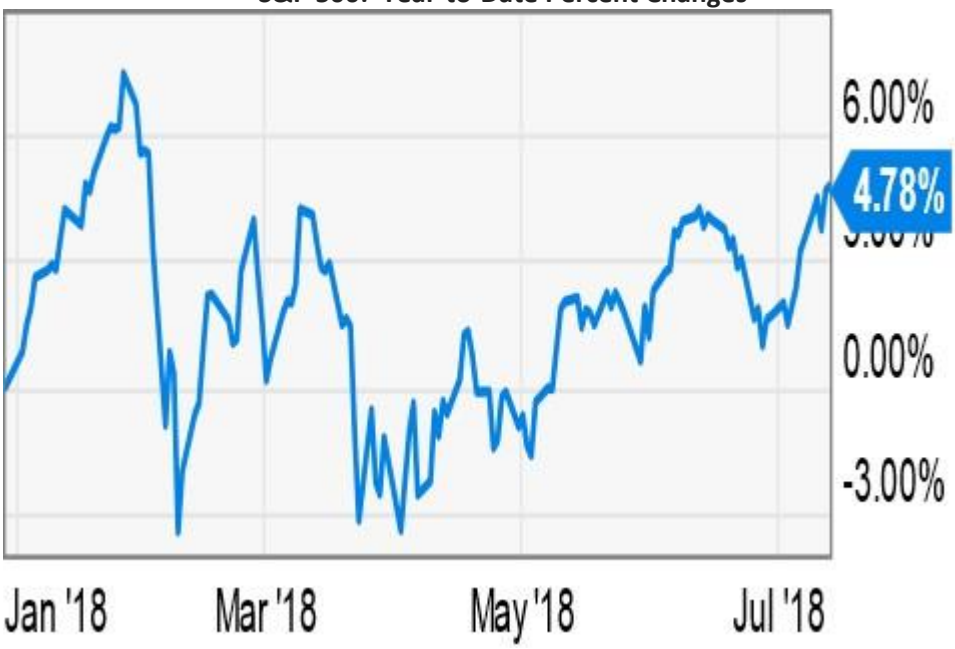
The Outlook: July 14, 2018

Big worries, poorly understood.

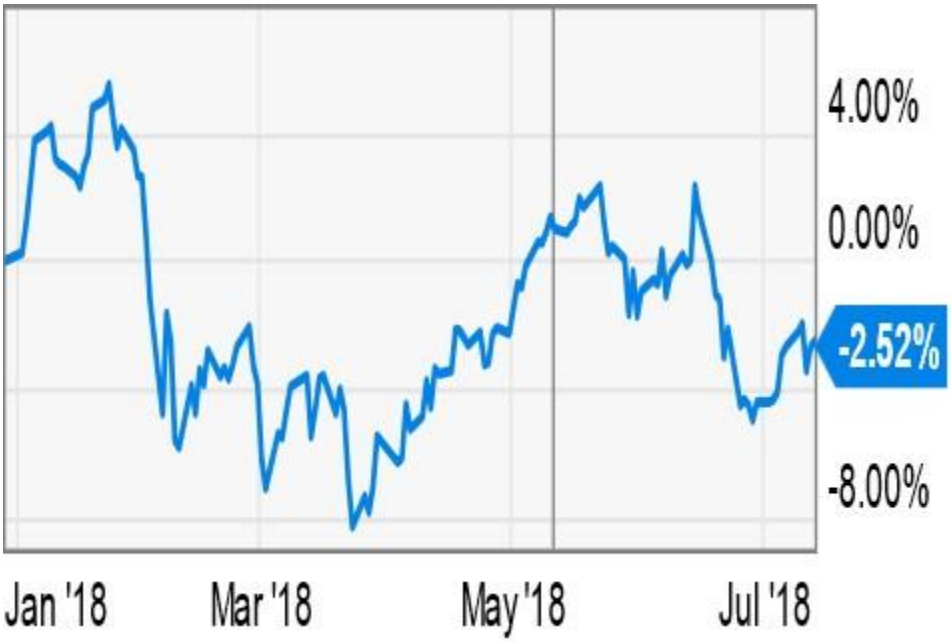
Most of us like history, and we're always inclined to wonder whether the global situation which is giving us a headache, today, might be just like a global situation ten, fifty or a hundred years ago—where we already know how it turned out, so we can either sit back and relax, or pack up and run for the hills, accordingly. There are indeed useful parallels, pretty often . . . but not this time, as far as Outlook can tell. The markets have spent this first half of 2018 in a dither—which we'll define (speaking for the markets) as "Sharply worried about things we don't clearly understand, so we never know just how worried we should be . . . so we keep changing our minds about it."

Here are a few pictures of the dither:

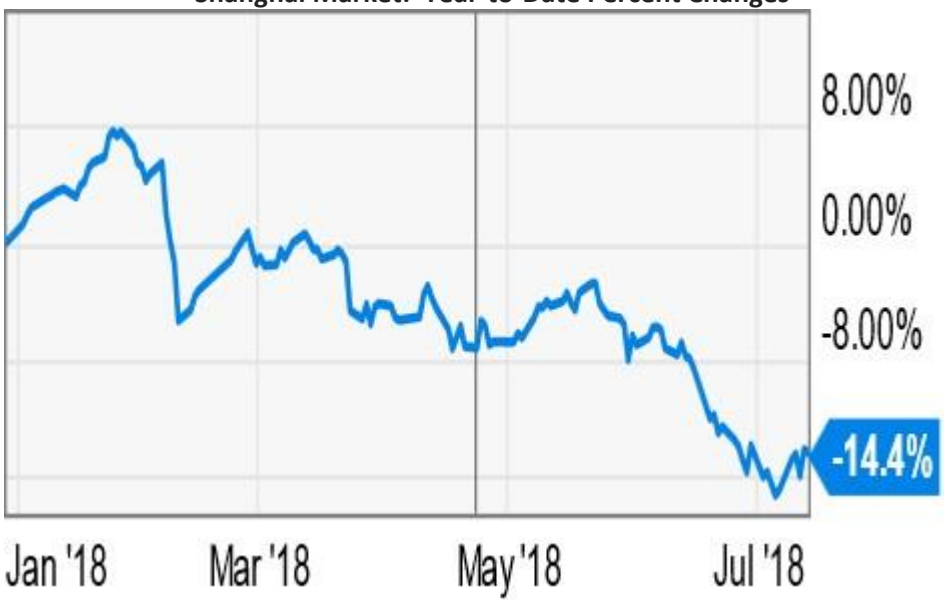
S&P 500: Year-to-Date Percent Changes



DAX (German Market): YTD Percent Changes



Shanghai Market: Year-to-Date Percent Changes



In a nutshell, up there: US market, up 5%; European market, down 3%; Chinese market, down 14%. So those three markets have made three sharply different statements of opinion, so far, about the near future, ranging from "pretty good" to "awful." On the other hand, they have something in common: the dithers. A glance at those charts reminds us that the U.S. and Europe have spent 6 months chewing their fingernails about the seeming emergencies threatening their economies and companies, so that America's 5% gain hasn't brought the slightest degree of good cheer, but instead has felt like Europe's 3% loss, or even something closer to China's 14% plunge.

Why? What are we worrying about? Here are the highlights:

- Global Trade War.
- Euro and/or Eurozone Economic Crisis. (Triggered by Italy's banking crisis, or multiple anti-Eurozone political leaders, or Brexit, or . . . the next serious problem in a fairly long line.)
- Chinese Economic Stagnation. (And/or a run on the yuan, collapse in the Chinese market, debt crisis, or . . . the next serious problem in a fairly long line.)
- Oil. Sharply up? Sharply down?

It's pretty hard to find a historic parallel to today's set of worries. They are all "big." They are all "uncommon." And they are all unusually complicated even for the financial world, which specializes in complicated problems. All of that means that they are poorly understood. We are handed "Exhibit A" in proof of that last claim practically every passing week in the market, including last week. One day the market decides "global trade war" is the beginning of the end of life as we know it. The next day it's "Oh well, the bus hasn't run over us, yet." One day the market decides oil has finally stepped over a cliff, because the Saudi's said something, or the Libyan government announced something (good grief!) or U.S. shale production had a good week. The next day—the very next day, pretty often—the market decides there are so many problems with global oil supply that $100 oil is surely around the corner. And on and on, regarding all four "big worries" contributing to this year's dither.

Facing poorly-understood "big worries," what shall we investors do?

Outlook's answer will surprise nobody. First, look at the financial strength of the companies we own. Next, look at how the market feels about them. If the market's valuation is cheerful in the face of big worries, we should be thinking about packing and running. If the market's valuation is doubtful, concerned, anxious and often downright frightened . . . we'll leave the packing and running to speculators and investors who can't help feeling the speculators always "know something" important. But we will hang on, and buy more shares when we can.

As Outlook has often noted, the general U.S. market is sharply divided when it comes to valuation. A relative handful of giant companies are valued with extreme good cheer—that is, dangerously. The great majority, though, are valued with those "dithers" we mentioned at the beginning. Here are a few price/earnings ratios: Micron, 5; Cummins, 9; Shell, 11; Caterpillar, 12; Freeport, 14; Conoco, 15; Lockheed, 17; Texas Instruments, 18. The big U.S. market is around 19. Amazon is at 91; Netflix, 85. Tesla . . . we get the idea.

Buying and holding strong companies, valued doubtfully, is how good investors make money—sometimes a great deal of money. Enduring the market's dithers is no fun, but it's a good thing rather than a bad thing. We must endure several poorly-understood 'big worries" these days; but we ought to remember, while we're chewing our fingernails, that such headline worries are sharply exaggerated, most of the time; and that the companies we actually own have created financial strength which is not the slightest bit poorly-understood, over the past decade. It's spectacular by any historical measure, not "poorly understood." So we'll hold, and watch the big worries play out.

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