

The Outlook: Jan. 23, 2020

Micron. The speculators. "Amazed and dumbfounded."

Here's a phenomenon of the investment world we've seen countless times over the years . . . but it still leaves us somewhere between amazed and dumbfounded.

MU : Morgan Stanley turns bullish on two memory giants - 10:53 AM

- Morgan Stanley analyst Joseph Moore raises Western Digital (NASDAQ:WDC) and Micron (NASDAQ:MU) from Equal-Weight to **Overweight**.
- The analyst cites signs of an earlier than expected memory bottom.
- Moore: "The higher trough and the elevated valuation environment for semiconductors suggests memory rerating potential, even given the moves we have already seen."
- For DRAM, Moore sees signs of a gradual bottoming for demand. NAND will likely have "more of a classic cycle bottom that looks more V-shaped than we thought a month ago."
- Morgan Stanley raises its Micron target from \$56 to \$73 and Western Digital from \$64 to \$88.

Morgan Stanley's Mr. Moore is a Wall Street veteran: an analyst respected for the depth of his knowledge on the semiconductor companies, especially Micron, which was his subject this morning (above.) At Outlook we've heard him during many Earnings Calls, taking his turn to question Micron's management—and he really is an expert. He knows the company up and down, and we'd guess he could give an informed opinion about anything the company prints in a 50-page quarterly filing.

But we're amazed, nevertheless. Here's a Micron chart.

Micron: Operating Cash Cyclical Bottoms (red) and Tops (green)



The orange line is operating cash flow at Micron. That number doesn't tell the whole story about Micron or any other company . . . but it's a pretty good rough guide for today's purpose. Let's sum up Micron's cyclical story since 2012:

Operating Cash Cyclical Bottoms

\$1.5 billion	2013
3.0 billion	2016
\$10.4 billion	2019

Operating Cash Cyclical Tops

\$6.0 billion	2015
19.0 billion	2018

One more thing. The yellow arrow pointing at \$59.85 (Micron's stock price today) is where Mr. Moore told Morgan Stanley's clients that they ought to start buying Micron. (That's what "Overweight" means, though Morgan Stanley might hem and haw about it.)

Mr. Moore's explanation, above, comes in his second bullet point—the rest is just extra words. "We see signs of an earlier-than-expected bottom in the memory cycle." Here's the amazing part. As we can see in the Micron chart, its stock bottomed at \$31/share at the very end of 2018: a year ago. There were certainly no signs whatsoever of the bottom in the current memory cycle, a year ago, hence Mr. Moore's "Equal Weight" or possibly "Under Weight" (we don't remember.)

But Mr. Moore understands this company, the memory industry, and the memory price cycle. He knew there would be a bottom; he knew how Micron's operating improvements were sure to generate an explosive upside for operating cash and the stock price, as they've been doing for 12 years of cycles, and more; and surely he knew how hideously difficult it is to predict just when that "bottom in the memory cycle" will show up.

But he waited, sticking with his "Equal" or "Under" Weight ratings—which mean "Buy something else"—and he missed the first 100% of Micron's up cycle. Perhaps "amazed" and "dumbfounded" aren't too strong, after all.

For heaven's sake, why? What's behind this kind of thinking from a genuinely knowledgeable, experienced expert?

Outlook's guess is that Morgan Stanley—and Mr. Moore—understand who the company's clients are. At Outlook we've always called them "speculators" because that old-fashioned word describes them, in our opinion, even though they describe themselves with a good many higher-sounding titles. As Outlook has remarked once or twice, over the years, an ocean of speculators dominate daily trading, in the stock market—and their business is making money fast. (Trying to make money fast, that is.) They do this mostly by betting on the effect that impressions from the daily headlines will have on their fellow speculators. Up until recently, the impressions created by the headlines in the memory business have been: "Still stuck in the down cycle, no sign of the bottom yet!" With Mr. Moore's announcement, this morning, he is just catching up to the first few analysts, who began to guess the bottom might be near, a few weeks ago.

Let us leave behind any further comments about this way of "investing." At Outlook we hadn't the faintest idea, a year ago, just when "the bottom in the memory cycle" would show up. We're still not sure, regardless of the speculators' obvious willingness to bet on it coming around the bend. But we knew it would come; and we perfectly understood the admirable work Micron's people were doing at strengthening their company in every important way: financially, technologically and with factory efficiency. So we held, and bought more shares in waves as the stock price fell, bottomed, and began rising again. We're rather certain that Micron is going a long way beyond \$59.85 per share, eventually . . . and we want every dollar of its long-term gains.

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