<u>The Outlook: Dec. 22, 2018</u>

Freedom, and fear . . . and the nature of the only two things that matter.

Only three months ago we were turning into the homestretch of the year 2018. The year seemed firmly headed for a final label of "OK" . . . not the "Wonderful" of 2016 and 2017, but nothing bothersome. Then the market plunged straight into screaming, running-in-circles, sky-is-falling mode, capped by this week's headline: "Worst Week Since 2008!" It was indeed an interesting week for watching the market behave, seeming to follow a secret rule that it could do whatever it liked during the course of each day, but was required to <u>end</u> each day down another 400 points.

At Outlook we've remarked, a few times, that the market is capable of doing anything at all . . . for a while. We've also remarked, just as often, that the market is <u>not</u> capable of doing anything at all, in the long run. For a while it can ignore facts about the real world, even profoundly obvious and important ones. It can do that, and it does do that, now and then. But the real-world facts—*<u>the picture of all of those facts, as a whole</u>*—always dominate the market's behavior in the end. It is never the other way around.

It doesn't matter what the media chooses to call the last 3 months: "correction," "bear market," "doomsday around the corner," or anything else. Here's what Outlook calls it: a "chips are down" moment. The media labels and percentage calculations have no value to us, or any good investor. What matters is understanding that this market is trying harder to frighten us than any time in the last 10 years. The chips are down indeed. That means we must decide how deeply we believe some bedrock things about the nature of the U.S. and real-world economy; and about the nature of "the market." If we don't believe these things with complete conviction, we are likely to hurt ourselves with bad decisions. If we do, we'll do very well. Here they are:

- **The U.S. economy (and a good deal of the world economy to a lesser degree) has created a miracle of long-term growth and prosperity** because its markets are mostly very free and highly competitive; because competition and freedom of choice bring out the best, by far, in everyone from top to bottom of economic life; and finally, because the entrenched culture of complete <u>responsibility and accountability for business leaders</u> means the U.S., in particular, is much faster than the rest of the world at growing businesses, making them profitable, capitalizing on new technology, and fixing companies when they have problems.

  When we really believe that this is the heart of the matter—that it explains the economic wonders we see around us and naturally take for granted, most of the time—we can have the only right perspective on these "chips are down" moments: namely, that the engines driving the economy and our companies forward have astonishing strength, hence <u>always</u> overcome setbacks without taking very long to do it. We might ask ourselves how often we hear about these engines from the media, from legions of eminent authorities, from politicians or professors . . . from anyone. Not very often. Almost never, in fact. Let us keep that in mind.

  On the other hand, we might not really be convinced about this "heart of the matter." We might wonder, instead, if more fickle things are the real drivers, like the wisdom of political leadership; the level and trend of interest rates and whatever's in the Fed's mind about them; the behavior of foreign governments; and maybe even the inextricable meandering of blind luck.

If we think those things are what really matter, it will be hard to do the right thing when the chips are down. We will be at risk of failure, mainly because we'll find it impossible to ignore the market's frightful behavior and the tidal wave of silly things we'll hear about that behavior from the media and the investment world in general.

- **The nature of the market is this: a really gigantic crowd of people who are perfectly free to do whatever they please with their money, whenever they choose.**

  Free markets and free speech are very much alike. When it comes to "free speech," we all understand that means everyone gets to say anything they like, no matter how profound, how silly or even how offensive it might be. Everyone can say things that are really wise, or are really dumb . . . and they certainly do say both, and everything in between. Further, most of us recognize and instantly categorize most of what we hear people say, under one of those labels, from "Awesome" to "Asinine." Finally, most of us "get" that from time to time vast crowds of people say and believe the same thing about some topic, no matter how misguided or even disastrous that "same thing" looks later.

  But for some reason it's a little harder for us to grasp that in free markets (especially in free investment markets) exactly the same range of people, from sensible to silly, are constantly making the same range of decisions, from wise to disastrous . . . and periodically collect into vast crowds who all do the same thing, no matter how misguided it looks to those who step away from the crowd. People collect into such tunnel-vision crowds in free markets, all doing what the crowd is doing, because that's their nature, sometimes; just as sometimes they collect into free-speaking crowds which say and believe the same thing for a while, no matter how distant from common sense or reality it seems to be.

  When we understand this nature of the free stock market, we know the market will sometimes act like a big crowd uninterested in making investment decisions based on painstaking analysis of "the whole picture," built upon careful absorption of the constantly-flowing river of real-world facts about that picture. We also know that fear is the most common trigger for such crowd behavior. But finally, and most importantly, we know fear only dominates real-world facts for a while. Eventually the facts are too clear to be ignored, and the frightened crowd breaks up.

That's all there is to the "bedrock." The free-market economy is an under-appreciated miracle of economic power and growth. The free stock market is a crowd of people who act and "think" out of fear, from time to time, so that the result of their actions are stock values which become so extremely detached from underlying realities that it's hard to believe . . . until we've seen it happen enough times, over a few decades.

This is one of those times. It might last another day; another month; another 6 months. The screaming media headlines will not tell us that it's over, until it's long past "over." They will do the opposite: suggesting that we disconnect our brains, forget the two bedrock beliefs, and take our guidance from the market crowd. They'll hint that if we don't, we're just doomed. That's what they always do; and they're always wrong. Warren Buffett's partner, Charlie Munger, said it best: "Good investing takes good judgment and hard work, which lots of people have. But it also takes nerve, which is much more rare." Mr. Munger was talking about the nerve needed at exactly these times, with the chips down and the crucial thing being to disbelieve the market . . . and be patient.

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