

The Outlook: Jan. 28, 2022

Buying, at cliff-bottom at Acapulco.

It's been an interesting week for the market. (Most of them are.) We've been treated to screaming cliff-dives almost daily; but when, toward the end of each day, we edged up to the cliff and peered down—ready to wince at sight of the market's shattered remains strewn all over the rocks below—we blinked and stumbled back, because there was the market climbing hand over fist back up toward the top. To get a grip on all this let's look at today's star cliff-diver, Caterpillar.



The circle marks today's plunge. It was impressive: 11 points and 5%, which gets a "9" or "10" from the judges any day of the week. But what's going on in the big green square?

"Caterpillar has beaten Wall Street's earnings estimates 7 quarters in a row," said one analyst. "But the stock has dropped after 5 of the last 6 of those quarters." Our big square covers those quarters, whose story was: "Outstanding company shows impressive business performance, quarter after quarter. But company's stock acts as if the wheels have fallen off, quarter after quarter . . . briefly."

Today was exactly the same story. CAT's 4th quarter and full-2021 results were excellent in every way, with the end result being a record \$6 billion of free cash flow for the year, of which a record \$5 billion was handed back to investors. But the "bad" news was CAT's statement that its materials costs had risen faster than its product prices—due to the supply chain headaches sweeping the business world, and the inflation sweeping the world at the same time. "We think we'll see another 3 to 6 months of this

problem,” said CEO Jim Umpleby, “but by year-end we’re pretty sure our prices will more than catch up to our costs.”

And that was “more than enough” to trigger another cliff-dive. The Big Question is: “Should we care?”

Outlook’s clients and friends know what’s coming, of course: “Nope.” It is the nature of the market to sell upon a bad impression, not to think about it. And it’s the nature of the market to look silly as a result . . . eventually. That’s what CAT’s behavior in that green box shows, as the stock shrugged off cliff-dive after cliff-dive since early 2020. This is a remarkably strong company run by remarkably capable people; but the market never stops doubting it. Today’s price-earnings ratio of 13 tells that story. That valuation is the height of an Acapulco cliff lower than the valuation handed to Celebrity Tech companies, who’ve been “priced for perfection” for many years. But “priced for perfection” always ends badly . . . as we’re seeing these days. “Priced for destruction” and “riddled with doubts” are ever so much safer. They say “Buy” when the market is throwing them out with the trash. That’s what we’re doing, as always.

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Outlook Capital Management, LLC
125 S. Wilke Road, Suite 200E
Arlington Heights, IL 60005
847-797-0600

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