

The Outlook: Nov. 26, 2018

What really matters: the Death Cross, or Mr. Churchill?

About the middle of last week, as the market was wallowing in its bloodbath, an experienced investment manager wrote something memorable in his blog. “Over the next days, weeks or months,” he wrote, “no matter how long this lasts, every last bit of my experience and wisdom must be aimed at one purpose: *to make sure my clients don’t let the market frighten them out of their positions.*”

This particular manager does some things like Outlook (holding oil companies), and some quite differently, but he hit the nail on the head. Among the hundreds of famous quotes from Warren Buffett is one that goes something like this: “It’s easy to impress people when things are going up. But that’s not where we earn our pay. We earn our money when things are terrible; when the world says they’ll get even worse; and our investors are inclined to doubt everything we do. But if we stick to our guns then, the payoff is tremendous.”

Of course it’s just a long way of saying, “Buy low. Sell high. Never the other way around.” But it’s worth saying many different ways, because like other profound truths about the world, it helps to keep reminding ourselves. Here’s another perspective on that profound truth from Outlook. It’ll sound a little different at first, but not in the end.

We were reading—for the umpteenth time—about Winston Churchill’s years as a political outcast in the 1930’s. It’s really hard for us to imagine, today, how Mr. Churchill was scorned and reviled during those years by his own political party as well as all the others, and by nearly the whole of the media, because he said terribly unpopular things, which (much later) turned out to be terribly true. But whether he was being reviled or praised, there was never anybody in British politics who worked as hard as Churchill to discover the underlying facts which told him what was true, popular or not. Looking back at Mr. Churchill, it’s easy for everyone to see how a great man, working incredibly hard in the face of a life-or-death crisis, performed miracles with his leadership in World War II. Less well known are the many profound benefits Mr. Churchill brought to Britain’s poor and middle classes over the earlier decades of his career: most of which came from taking unpopular positions and eventually marshalling enough facts and logic to persuade his fellow politicians to adopt programs which seemed new and radical in the early 1900’s. (Unemployment benefits, low-income medical insurance, criminal justice reform, and many others.)

The point is really simple, and it’s also an opinion of Mr. Churchill’s which stands out, clear as day, in his memoirs as he discusses both world events and the individuals who shaped them.

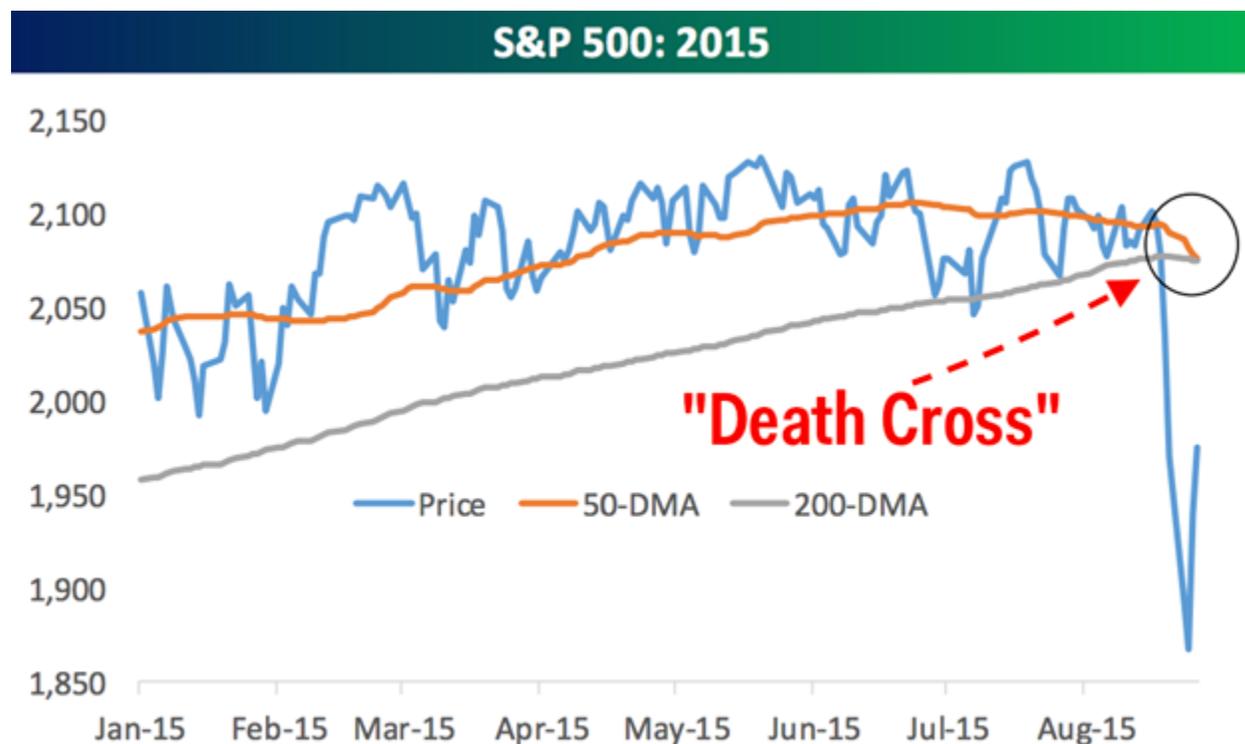
- In human affairs, everything good that’s created is always the result of a few exceptional people working hard and long to make it happen.
- That coin has another side: everything bad is always the result of either downright bad people aiming to do harm; or the result of well-intentioned but weak people who lack the strength demanded by the problems (or bad people) they face.

At Outlook we believe with some passion that exactly the same principles govern the investment world. We think one of the most valuable things an investor can do is to find Big Trouble somewhere, then see if there might be a few really good people running a financially-strong company or two, who are

facing their Big Trouble with a work ethic and determination which might just be somewhere close to Mr. Churchill's neighborhood. It is a philosophy which says not only that people matter; but that in the end, they're all that matter, for good or bad. It is a philosophy which has seen, again and again, the astonishing long-term investment rewards created by such people fixing their companies' troubles, always in the face of near-universal skepticism, in the early stages, from most inhabitants of the investment world.

Finally, it's a philosophy which might as well be written in Martian, as far as the vast majority of market participants are concerned. At Outlook we always call that vast majority "speculators" because that term certainly captures the essence of what they do . . . but unfortunately a great many people who think of themselves as long-term investors are also powerfully influenced by the way the speculators think about the investment world—when the market is falling. Here's the heart of how those speculators think: "If it's going up, we're good; if it's going down, something must need changing."

And that, at last, brings us to a chart, and one of the best labels for a market nightmare ever invented: "The Death Cross."



This chart was made in 2015, which was apparently the last time the dreaded "Death Cross" showed up, wearing black robes and carrying a sickle, naturally. But there've been a fair number of warnings, as we've soaked in the bloodbath lately, that another Death Cross is sure to show up any day. The Death Cross happens when the market's 50-day moving average "crosses" its 200-day moving average, heading downward. (If we blinked at that sentence, we're normal.) In essence, it happens when a market which has been generally rising, for a good while, makes a somewhat sustained turn downwards.

There are countless millions of players in the market. They don't all believe a Death Cross means "grab your canned goods and run for the hills." But a good many do . . . and what really matters is that much of the speculating crowd thinks the rest of that crowd will be awed or frightened enough by a Death Cross

so that the crowd will run in the same direction for a while, and must be joined in that direction by any speculator worth his futures trading badge. Yes . . . “If it’s going up, we’re good. If it’s going down, we’ve got to change something!” Not much room for Mr. Churchill’s philosophy there, is there? Not much attention paid to extraordinary people doing very hard things, tackling Big Trouble one day at a time and gradually winning, is there?

In the investment world, for each rare bit of attention paid to some exceptional business leader who won when everyone said she’d lose, there are a thousand stories about “Death Crosses” and their cousins. Their cousins are the countless ways people try to be sophisticated or clever in their investment actions . . . and which so very often turn out to be actions where the driving engine was just fear or greed, as always, dressed up in formulas, complicated analyses, or investment jargon.

Thankfully, the investment world is also filled with people who like to analyze (and over-analyze) things, and the Death Cross has been placed under the microscope. In the past 65 years, there have been 33 Death Crosses. After four of those Crosses appeared, the market lost 20% or more, over the next 2 years. After fourteen Crosses, the market gained 20% or more, over 2 years. Now, we might think our world’s analyzing types would say, “Wow. So much for Death Crosses!” upon unearthing only those two statistics. Nope. There are pages and pages of additional statistics, which mean nothing significant, but which somehow lead a remarkable number of current experts to conclude, “Well there are some flaws, but still, we’d best not ignore Death Crosses when they arrive.”

We plan to ignore them, at Outlook. In fact, even if the market found itself cursed with a Double Secret Death Cross (Probation, that is) we’d be inclined to follow Mr. Belushi’s legendary example: shrug, and plan a Road Trip. We think Mr. Churchill’s example is the real North Star, though: find good people fixing big problems; invest in their companies; never let the crowd’s recurring fears shove aside clear thinking and patience. That’s how we win, in this business, rather than lose.

Oh yes . . . that 2015 Death Cross was another emphatic false alarm. The market dipped around 10% for a few months, then took off.

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