stock. Compensation was 59% of expenses in 2017, and about 34% of revenues. We believe that the company’s compensation structure is very well aligned with shareholder interests, as 80% of top management’s incentive compensation is tied to financial performance and to measures of client retention and risk management.

BlackRock operates in the highly competitive field of asset gathering, and growth requires consistent asset inflows. Growth in asset management fees also depends on global market appreciation. We believe the company is well positioned with key differentiators that include breadth of technology and scale, a strong investment platform, global and local distribution, and an innovative culture.

The asset management industry is highly regulated, with changes in regulation often resulting in high compliance costs.

COMPANY DESCRIPTION

BlackRock provides investment management, risk management, and advisory services for institutional and retail clients worldwide. It is the largest asset manager in the world with $6.3 trillion assets under management. Its range of products includes separate accounts, mutual funds, the iShares series of ETFs, and other pooled investment vehicles.

iShares is a global leader in ETFs, with more than 700 funds in multiple asset classes and more than $1.8 trillion in assets under management as of March 31, 2018.

PNC Financial Services Group holds 21% of BlackRock common shares.

VALUATION

BLK shares have traded between $409 and $596 over the past year and are currently about 9% below the top of this range.

BLK trades at 19.1-times our 2018 EPS estimate. In our view, BLK should trade at a greater premium to peers given the company’s mid-40s operating margin, well above the average for most large-cap financials; broad product suite, which provides diversification; and history of strong fund flows. Our target price of $620 assumes a multiple of 21.7-times our 2018 EPS estimate.

On June 6, BUY-rated BLK closed at $551.86, up $20.36. (Stephen Biggar and Olivia Hoyda, 6/6/18)

BOSTON SCIENTIFIC CORP. (NYSE: BSX, $30.80) .... BUY

BSX: Raising target price by $4

* The BSX shares have outperformed the market over the past three months, rising 12% while the S&P 500 has gained 1.3%.
* We believe that BSX deserves to trade at a premium to the peer group, given its growth outlook and high level of profitability.
* Our revised target price of $36 assumes a P/E multiple of 22.5-times next year's earnings, just above the industry average.

ANALYSIS

INVESTMENT THESIS

We are reaffirming our BUY rating on Boston Scientific Corp. (NYSE: BSX) and are raising our price target by $4 to $36. BSX continues to deliver solid sales growth, with first-quarter organic revenue up in all three segments and across all regions. At the same time, the company is facing remediation costs for its Lotus heart valve, which was recalled in Europe in February 2017. Management reiterated its goal for a relaunch of the Lotus in Europe and an initial launch in the U.S in 2019. Despite this setback, we believe that BSX has compelling long-term growth opportunities, driven by strength in the MedSurg and Rhythm and Neuro segments, and through its four acquisitions. We believe that BSX deserves to trade at a premium to the peer group, given its growth outlook and high level of profitability. Our target price of $36 assumes a P/E multiple of 22.5-times next year's earnings, just above the industry average.

RECENT DEVELOPMENTS

The BSX shares have outperformed the market over the past three months, rising 12% while the S&P 500 has gained 1.3%. Over the past year, the shares have underperformed with a 12% gain compared to a 14% advance for the broad market. The BSX shares have performed in line with the Healthcare Industry (ETF is IYH) over the past year and have outperformed over the past five years. The beta on BSX is 0.99.

The company recently reported results that topped consensus expectations. On April 25, BSX posted 1Q18 adjusted EPS of $0.33, above the consensus of $0.32 and up from $0.29 a year earlier. Net sales rose to $2.38 billion, up 10.1% on a reported basis and 5.2% organically. The adjusted operating margin increased 230 basis points year-over-year to 25.3%.

Along with the results, management raised guidance. The company now estimates 2018 revenue of $9.750-$9.900 billion (compared to prior guidance of $9.650-$9.800 billion), which represents growth of approximately 8%-10% on a reported basis and approximately 5%-7% on an organic basis. Management projects adjusted earnings of $1.37-$1.41 per share (compared to prior guidance of $1.35-$1.39). The company estimates 2Q sales of $2.450-$2.500 billion and adjusted earnings of $0.33-$0.35 per share.

The company has a growth by acquisition strategy. In March 2018, Boston Scientific announced the definitive agreement to acquire NxThera, Inc. to expand the company's portfolio with the Rezûm system. This system is a minimally invasive therapy that aids men with symptoms of benign prostatic hyperplasia. Additionally in March, Boston Scientific acquired EMcision Limited which brings along the Habib EndoHPB probe that reduces duct obstruction to help physicians in their treatment of pancreaticobiliary cancers. On April 3, BSX acquired Securus Medical Group Inc. will add a thermal esophageal monitoring system to the cardiac division. Also in April, the company acquired nVision Medical Corp., which has developed a device to collect cells to diagnose ovarian cancer.

In conjunction with the acquisitions, Boston Scientific issued debt. In February, BSX raised $1 billion of 4.0% senior notes due March 1, 2028.

EARNINGS & GROWTH ANALYSIS

The company organizes its businesses into three segments: MedSurg (30% of 1Q sales), which includes Endoscopy and Urology and Pelvic health; the newly created Rhythm and Neuro, which consists of Cardiac Rhythm Management, Electrophysiology, and Neuromodulation; and Cardiovascular (39%), which includes Interventional Cardiology and Peripheral Interventions.

In 1Q, organic sales grew in all segments, with growth of 7.4% in MedSurg, 6.4% in Rhythm and Neuro, and 2.7% in Cardiovascular. By geographic region, 1Q organic revenue rose 4.8% in the U.S., 5.7% in the EMEA, 5.8% in APAC and 16.7% in other emerging markets.

Management keeps a close eye on the company's cost structure. The adjusted gross margin widened 170 basis points year-over-year to 72.3%, while the adjusted operating margin widened 230 basis points to 25.3%.

Turning to our estimates, based on the solid sales trends in MedSurg and Rhythm and Neuro, as well as expectations for margin improvement, we are raising our 2018 EPS estimate to $1.41 from $1.37. Our estimate is at the high end of management's guidance range and implies growth of 12% for the year. We expect continued growth into 2019 and are also boosting our 2019 EPS estimate to $1.58 from $1.52.

FINANCIAL STRENGTH & DIVIDEND

Our Financial Strength rating on BSX is Medium. The company achieves average scores on our key financial strength criteria of debt levels, fixed cost coverage, cash flow generation and profitability.

The company's total debt/total capitalization ratio was 45% at the end of its most recent quarter. The operating margin was a healthy 25.3%. Adjusted free cash flow rose 69% to $283 million; management's full-year guidance for FCF is $1.9 billion.

BSX does not pay a dividend.

MANAGEMENT & RISKS

The CEO of Boston Scientific is Michael F. Mahoney. He has been in the position since November of 2012 and became chairman of the board of directors in May 2016. He previously held senior positions at Johnson & Johnson's Medical Devices and Diagnostics division. The CFO is Daniel J. Brennan.

Investors in the BSX shares face risks. The devices market is competitive. BSX's cardiac rhythm management products face competition from industry leader Medtronic and from the St. Jude Medical business now owned by Abbott. Its coronary stents also face challenges from Abbott and Medtronic.

We are monitoring the company's efforts to resolve issues surrounding its Lotus heart valve device. This device, which essentially replaces the aortic valve in a catheter-based minimally invasive procedure, was recalled in European markets in February 2017 due to a problem with the release of the valve from the catheter. On February 2, 2018, CEO Mahoney announced that Lotus will remain off the market until 2019 with hopes of getting approval by the FDA during this year. Its U.S. marketing application was also delayed. Nevertheless, we believe that the Lotus valve has a large addressable market and the potential to be a significant revenue driver in the upcoming year. In the transcatheter aortic valve replacement market (TAVR), Edwards Lifescience and Medtronic are the leading players. The TAVR market is expected to grow to $5 billion worldwide by 2021, according to Edwards. The TAVR devices, which are implanted through a catheter, eliminate the need for surgical replacement of the aortic valve. Although the Lotus valve has strong clinical data showing its benefits to patients, BSX will be playing catch-up as it seeks U.S. marketing approval and works to relaunch the product in Europe in 2019.

Boston Scientific also faces regulatory and technological risks. The company is developing new products to fill its product pipeline, which is also benefiting from acquisitions. However, these products must complete clinical trials and clear regulatory hurdles before reaching the market.

We note that product pricing and customer demand depend on the reimbursement policies set by government agencies and managed care companies. Governments in Europe and Japan, in particular, have imposed significant price cuts on medical devices.

COMPANY DESCRIPTION

Based in Marlborough, Massachusetts, Boston Scientific is a developer, manufacturer and marketer of medical devices used in a range of interventional medical specialties, including interventional cardiology, peripheral interventions, vascular surgery, electrophysiology, oncology, endoscopy, urology, gynecology and neuromodulation.

VALUATION

We think the BSX shares are attractively valued at current prices near $31. Over the past 52 weeks, the shares have traded between $24 and $31, and they are currently at the upper end of the range. From a technical standpoint, the shares are in a long-term bullish pattern of higher highs and higher lows that dates to 2012.

On the fundamentals, the shares trade in line with a peer group that includes BAX, ABT, MDT and SYK. BSX trades at 21.6-times our FY18 EPS estimate, slightly below the average multiple of 22 for peers, despite higher margin. They trade in the upper half of the five-year historical range of 12-25. The price/sales multiple of 4.2 is slightly above the peer average of 4.0. We believe that BSX deserves to trade at a premium to the peer group, given its growth outlook and high level of profitability. Our target price of $36 assumes a P/E multiple of 22.5-times next year's earnings, just above the industry average.

On June 6, BUY-rated BSX closed at $30.80, up $0.08. (John Eade and Olivia Hoyda, 6/6/18)

CONSOLIDATED EDISON INC. (NYSE: ED, $72.39) .... HOLD

ED: Solid dividend yield; maintaining HOLD on valuation

* Over the last three months, ED shares have underperformed the S&P 500, declining 3%, compared to a 1% return for the broad market. The shares have also underperformed over the past year, declining 12%, compared to a 14% gain for the index.
* We expect the company to grow earnings and dividends more slowly than peers. We believe that investors will favor companies with stronger dividend growth as the Federal Reserve raises interest rates.
* We are raising our 2018 EPS estimate to $4.33 from $4.27, based on the better-than-expected 1Q EPS. However, we are lowering our 2019 estimate to $4.32 from $4.44 due to an expected rise in expenses. Con Ed continues to benefit from a solid capital expenditure program, strong cost controls, positive economic conditions in its service territory, and conversions from oil to gas heat.
* ED appears fairly valued at 16.7-times our 2018 EPS estimate, near the top of the five-year average annual range of 14.1-20.9 and in line with the peer median.

ANALYSIS

INVESTMENT THESIS

We are maintaining our HOLD rating on Consolidated Edison Inc. (NYSE: ED). We expect the company to grow earnings and dividends more slowly than peers, and believe that investors will favor companies with stronger dividend growth as the Federal Reserve raises interest rates.

Our long-term rating remains BUY, however, reflecting the company's strong financial position, continued capital investments, and record of steady earnings. The dividend also appears secure, and the current yield of about 3.9% may be attractive for income-oriented investors. Overall, we believe that Con Edison is committed to optimizing the value of its portfolio of regulated utility and nonregulated businesses in order to generate meaningful long-term returns. We expect shareholder returns to average 7%-8% annually over the next four to five years.

RECENT DEVELOPMENTS

Over the last three months, ED shares have underperformed the S&P 500, declining 3%, compared to a 1% return for the broad market. The shares have also underperformed over the past year, declining 12%, compared to a 14% gain for the index. The beta on ED shares is 0.55, below the peer average of 0.70, which indicates that ED has less sensitivity to broad market moves.

On May 3, Con Ed reported 1Q adjusted earnings of $428 million or $1.37 per share, above our estimate of $1.32 and the consensus estimate of $1.29. EPS rose 9% from the prior year, reflecting a change in utility rates and the impact of weather on steam revenue.

GAAP results (which includes the remeasurement of Con Ed's deferred tax assets and liabilities due to the new U.S. tax law, the sale of the competitive energy business, asset impairments, gains related to solar investments, and mark-to-market effects) were the same as adjusted results. First-quarter operating revenue rose 4% to $3.4 billion, above both our estimate and the consensus forecast of $3.2 billion.

Along with 1Q earnings, management reiterated its 2018 non-GAAP EPS forecast of $4.15-$4.35. Con Ed's guidance assumes capital investments of $4.0 billion, and operating and maintenance expenses of $2.6 billion. The company also has a three-year, $11.1 billion infrastructure investment plan.

The Utility industry is heavily regulated, and Con Ed works closely with local officials to set rates and returns. In April, Orange and Rockland Utilities (O&R) filed updates to its request in January with the NYSPSC asking for an electric rate increase of $23 million, up from its previous request of $20 million, and a gas rate increases of $3 million, down from its previous $5 million, to begin in January 2019. The increase implies a return on common equity of about 9.75%.

In 2018, the company expects to invest $360 million in gas pipeline projects and $400 million in renewable electric projects. Demand for natural gas has grown 30% since 2011 and Con Ed expects demand to grow by 20% over the next twenty years.

In March, two winter storms caused $148 million in damage across Con Ed's geographic divisions. The extent that Con Ed receives cost recovery through rate increases depends on reviews by the regulatory commissions of New York and New Jersey.

There were no acquisitions or dispositions during the first quarter.

EARNINGS & GROWTH ANALYSIS

Consolidated Edison is organized into two operating segments: Consolidated Edison Company of New York (CECONY, 87% of 2017 sales), and O&R (7% of sales). The remaining revenue comes from the Clean Energy Business (6%), which records realized and unrealized gains and losses on derivative contracts in purchased power, purchased gas for resales, and nonutility revenue. These derivative instruments are used to hedge against fluctuations in commodity prices.

First-quarter energy deliveries (sales volumes) at CECONY, adjusted for variations in weather and billing days, rose 2.1% for electricity, 2.9% for gas, and 11.6% for steam. First-quarter segment revenue for CECONY rose 1% to $2.9 billion. First-quarter deliveries at O&R, adjusted for weather and billing days, rose 2.4% for electricity and 7.8% for gas. We expect revenue to grow at a low single-digit rate in both the CECONY and O&R segments.

The company has benefited from customer conversions from heating oil to gas, and expects these conversions to drive 1.6% annual growth in gas usage at CECONY over the next five years. Over the same period, electric deliveries at CECONY are expected to grow at a 0.1% rate, while deliveries at O&R are expected to be flat. Steam deliveries at CECONY rose by 11.6% as equipment becomes more energy-efficient. Con Ed has invested in several solar and wind energy projects around the country, which may provide opportunities for long-term growth.

Turning to margins, on a GAAP basis, which includes derivative hedges and the sale of the retail electric supply business, the CECONY 1Q operating margin fell 180 basis points to 24.2%.

We are raising our 2018 EPS estimate to $4.33 from $4.27, based on the better-than-expected 1Q EPS. However, we are lowering our 2019 estimate to $4.32 from $4.44 due to an expected rise in expenses. Con Ed continues to benefit from a solid capital expenditure program, strong cost controls, positive economic conditions in its service territory, and conversions from oil to gas heat. Our long-term earnings growth rate estimate is 3%.

FINANCIAL STRENGTH & DIVIDEND

Our financial strength rating for Consolidated Edison is Medium, the midpoint on our five-point scale. Total debt stood at $17.4 billion at the end of 1Q18, compared to $15.7 billion at the end of 1Q17. Debt/capital stood at 53%, in line with peers. Con Edison's debt is rated investment grade. Moody's has an A3 rating, with a negative outlook, while S&P has an A- rating, with a stable outlook. Adjusted EBITDA covered interest expense by a factor of 5.4 in the first quarter, below the peer average of 5.8. The adjusted net margin in 1Q18 was 12.7%, in line with peers and up from 12.0% a year earlier. Con Ed expects to spend $4.0 billion on capital projects in 2018 and $3.5 billion in 2019. The company also plans to issue up to $450 million in equity and $1.3-$1.8 billion in debt at its utilities this year. The remaining funds will be generated from internal cash flow. We do not foresee any difficulty accessing the capital markets.

In 1Q18, cash flow from operations came to $143 million and covered 16% of capital expenditures. This compared to cash flow from operations of $448 million and a coverage ratio of 50% a year earlier. The peer average coverage ratio for 1Q18 was 92%.

The company pays a quarterly dividend of $0.715 per share, or $2.86 annually, for a yield of about 3.9%, in line with peers. The dividend was raised by 3.6% in January 2018 and has risen at a CAGR of 3.1% over the past five years. We think the dividend is secure and likely to grow. Our dividend forecasts are $2.86 for 2018 and $2.94 for 2019. ED has increased its dividend for 44 straight years.

MANAGEMENT & RISKS

Management is committed to electric and gas service expansion strategies in the company's regulated service territories. The company has a few nonregulated operations, though providing transmission and distribution service is the company's focus, and 90% of ongoing earnings over the past five years have come from regulated energy delivery. Its platform for growth is solid, in our opinion, and we believe that management will provide shareholders with increased value over the long term.

Capital expenditures will also drive rate-base and earnings growth. Con Edison will continue to invest in infrastructure projects in New York City and Westchester County. These expenditures are focused on maintaining and upgrading the company's electric, gas, and steam systems, as well as on new transmission cables and substations; the expansion of the company's underground and overhead distribution system; and the installation of new computer equipment and software. Given the company's strong cash flow, we do not foresee any erosion of the balance sheet as a result of this spending.

The economy in the company's service territory (parts of New York City and surrounding areas) continues to gain momentum. Positive employment trends as well as subway line extensions and high-profile developments (such as One World Trade Center and Hudson Yards) are likely to attract new residents and boost population growth — leading, in turn, to stronger load growth. The company projects 0.1% average annual growth in electric demand at CECONY over the next five years.

Low natural gas prices and New York City clean-air initiatives have boosted interest in oil-to-gas conversions, and led to increased peak gas usage. ED management currently expects 1.2% growth in peak gas usage in the New York City area for the next five years (2018-2022), down from previous expectations of 1.6% growth. Future conversions are expected to boost earnings growth.

Key risks for stocks in our electric utility universe include commodity price fluctuations (such as the cost of fuel for electric generators), the effect of adverse weather on revenues, regulatory issues (especially construction cost recovery), rising interest rates, and potential environmental and safety liabilities. In addition, the capital-intensive nature of the Utility industry creates ongoing liquidity risk that must be actively managed by each company.

COMPANY DESCRIPTION

Consolidated Edison provides a wide range of energy-related products and services through the following subsidiaries: Consolidated Edison Co. of New York, a regulated utility providing electricity, gas and steam in New York City and Westchester County; Orange and Rockland Utilities, a utility serving customers in a 1,300-square-mile area in southeastern New York State and adjacent sections of northern New Jersey and northeastern Pennsylvania; Con Edison Solutions, a retail energy supply and services company; Con Edison Energy, a wholesale energy supply company; and Con Edison Development, which owns and operates generating plants and participates in other infrastructure projects.

VALUATION

ED shares are trading toward the low end of their 52-week range of $72-$90. To value the shares on a fundamental basis, we look at price multiples for the company on a historical basis and relative to peers. At current prices, ED trades at 16.7-times our 2018 EPS estimate, below the midpoint of the five-year historical average range of 14.1-20.9. The stock also trades at a price/book multiple of 1.5 (slightly below the midpoint of the range of 1.3-1.8) and at a price/sales multiple of 1.8 (above the midpoint of the range of 1.2-2.3). The stock trades in line with the 2018 peer median P/E and the median price/book multiple but below the 2.2 price/sales ratio for peers. For income-oriented investors, ED offers an attractive dividend yield of about 3.9%, in line with the industry average. We will look to get this well-managed utility back on the BUY list in the event of a nonfundamental pullback to the mid-$60s.

On June 6, HOLD-rated ED closed at $72.39, down $1.62. (Jacob Kilstein, CFA, and Ryan Schultz, 6/6/18)