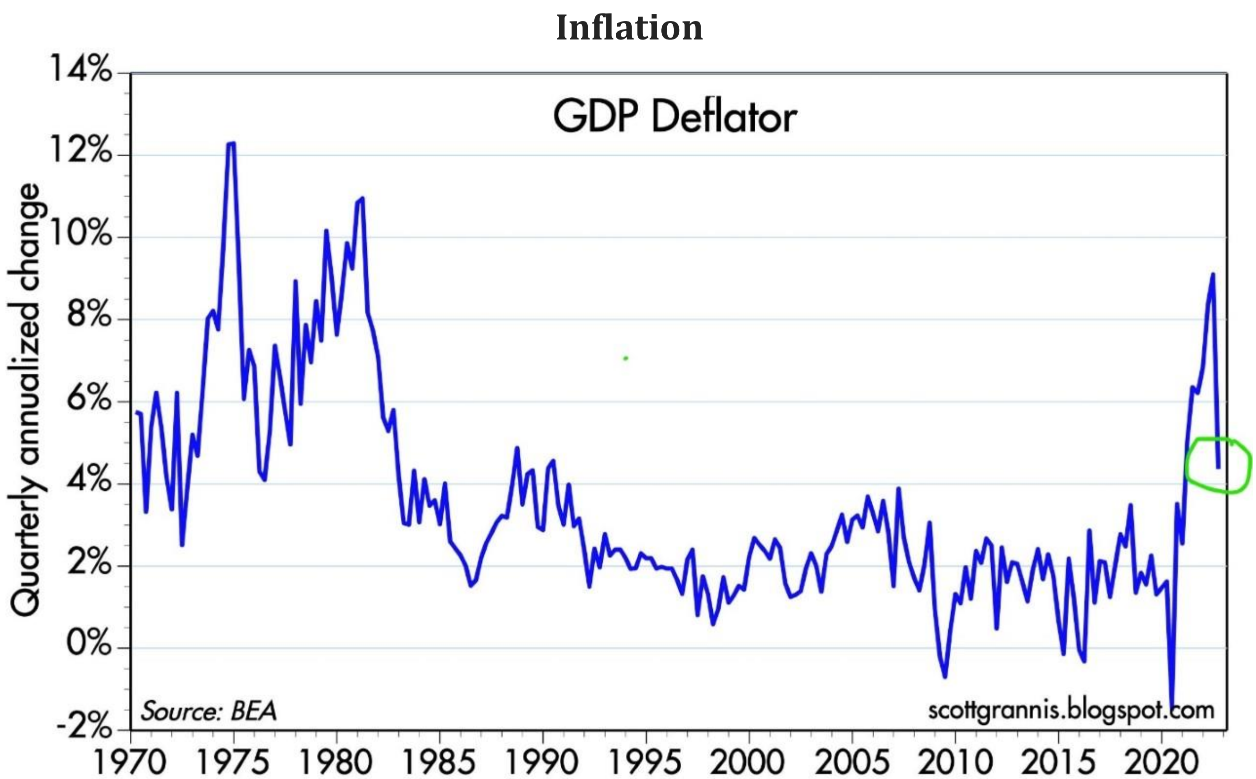
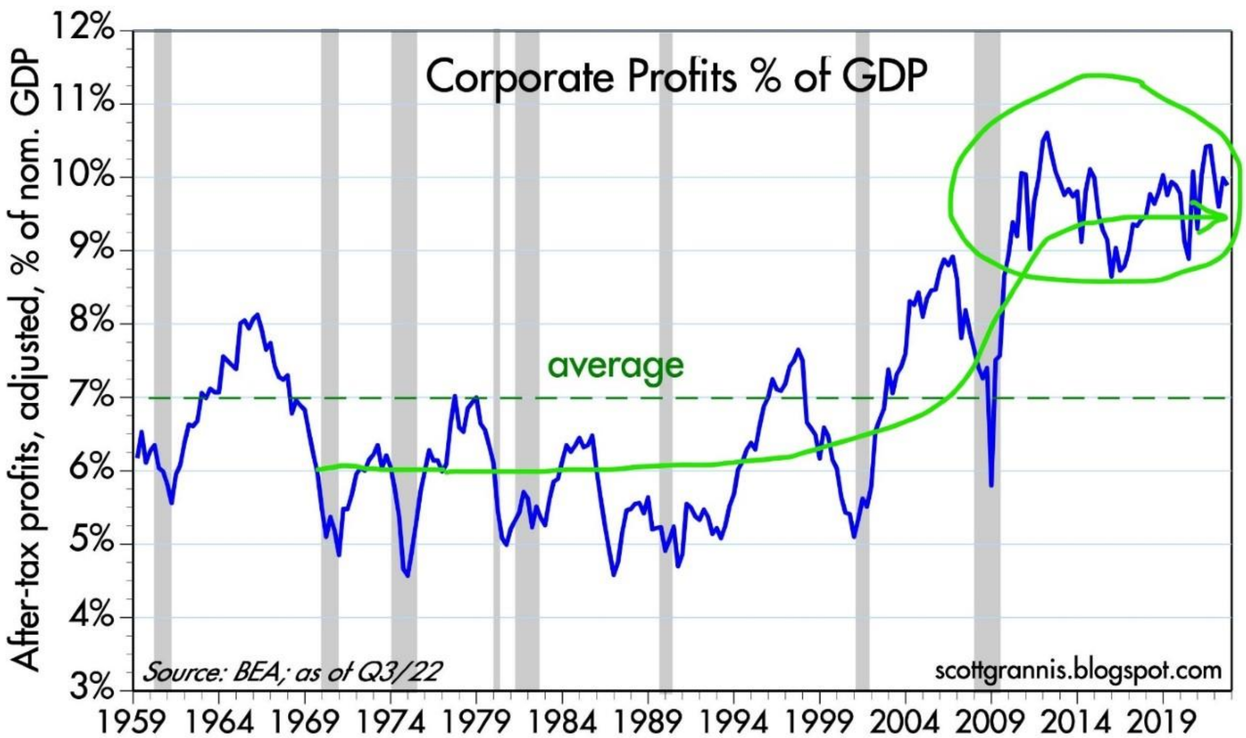
The Outlook: Dec. 27, 2022

The "solid grounds" kind of hope.

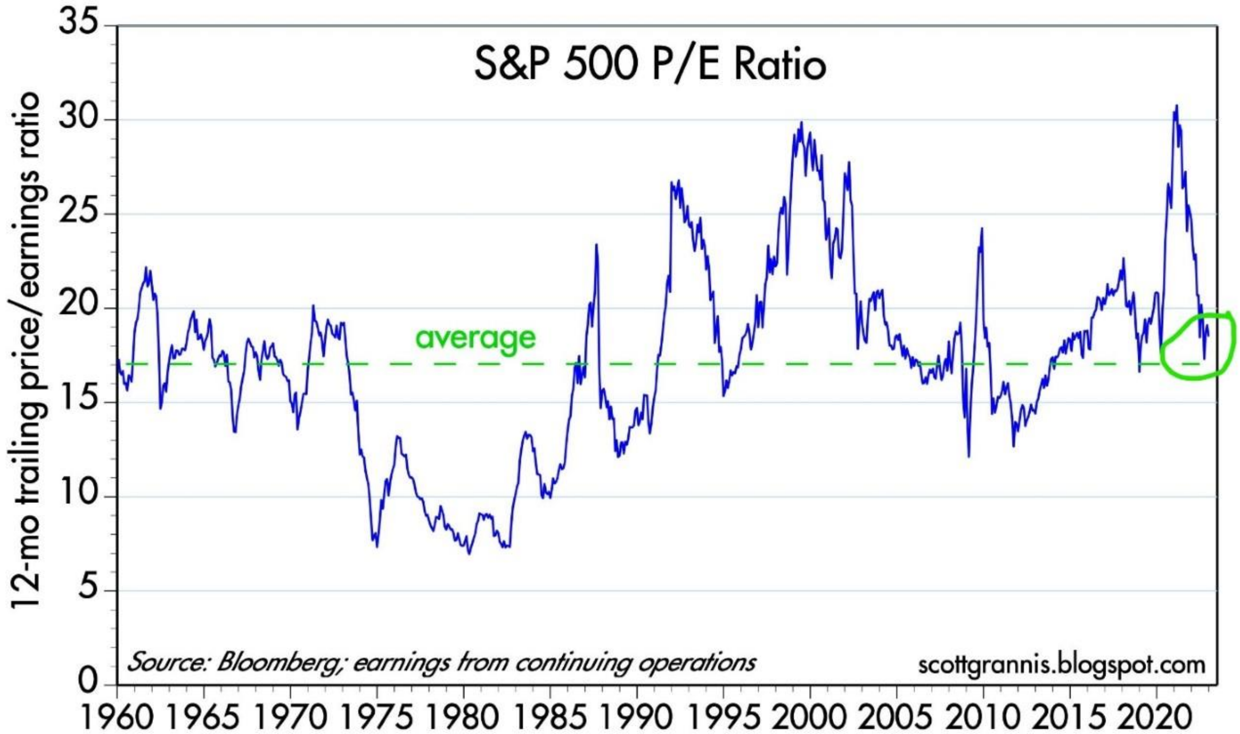
2022 has been The Year of Troubles . . . to put it mildly. Let's wrap it up with some hope: the "solid grounds" kind, not the "wishful thinking" type. As usual, economist Scott Grannis offered the kind of perspective which means "solid grounds."



The 2022 market has had a rich menu of nightmares to pick from: war, endless virus variations, elections, supply chain chaos and more. But "Inflation!" really has topped the Nightmare List for the market all year. There it is at the far right, shooting up toward 10% for the first time in 40 years. There has never been such a perfectly obvious inflation, with the government's jaw-dropping 40% spike in money-printing during the "Lockdown Calamity" side by side with the world's first economic shutdown. Too much money chasing too few goods, indeed. But the dramatic difference between the early 2020's and the early 1980's has been that the 40% spike was just that: sharply up then sharply down, rather than year after year of too much money-printing. Mr. Grannis has been one of the few economists who've said, "This inflation spike will not last," because of exactly that difference. And the picture up there begins to suggest he's right, doesn't it?



That green line and circle tell an amazing story about Main Street. Corporate profits have run in the range of <u>5% - 7% of GDP</u> (annual economic output) for over 50 years. After the Financial Calamity and Bank Runs of 2008 – 2009, they plunged but recovered in a flash; then rose to <u>9% - 11% of GDP</u> . . . where they have stayed for 12 years! Main Street was frightened by that Calamity, as it should have been; and it reacted with the caution and determination which are its nature. It vowed never to be vulnerable again, and cut costs and debt to move itself a good deal closer to "Rock of Gibraltar" financial strength. Naturally, profitability rose and stayed high. A great many experts thought the spike to 10% would last a year or two before sinking back to "normal." They were wrong again, having misunderstood what Main Street is capable of doing.



Most investors suffered through a Bear Market in 2022. (Not Outlook's clients, and we promise we won't mention that again.) We can see the Bear Market at the far right, as its P/E ratio plunged from 30 times earnings to 17 times . . . the 60-year "norm," sort of.
What was really going on, though, was not a Bear Market where everything gets crushed. It's been a Bear Market where silly, priced-for-perfection valuations (mostly attached to Celebrity Tech stocks) have gotten crushed. They've had it coming for a long time. Those Celebrity Techs had risen so high they had almost "become" the market index. When "priced for perfection" finally met its day of reckoning, the whole market index plunged with the Techs . . . very far beyond the generally-muted damage done to the stodgy old "non Techs" which, after all, are most of Main Street USA.

That picture is "solid grounds for hope." Both the Celebrity Techs and the market as a whole are now reasonably valued. They are often quite cheaply valued for those investors willing to believe in 5-year futures, rather than the 5-day, 5-week or 5-month varieties so loved by the betting crowd. At Outlook we'd bet our sacred fortunes that 2023 will bring its own "Troubles." But it is a very good thing to own companies which have no fear of Troubles, and whose stocks are cautious-to-solid values instead of "too cheerful by half" values. That means we have the right to hope: not wishfully, but with confidence.

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