The Outlook: March 12, 2020

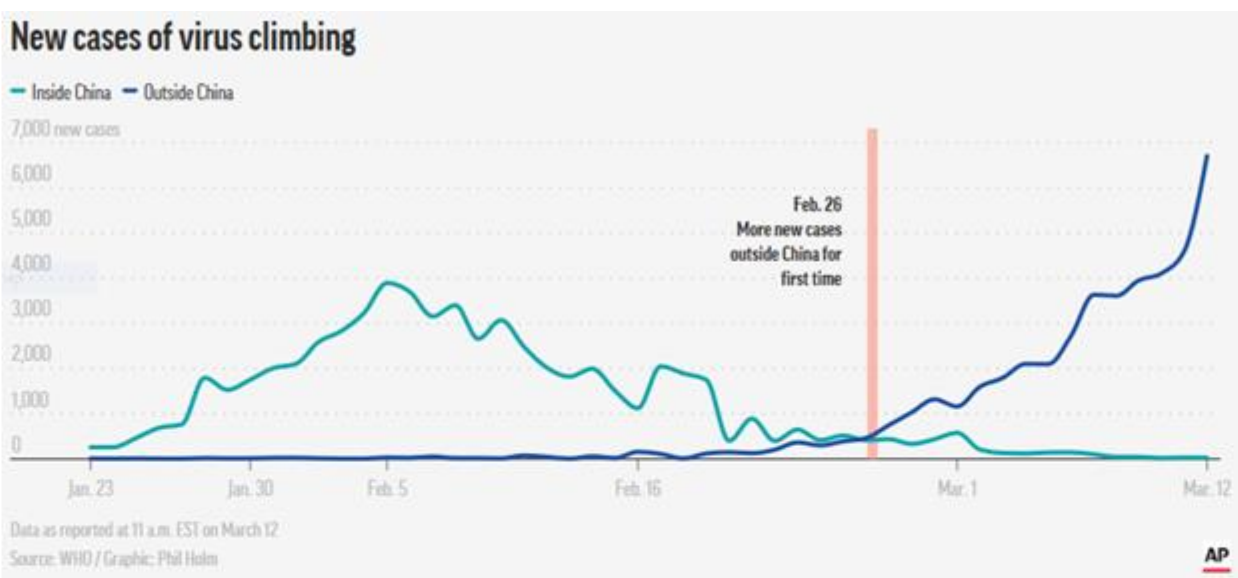
Understanding the Spectacle.

There is nothing more important for us investors, at this moment, than understanding what we are seeing.

What we're seeing each day—as the market "Ends the 11-Year Bull Market!" or "Plunges Most Since 2008!" or any of the countless other scary headlines—is simple. We're watching the market's vast speculating crowd piling onto a trend. The trend looks to that crowd like one of those fairly rare, one-way downtrends that "has legs" for a while. That just means the daily news is so sensationally bad that the market's countless gamblers have more confidence in making one-way bets for longer than the usual day or two. But the essence of what we are seeing, in this supposedly "panicked" downturn, is exactly the same thing as in every other "panicked" downturn in 150 years of market history: *speculators piling onto a trend*. "Look! The Duke brothers are cornering the market! Let's get in on it!" That line from the great old movie, "Trading Places," from one idle orange-juice futures trader to his pal, still captures the heart of how the short-term market works, today.

The market "knows" nothing more than any Main Street American with common sense, about the depth and length of the coronavirus pandemic, or about how much damage it will do, for how long, to the economy. All those speculators "know" nothing more than the average American, either. The many pundits giving us their daily expert opinions about the virus and/or the economy, plus the market, "know" nothing more than Main Street either—<u>as a group</u>. (There are a few genuine experts with good judgment who do "know" a little more, of course, as is true of any group of analysts upon any subject.)

Here's Outlook's opinion about what our sensible Main Street American knows about the coronavirus pandemic:



The headline caption, naturally, is anxious: "New Cases of Virus Climbing!" But what Main Street grasps—despite the absolute deluge of fearful-but-conflicting headlines, reports and deep analyses—lies in the first curve (the kind of green one.) That's the virus in China . . . behaving as all viruses do, pretty much: infections showing up, then rising, accelerating, and peaking . . . then falling.

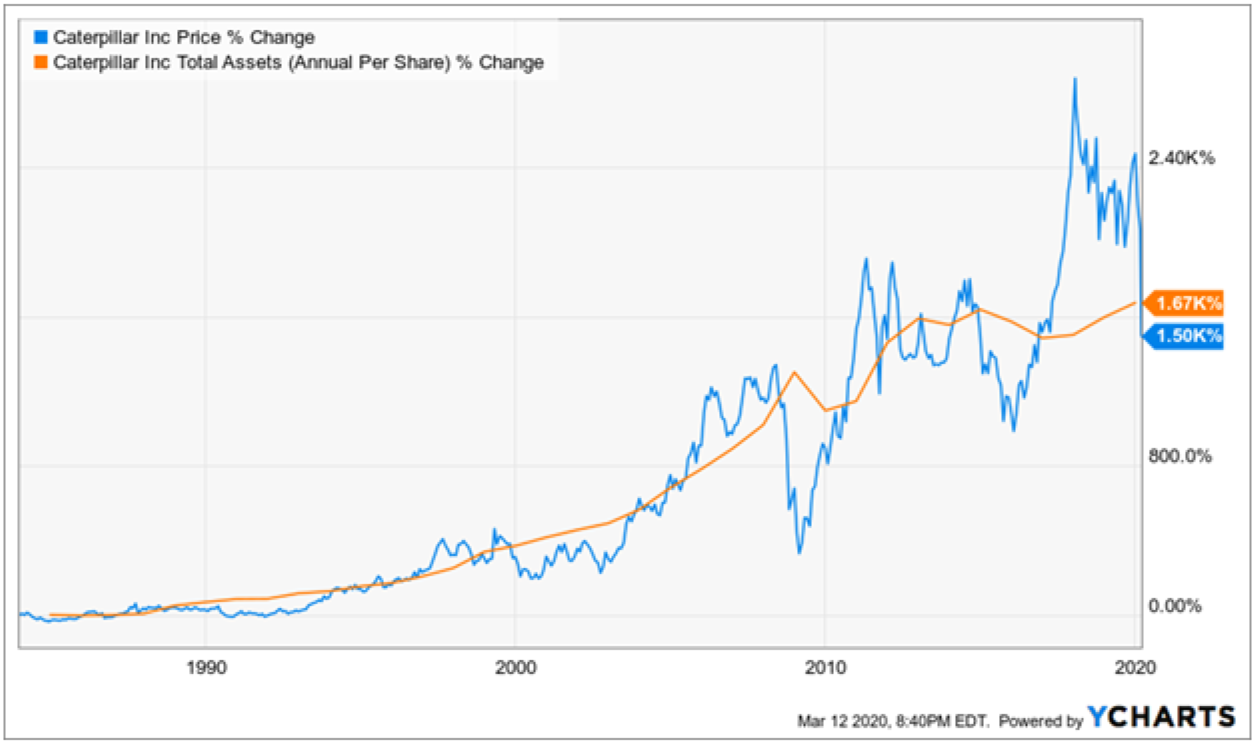
There is an enormous additional amount to say about the coronavirus, and it's certainly being said. The media's intense focus, naturally, is on the accelerating blue line at the right: infections spreading around the world. That same accelerating line could just as well describe the economic damage rippling through the rest of the global economy, as the virus and actions to fight it have their inevitable slowing-down effect on business and consumer activity.

Damaging economic ripple effects, though, also show up, then rise, accelerate and peak . . . and then they fall. And the more dynamic and strong the national economy they infect, the sooner they peak and fall—because so very many participants in such economies have the freedom, flexibility and determination to <u>adapt</u> to the problem.

Main Street America, in other words, knows the damage is <u>temporary</u> regardless of being unsure just how long "temporary" might be. The speculators' market "knows" that, too—but its business is to pile onto trends when they appear to have legs, and keep an eye out for the arrival of the kind of facts which signal the approaching end of "temporary." It is interesting. Those speculators and we investors are both waiting for the inevitable "good facts" to show up. They're waiting because they *really* want to jump off the down bandwagon before it burns them by reversing. We're waiting because we know those facts will be the engine restoring our capital to where it's been, and belongs.

We've picked on Caterpillar a lot, lately, as an example of different things. It's a good one at times like these, because it's a heavy industrial company which is driven by trends in Main Street economic activity, both up and down. This particular chart tells a story about Caterpillar (and every other strong company) and about the market. It is a picture of the market's endlessly repeating "disconnects" from Main Street, and just as endless "reconnects" . . . which are always forced upon it by the arrival of real facts about cash flows, cash payments to investors and profits.

Caterpillar's "Main Street" Assets versus the Market's Valuation, Over Time



We'd have liked to show CAT's shareholder equity over time (assets minus liabilities) but the sometimes-incomprehensible rules of accounting make that figure misleading. In fact, CAT's company equity has steadily grown over all those years, with minor interruptions. So "assets" gets to the heart of it. There's that orange line, showing the company getting bigger and bigger over the years, with minor dips during recessions (even deep ones.) It's pretty steady. But then we have the blue line—CAT's stock price—which is a yo-yo between gloom so deep it's in the Twilight Zone (like today) and cheerful recognition of the growing value and achievements of this company.

There really is nothing more important, down here in that Twilight Zone, than truly understanding what we are seeing. The Main Street value of Caterpillar—and its enduring strength for growing and sharing its cash with investors—hasn't changed at all. The only thing that's changed at this "End of the 11-Year Bull Market!" is the unanimity of the speculating crowd's feeling that this trend has legs, for a little while, so everyone can "get in on it" . . . for a while. But "for a while" means exactly what it says. It will change.

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