The Outlook: March 28, 2018

"Tech Leaders Stagger and Fall!" Watch out below? Or so what?

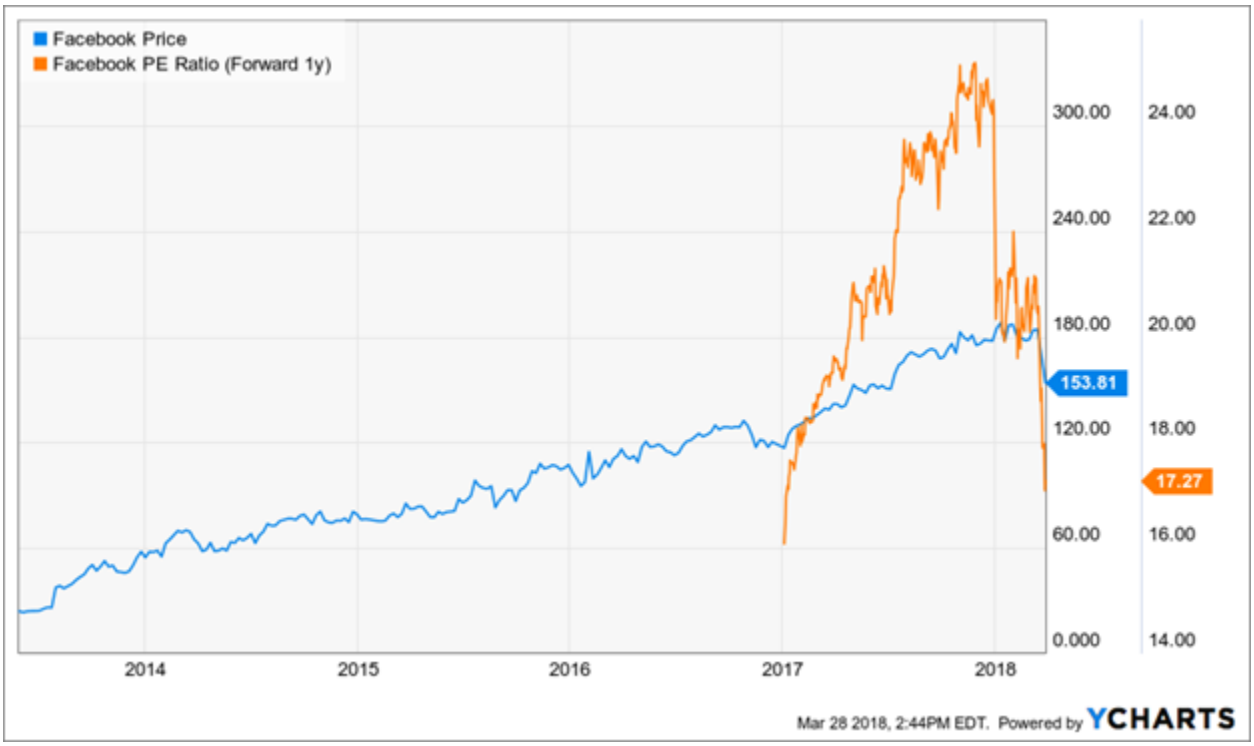
Sometimes the strongest way to give ourselves good advice is to turn it upside down: rather than, "Do this, and we will probably succeed," it should be "If we do that, *we will absolutely fail*." Yesterday's miserable market, and the headline stories explaining it, reminded Outlook of that rule. Let's put the upside-down advice this way: "If we ever feel inclined to generally believe headlines—or splashy news stories in general—we will certainly fail with our investments, eventually."

Why? Because one hundred percent of the time, headlines and splashy stories show us only a corner of the picture, rather than the whole picture . . . and only the whole picture tells the truth about anything whatsoever. Partial pictures are always distortions. As the saying goes, "Partial truths are whole lies." That's harsher than plenty of splashy stories deserve, but it does get the point across.

"Market's Tech Leaders Stagger and Fall: Watch Out Below!" captures the essence of the story. Let's look a little farther into it.

That's Facebook's 2-month picture, and though it's more chilling than its fellow members of the "Tech Leaders" club, Facebook's story is, at bottom, the story for all of them. Here is the foundation for that common story:

Hmm. 5 years and 728% gains right up until February 1st, bringing us to the top chart, when the bottom fell out. Here's more of the picture:



The orange line is Facebook's price/earnings ratio. It only begins in 2017 because the company lost money until then. Facebook had already gained 400% by early 2017, and the market's esteem rose like a

rocket, even faster than the stock itself, which had another 330% to gain—until 60 days ago. Then the market's esteem flipped in about one day into contempt, and the orange valuation line fell like a stone.

"Market's Tech Leaders Stagger and Fall!" Hmm. If Facebook is in truth what a "Leader" looks like and acts like, then indeed we'd better "Watch Out Below!" and head for the hills. Is it?

One of the hundreds of market groupings admired by some keen-eyed analysts is called the "NYSE FANG+ Index." This morning's Journal discussed it. It tracks 10 "global tech heavyweights:" the "Leaders" rising like rockets for a good while, but doing the staggering and falling lately. Let's look at a little more of the whole picture. Here are the 10 companies, their forward price/earnings ratios . . . and their dividend yields, for another way of measuring valuation.

Company	Price/Earnings Ratio	Dividend Yield
Apple	13x	1.5%
Alibaba	35x	0
Amazon	90x	0
Baidu	22x	0
Facebook	20x	0
Google	21x	0
Netflix	70x	0
Nvidia	30x	0.3%
Tesla	120x	0
Twitter	45x	0

Hmm, again. One company hardly belongs in this particular club: Apple. At 13 times earnings, the market does not esteem Apple, it doubts it. Relative to the other 9 members of that club, the market downright despises Apple. If we dared to mention the name "Micron" in this discussion, with its price/earnings ratio of about five, the word "despise" just wouldn't cut it: the market passionately hates Micron, by this comparison. And—just to continue into extremes of emotional involvement—this list informs us that the market doesn't merely "esteem" Alibaba, Amazon, Netflix, Nvidia, Tesla and Twitter—it's head-over-heels in love with them. (Until a few days ago, anyway, when they began to get a touch of the Facebook cold shoulder.)

What jumps out at us, as we keep enlarging this picture?

The market certainly has lost its heart to these 9 stocks—until recently. There are 2 good questions. "Why?" and "So what?" For the answer to "Why?", Outlook recommends another glance at Chart 2, above: 728%. Here's how the market's heart and mind often work: "Fall in love first, as a stock rockets up; ask hard questions later . . . after a hard enough stumble." Every one of these companies except for Apple has been "priced for perfection," to degrees ranging from "emphatically optimistic" to "insane," for some time now. A stunningly obvious truth to most normal human beings, but not so many market speculators and prestigious investors, is that nothing is perfect. In business and market history, every company whose power and potential looked galactic in scale, for a time, eventually turned out to be mortal—to have weaknesses which were almost always pretty darned obvious, if investors with stars in their eyes had wrenched their gazes away, and looked down at the ground where the facts are.

So what? Does "Market's Leaders Stagger and Fall!" really mean "Watch Out Below?"

Well, it would if the other hundreds and thousands of companies in the market were like Facebook and club. But they are not. A great many of them are like Apple, dealing with big threats with partial success, no guarantees about the future but fixing the problems year after year—and doubted all the while by the market. Some of them aren't far from Micron, fixing big problems and transforming itself toward strength never approached in its 40-year history—and doubted to the point of contempt by the market, all the while.

It's a lot more fun to be head-over-heels in love with a stock on a rocket ride, when it is just as loved by the rest of the market crowd, as demonstrated by sky-high valuation measures. But it's not the least bit safe. In fact it is the most dangerous way to invest in the world, because when "priced for perfection" finally runs into "no such thing as perfection," then "Watch Out Below!" actually is good advice. Investing, instead, in companies which are actually doing admirably with their problems, but which the market doubts, is far safer. It doesn't feel comfortable—but it is safer. All of Outlook's companies fit that bill. We're holding and buying more.

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