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Chased by the zombie market; thinking straight, anyway.

October was frightful. November began better, but always felt like that scene from a zombie movie: where our heroes, running for their lives, have turned down a dark alley to catch their breath, thinking they've left the mob of living dead behind . . . but the background music tells us horrified viewers just how wrong they are. Down went the market yesterday—600 points—and down another 100 today, in case we hadn't been listening to the background music.

It's pretty important for us to understand what's going on here.

It isn't complicated. A few of the market's favorite stocks—through most of this long, 10-year Bull Market but especially the past 3 years—had risen so far, so fast that their valuations moved far beyond merely "optimistic" to "downright silly." The media have been calling this group the FAANG stocks (Facebook, Amazon, Apple, Netflix, Google) though like many media generalizations, putting those 5 stocks together makes no sense when we actually look at them. No matter, though, to the media or the market . . . until October.

October happened, and is spilling over to November, because silly valuations must finally end. Amazon is a wonderful company . . . but its stock's average price/earnings ratio for the past 3 years has been 220. Today it's down to "only" 91. Netflix' average 3-year price/earnings ratio has been 243. Today it's only 105. The market as a whole is in the 16 to 20 neighborhood. That difference in valuation might be justified if Amazon and Netflix were inventing a cure for a different kind of cancer every week, plus possibly solving world hunger or eliminating war. As operating companies, they're both doing reasonably good things (Amazon much more emphatically than Netflix), but they're not working miracles. When the market values companies so optimistically that only a continuing stream of near-miracles can live up to the optimism, there will be an ending, finally, and it will be something out of our zombie movie, not Mary Poppins.

What always tempts investors into bad decisions is the amazingly long time the market can keep up the silliness. It does that in both directions: silly highs, silly lows. While the market is acting this way—keeping "silly high" Netflix at 243 times earnings, or "silly low" Micron at 3 times earnings—it is very, very hard for many investors to stick with their initial judgments that the market is making a big mistake. Fanned by the flames of media noise, we always feel ourselves beginning to wilt . . . beginning to wonder if the market "knows" something, or understands something, which we don't. As the market's silliness goes on and on, and the media gives us a constant supply of reasons to believe the silliness, we struggle to resist doing what everyone else seems to be doing: yes, buying high, selling low. At Outlook we've been watching the market behave every day for 41 years, so we don't make that classic blunder . . . but we absolutely understand why non-professional investors struggle with it.

To win that struggle, investors must make a choice. They must decide which thing they believe: either that the giant crowd of speculators which is the market generally has pretty good judgment, and thinks straight; or that its judgment is so bad, often enough, that we must never let the market's behavior guide our thinking. There is no middle ground. Outlook Capital Management's judgment on this is absolute: an investor who makes the first choice—respecting the market's judgment—will fail, eventually. The only uncertainty will be when "eventually" actually happens.

“Eventually” arrived for Amazon, Netflix and a few others, starting in October, more or less. But why did everything else get pounded down with them? Why did Apple, trading at 17 times earnings as a stock and performing admirably as a business, fall to the zombie mob and arrive at today’s 13 times earnings? Why did Outlook’s core stock, Micron—trading at 4 times earnings and performing splendidly as a business—stagger away from the zombie mob today at, yes, 3 times earnings? We could repeat those questions for dozens or hundreds of stocks and companies.

The short answer, and the best, is simple: because fear is by far the strongest, most infectious feeling sweeping any crowd. When a crowd catches it, facts in the real world and clear, calm thought have no power . . . for a while. The market’s speculating crowd is in the business, above all, of sniffing the wind for any strong mood infecting the rest of the crowd. When such fearful moods catch hold, as they do now and then, the speculators’ rule of survival is “Sell!” We thoughtful types call it “indiscriminate selling,” meaning it doesn’t matter how silly it is to value Micron at 3 times earnings, for anyone who knows the least thing about the company; or value Apple at 13 times earnings, ditto. When a speculator thinks it looks like “everybody is selling,” the way to make money (or merely survive) is to “sell everything.” The modern stock market, filled to the brim with algorithmic traders, quant funds and many other cool labels, has not changed in the slightest in 100 years, in that respect. People do remain people.

And real-world facts do remain all that matters . . . eventually. The crowd ignores them entirely today, tomorrow, or next month. It cannot do so indefinitely, because those facts of business operational success create cold, hard cash which our companies give back to us as shareholders, in a variety of rewarding ways. Apple, for example, is currently buying back $20 billion of its shares per quarter, which is almost 10% of the entire company per year—which means if the company did nothing but sit still, the profits and dividends going to shareholders grows 10% per year. Micron is doing exactly the same thing: buying back 25% of the company over the next 1 to 3 years. Those are facts, and they are phenomenal facts, by any standard of measurement. Yes . . . when the market “thinks” as it’s been doing lately, we must remember the choice we made. The market is a terrible thinker; and we’ll do very well if we hang onto that conviction.

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