The Outlook: Sept. 3, 2019

Sounding smart, thinking dumb.

The story was on page B1, which would be the 19th page of today's Wall Street Journal. For any reader determined enough to actually turn to page B1, the headline over the story was, well, pretty incomprehensible: "Bonds' Big Swings Amped Up by Market Strategy!" That's almost as eye-glazing a headline for the professionals at Outlook Capital Management as it surely is for the interested amateurs among the Journal's millions of readers. At Outlook we know, of course, that "Market Strategy" is code for "What Speculators Are Thinking and Doing, at This Moment" . . . so the headline simply meant, "Speculators Plunging In and Out of Bonds!" which further simplifies to "Speculators Speculating, Today!", which deserves a headline every bit as much as "Dogs Barking, Today!" But the media does have to write a lot of headlines every day, so we mustn't sneer.

The only reason Outlook's professionals bothered to turn to page 19 was the article's non-headline blurb in small print on page 1: "Recession signals flashed by tumbling long-term bond yields *may have been exaggerated*." Now we were hooked. That sentence referred to the global wave of Page One headlines from only last week: "Yield Curve Turns Negative! Recession On the Way!"

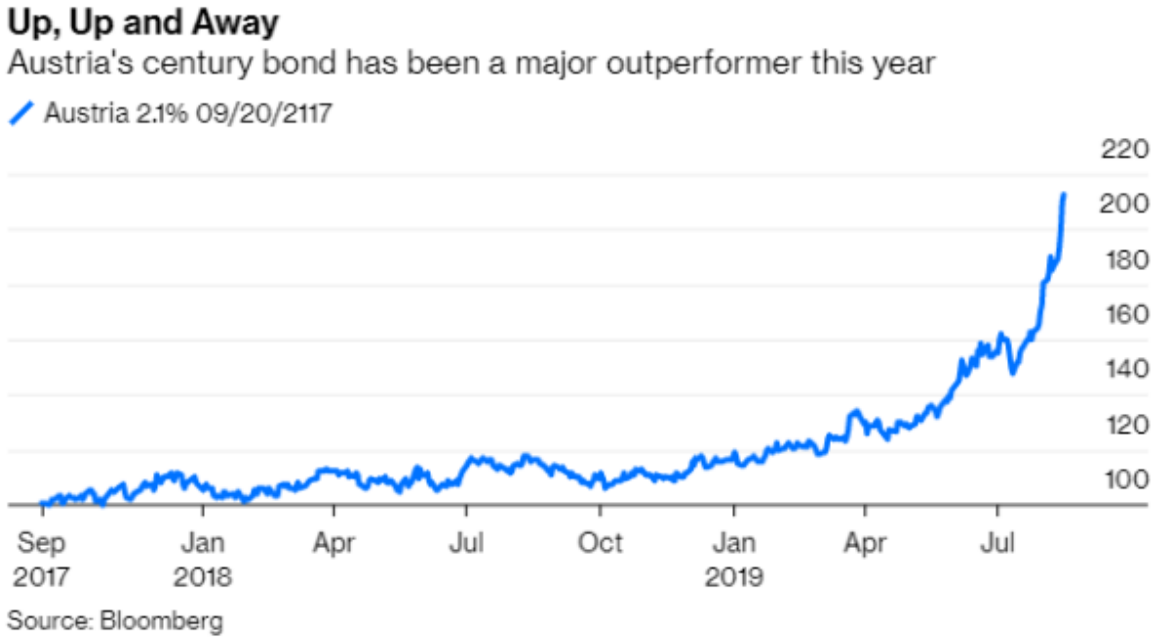
At Outlook we look at a fairly staggering array of news and analysis every day, from all over the world. That headline from last week, triggered by the bond market setting the yield on 2-year Treasury bonds higher than 10-year bonds, did indeed show up everywhere, usually in 20-point print. "Infallible Recession Predictor!" was the general idea beneath all the giant headlines. Of course, the moment any normal reader tried to figure out exactly *why* such an obscure event must doom the economic world to sickness, she was going to end up puzzled by a great volume of smart-sounding words, cloaking the issue in fog rather than light. And that finally brings us to our own headline: "Sounding Smart, Thinking Dumb." Let us cut down on further words and show some pictures of "Sounding Smart, Thinking Dumb."

REAL INVESTMENT ADVICE	Sovereign Yields			
Country	**1-Yr**	**2-Yr**	**5-Yr**	**10-Yr**
Switzerland	-0.65	-1.04	-1.02	-0.87
Japan	-0.19	-0.22	-0.27	-0.18
Germany	-0.74	-0.82	-0.77	-0.54
Austria	-0.66	-0.72	-0.63	-0.30
Netherlands	-0.64	-0.81	-0.73	-0.43
Finland	-0.62	-0.70	-0.66	-0.28
France	-0.64	-0.73	-0.66	-0.26
Belgium	-0.54	-0.72	-0.57	-0.20
Ireland	-0.59	-0.44	-0.45	0.02
Italy	-0.16	-0.02	0.59	1.16
Spain	-0.50	-0.50	-0.27	0.23
United States	1.78	1.62	1.55	1.72

Here is a very startling chart. That sea of red covers the negative interest rates (on government bonds) which exist right now among many of the world's richest, most "advanced" economies. Only the U.S. is all green: that is, our interest rates are still entirely positive.

A Mediterranean Sea of smart-sounding words has been spilled, over in Europe, about how economically-helpful those negative interest rates are, and how clever is the European Central Bank (and the Japanese Central Bank) for using its powers to create them. Europe, of course, seems to be teetering on the edge of a recession triggered by America's Trade War, according to the smart-sounding crowd, and doubtless would long since have fallen right into that recession if not for the ECB's far-sighted actions. Among last month's headlines, concerning Europe's fragile condition, was "ECB Prepares Big Bazooka Policy to Prevent Recession!" The general idea was that if negative 0.5% rates don't rescue Europe from harm, the Bank will forge ahead with negative 5% rates, or whatever it takes.

At Outlook we'd bet quite a bit that every single "interested amateur" reader of such articles is puzzled about exactly how a state of affairs in which savers must pay borrowers to borrow money from them can be a clever cure for anything at all, including an economy teetering on the edge of recession. We suspect our crowd of amateurs mostly feels that something must be slightly sick about that state of affairs, rather than helpful. Here's another picture.

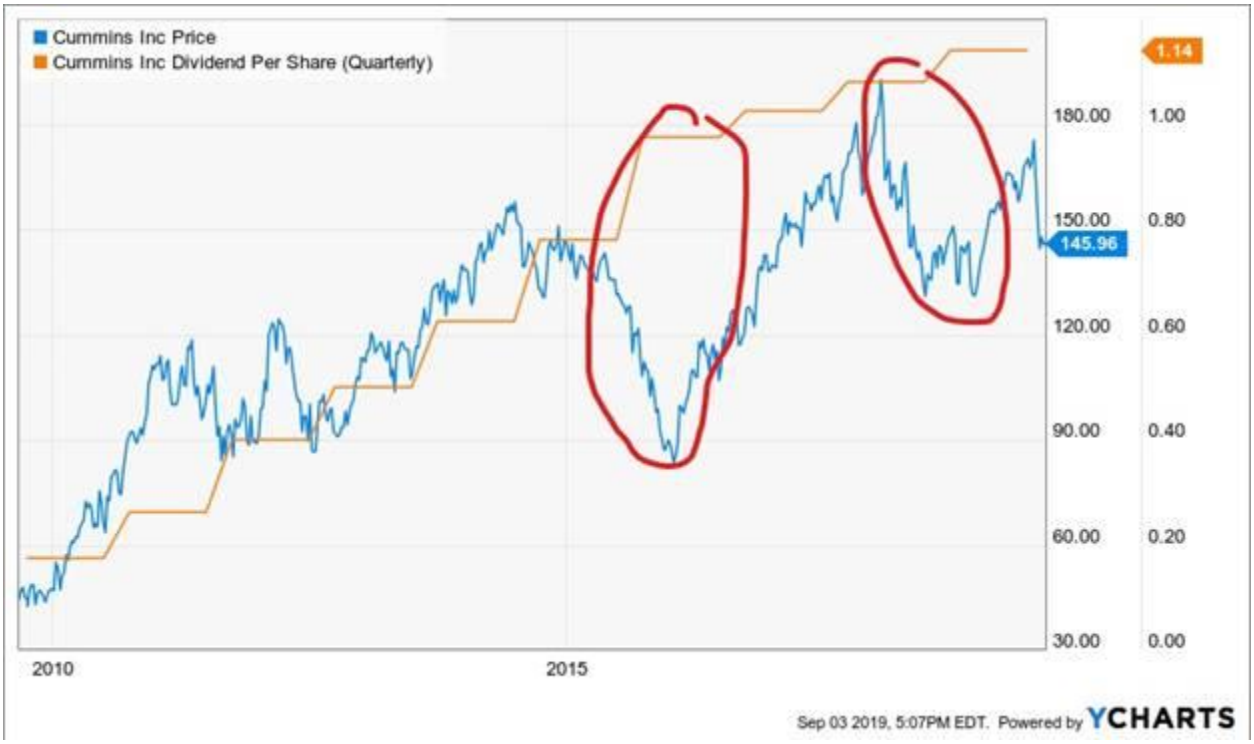


Two years ago the government of Austria issued a 100-year bond at a yield of about 2.1%. It was snapped up—by smart-sounding professional speculators carrying out their "market strategies." The price of that 100-year bond has now more than doubled, as the chart shows. It rose more than 30% since June alone, when Austria offered more century bonds to new buyers. At its current price of 210, its annual yield is 0.6%, and its return rate has been 50% per year since it was first offered back in 2017.

There are, of course, a great many smart-sounding words floating around today to justify how the market is valuing this bond—and all the negative-yield bonds in the first chart. But it's high time to call on the experience and common sense we mentioned earlier. When we see charts which rocket up like this one, it doesn't mean anything is wrong at all, necessarily. If the chart is Apple and the company has just invented the iPhone, that kind of blue rocket can make all the sense in the world. But that's very far from what is behind this chart. There is no invention or wealth creation going on whatsoever, behind the Austrian government's wish to borrow money for 100 years at 6/10ths of one percent per year. There are only speculators with clever words and smart-sounding "market strategies." And our experience and common sense tell us that when <u>that</u> kind of rocket has disappeared into the stratosphere, it's time to grab a helmet—because there will be one certain direction in the future, and it won't be "up."

One last picture.

Cummins, 10 Years of Dividend Hikes and Stock Swings



Those 2 red circles cover sickening past plunges in the share price of Cummins, Inc. (the world's diesel-engine king.) Cummins' orange dividend line has only kept rising, of course. But the same kind of speculators employing their "market strategies," who've been buying items like Austria's century bond, are those who've been selling Cummins lately, because "Trade War" sounds like it must be something pretty bad, <u>and because the rest of the speculating crowd is selling</u>.

To investors mainly interested in thinking smart rather than sounding smart, such "market strategies" seem to boil down to "buying high" and "selling low." And if today there is a Mediterranean Sea of smart-sounding words justifying throwing money at those negative yields . . . there is a Pacific Ocean of history reminding us that "buying high" and "selling low" are exactly what giant crowds of market participants do, time after time. <u>We won't.</u> Our conservative 5-year financial projections for Cummins tell us our company is highly likely to be earning about $22 per share at the top of the next upcycle . . . and trading 100% higher than today's "sell low" valuation. It will be paying us close to $9/share in annual dividends, versus today's $5.25. Cummins is a down-to-earth, nose-to-the-grindstone kind of company . . . whose CEO never tries to sound clever. It is quite a bit safer to invest with such people than to follow the smart-sounding crowd.

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