The Outlook: May 17, 2017

"Bloodbath!" . . . of the imagination.

For those who enjoy horror movies, or else just have a sense of humor, today offered endless entertainment. We had our choice of headlines, of which the best was also the shortest: "BLOODBATH!" The Dow fell 372 points—in the 2% neighborhood—and the individual losses—OK, "bloodbaths"—among some of our core companies were like trailers for those horror movies: Cisco, down 8%; Micron, down 7%; Texas Instruments, 4%, and a crowd of others down merely 2% to 3%.

The supposed reason for all this was the latest "Collapse of the White House" story, with the idea being that the giant "Post-Election Rally," counting on growth-and-business-friendly political policies, will now be exposed as a house of cards, built on the imagination of speculators. And the best possible thing about today's "Bloodbath" is this: "A house of cards? Very well, now we shall see."

At Outlook, naturally, we think the rally rested on a strong foundation, not wishful thinking:

- Exceptional financial strength in businesses and consumers;

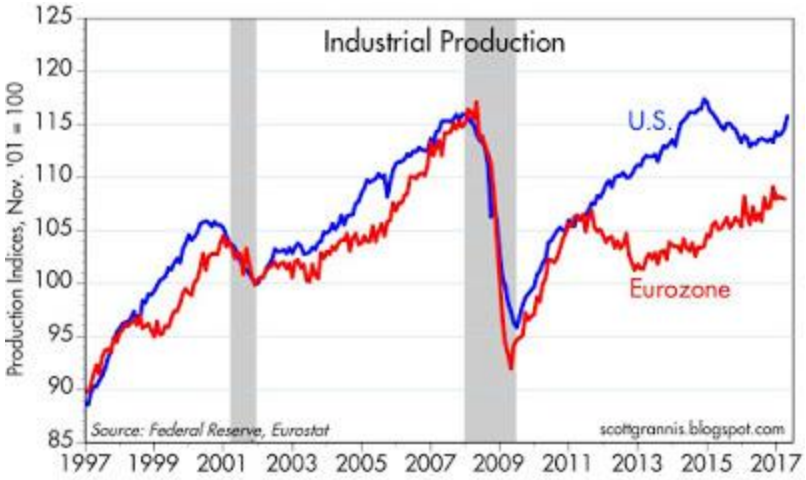
- Emphatic recovery in the energy and commodity sectors of the market, after a horrendous bear market in those sectors since 2014 or earlier, which was hidden within a still-rising broader market;

- Reasonable-to-cheap valuations still common in big sectors like Tech, Industrials, and Energy;

- And a persistent, trudging refusal to roll over and stagnate overseas, in China and much of Asia, and even in Europe.

The nice thing about a Bloodbath is that it says to the market: "All right, tomorrow you must decide which story is the truth about the "Trump Rally:" speculators' imaginations, or strong economic foundation? And you must keep deciding between the two, the next day and the next day." If there is nothing going on the U.S. and world economies but fevered speculation, today's bloodbath will become next week's Armageddon. But if that foundation is something starkly different and completely real, the market will have to face that fact, which it does when enough of the giant market crowd thinks, "These values are silly, time to buy."

Let's end with a couple of charts, courtesy of economist Scott Grannis, which are pictures of that strong foundation:



The top chart shows industrial production in the U.S., clearly resuming its upward march after a distinct slowdown from 2014 – 2016. That slowdown certainly grew out of exactly one thing: the energy and commodity "crash." That crash is history, since early 2016, and resurging capital spending in those 2 sectors is having emphatic ripple effects on U.S. manufacturers in general. And even Europe, for heaven's sake, is marching steadily ahead—which is a striking example of the fact that cycles fix themselves, no matter how burdened an entire continent may be, with slow-growth political policies.

And the bottom chart gives us a tiny bit of perspective on our "Bloodbath," today. There is the market's tremendous rally since early 2016: a rally which endured several spikes of market anxiety (terror, more like) with Brexit, the election, Frexit and now the latest "White House Collapse" story. And there at the top right is the small spike down . . . yes, the "Bloodbath."

Maybe that little spike will be followed by a Marianas Trench. The market is capable of almost anything, temporarily. But, thank goodness, it's not capable of ignoring the real world forever. There is too much strength among our companies, and many others, for either a downward spike or a Marianas Trench to last long. We'll be holding, and buying more.

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