<u>The Outlook: Dec. 31, 2019</u>

Forecasting 2020: Shall we use obvious facts, or fearful "external trends"?

Yesterday we summed up much of the investment world's "Explanation of 2019" as "We Got Lucky!" Wrong, we said. We earned it—that is, our hardworking companies earned it for us with real operating achievements and cash rewards to shareholders. Today let's glance at the investment world's "Forecast for 2020," which leans heavily toward "Look Out Below!" Here are the kind of 2020 warnings we are typically hearing.

"A Decade of U.S. Market Outperformance Probably Won't Repeat"

"A Decade of Debt: Skyrocketing Corporate Debt Can't Continue"

Under each of these headlines—and many more like them—we find journalists and eminent people in the investment world ticking off a laundry list of dangers for 2020 and beyond: the cycle must turn down; the Federal Reserve can't keep jump-starting the economy with rate cuts forever; the benefits of the 2018 tax cuts are all used up; after 2019's "unprecedented run up" stock valuations are dangerously high; an explosion in debt fueled 2019's good luck, but it will end badly as always . . . and many more.

As we observed yesterday, any investor who doesn't spend her days and years analyzing what people say in the investment world, to see if it makes sense or not, will find it impossible to judge this laundry list of 2020 doom. It sounds good on the surface—like many things which turn out to be wrong—but how does one know? That's the Big Question. And here's the Big Answer from Outlook.

Warren Buffett once said, "The market will always try to frighten you out of good positions." <u>It does that by dragging our eyes away from very obvious facts, right in front of us; and trying to persuade us that falling stock prices (or just the chance of falling stock prices) matter more than those obvious facts.</u>

What are the obvious facts about 2020?

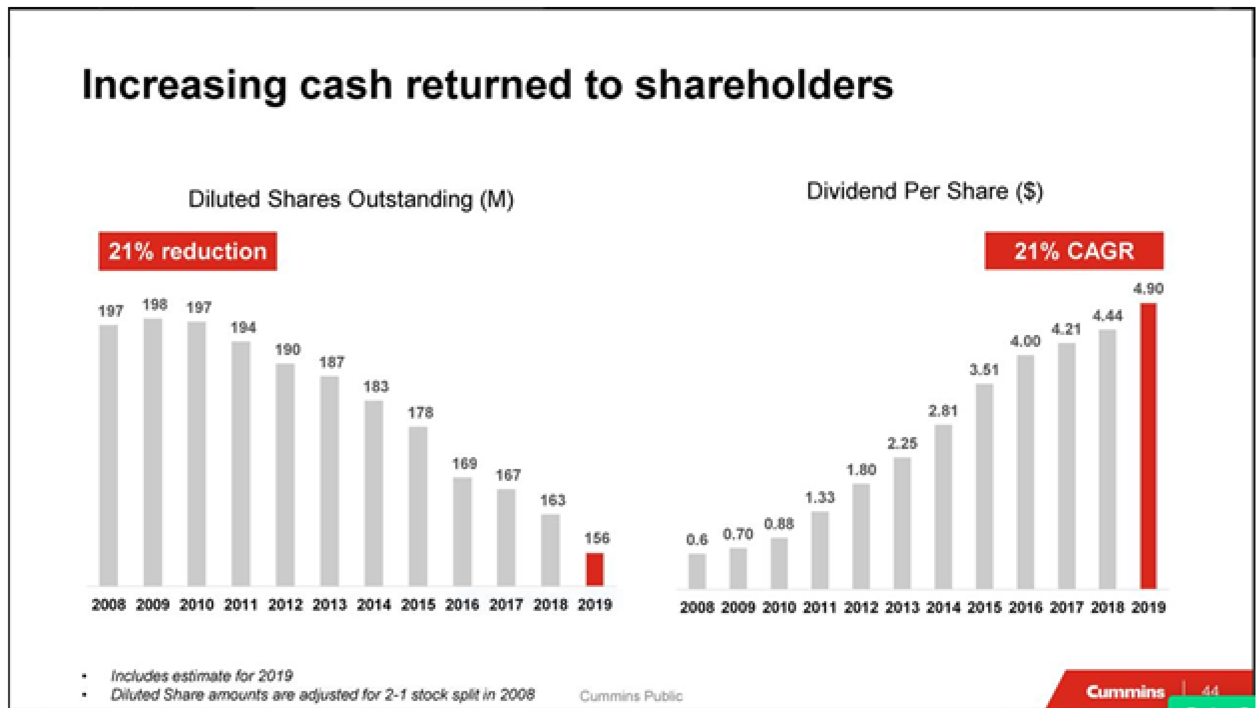
- **<u>Nothing suggests a weak U.S. economy. Everything points to the opposite:</u>** jobs, earnings, dividend growth, household financial strength, business financial strength regardless of that "skyrocketing corporate debt" story, which we'll glance at below; and the truly vast majority of other economic indicators. All of that can change; all can turn worse in a matter of months. The obvious fact that they're so positive today is never a guarantee they'll stay positive all year, or the year after that, etc. But knowing they <u>can</u> change for the worse is not thinking them through and judging they <u>will</u> change for the worse. All we're able to say, after that kind of thought, is that there is no sign of such a downturn on the horizon, even if our "horizon" only stretches out 6 to 12 months or so—which is all we've been able to say for the last 10 years of steady growth.

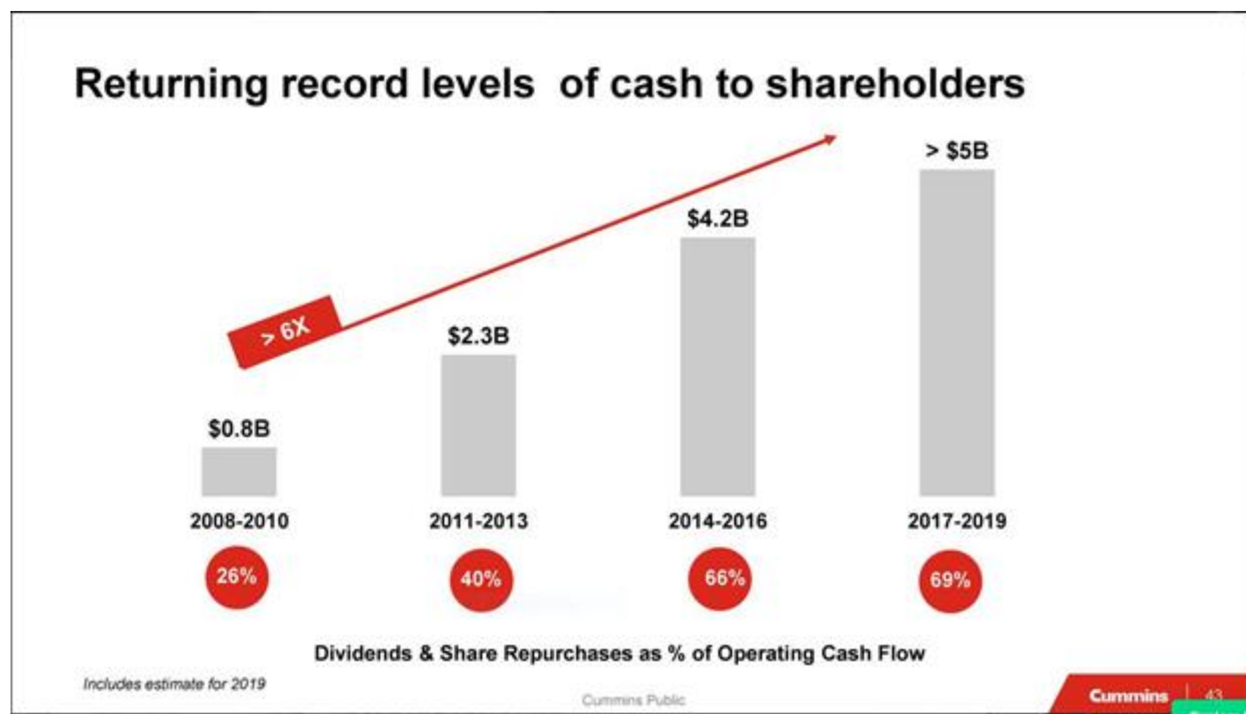
- **<u>Dividends and stock buybacks—that is, the cash rewards our companies give us every quarter—rose solidly in 2019, and are a near-certainty to rise solidly again in 2020.</u>** We investors watched the dividend cash come into our accounts in 2019—which is the kind of "obvious fact" we like. Though there are always a very few companies which raise those cash payouts when they really can't afford to, because their business operations or future threats don't justify it, the vast majority of companies do no such thing. When they raise dividends and buybacks, it's a genuine signal that they're strong and growing.

- **<u>Despite 2019's "big year" of gains, most U.S. companies' valuations are not anything close to "bubble" levels</u>**: that is the ridiculously optimistic levels which we ought to shy away from. The big market's price/earnings ratio (today's stock prices over 2020's expected earnings) is in the 19 – 21 range, which is well above the fearful valuations (hence wonderful investment bargains) of a decade ago, as well as many times during this past decade. That's obvious enough. But there is more in the "obvious" category. "You can drown in a pool whose average depth is only one foot," goes the old saying, because the pool has a 10-foot section and a 3-inch section and plenty in between, and their "average" happens to be one foot. The market, today, has stocks with ridiculously optimistic valuations (Tesla, Twitter, and that crowd); stocks with somewhat high valuations which seem to be justified (yesterday's focus, Microsoft, at 26); and stocks with fairly rock-bottom valuations which are the product, as usual, of the market's fear and loathing of most companies which are handling slowdowns or other problems successfully, but haven't yet arrived at "takeoff" stage.

  Since Outlook is a value investor, many of our companies fit that description: Cummins, Caterpillar, Micron, and many more, with price/earnings ratios in the 10 to 16 range. One can say all kinds of things about such companies—but one can't say they don't have strong futures; one can't say they aren't rock-solid financially; and one can't say the market is dangerously optimistic about them. The market is the opposite.

  Here's a look at a <u>very typical example</u>: Cummins.

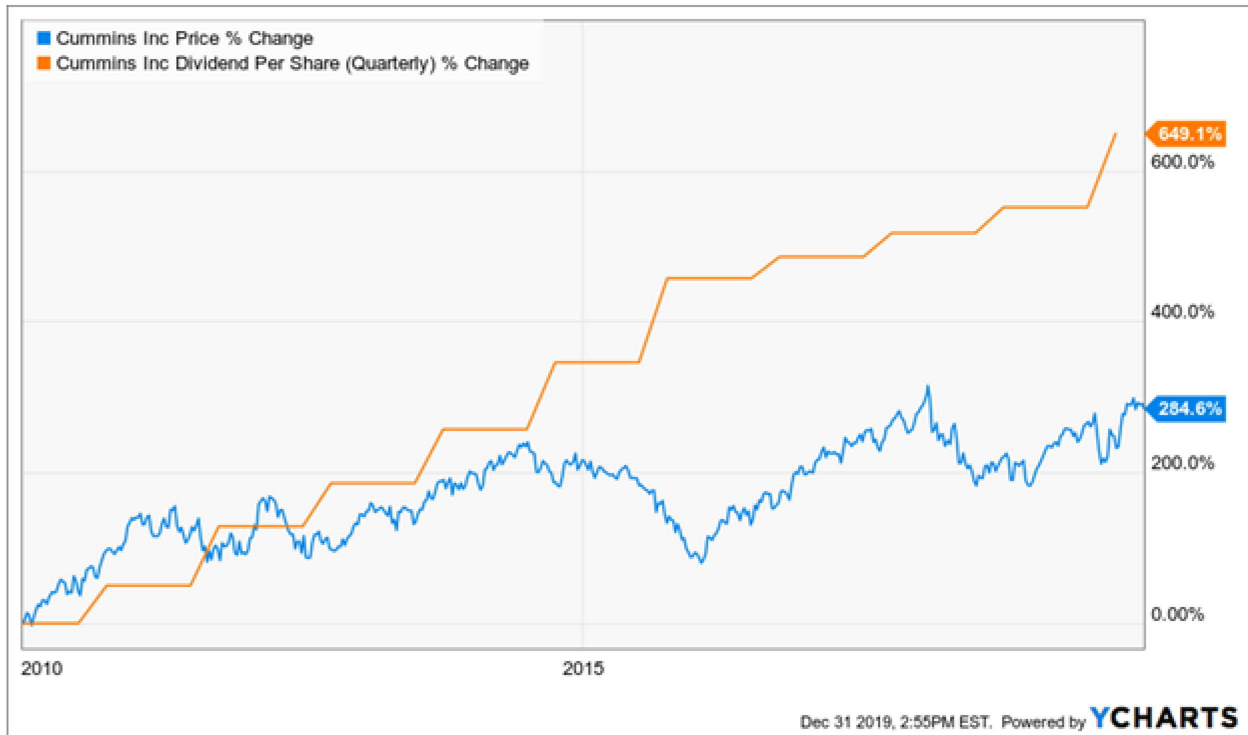




In a nutshell, these 2 pictures are those "obvious" facts, in front of our eyes. First, the remarkable shareholder rewards from rising dividends and stock buybacks; second, and even more impressive, the amazing growth in Cummins' cash generation in both up and down cycles (the first and third bars in the chart.) There is nothing more vital for investors to understand than this: that kind of business performance (just like Microsoft's since 2015 as we saw yesterday) only comes from hard work and good management by Cummins' people.

How very seldom we hear the investment world noting that obvious fact; and how very often we hear the investment world fixating on those "Big Trends" and "External Forces" we noted yesterday: the Fed and interest rates, government spending, and so on.

It's always easier to keep our eyes on those "obvious facts" when the market is rising, or at least not falling. When the market is falling, or when we're tempted to believe the voices persuading us it's time to "Look Out Below!" because it's sure to fall, we find it a lot harder to follow Mr. Buffett's rule: "Never let the market frighten you out of good positions." But the obvious facts are always the only things that matter in the end. There are Cummins' obvious dividends for 10 years, below: up 650%. There is its stock price: up 285%. That happened because of what the company did, not because of any "Big Trends" and "External Forces" trumpeted by crowds hanging out in the investment world.



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