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"Fear of vague possibilities" rules the market . . . for the moment.

The market's "pain and suffering" phase has lasted 10 weeks, now. While the Dow and the S&P 500 are "only" down 9 – 10%, many investors feel a good deal worse than that. Most of Outlook's most valued companies are down a lot more, as are the Tech Celebrity stocks which had soared far ahead of the market over the last few years. So it does indeed "feel" more like the pain and suffering of a real Bear Market than the minor inconvenience of an "Almost Correction." (Usually defined as a 10% drop.)

The most valuable lesson there is this: "Labels like "Correction" and "Bear Market" do not help us think clearly. They most often do the opposite: fogging up the picture, rather than lighting it up."

Those words always suggest that there is something going on which is organized and defined, following certain rules of behavior: in essence, that it *means* something which ought to guide our thinking. But as Outlook's clients and readers know very well, the market's behavior does no such thing. For this past 10 weeks, the sum total of what's gone on is that the market's speculating crowd has been trying on fear for size—as it regularly does—and watching to see how far and fast the fear might run. This never changes. First, the market tries a dose of fear; then it waits to see if enough facts flow in to support the fear. If the flow of supporting facts is too slow and too weak, eventually part of the market crowd asks itself whether the valuations of a lot of strong companies have become too silly to pass up—and the rest of the crowd senses the change in attitude, and follows. Then the "pain and suffering" episode is over, until next time.

In these 10 weeks, "Main Street" has shown us plenty of facts about the real state of the economic world. The harder one scrutinizes all these facts, the harder it is to think that "fear" is going to have a long life, this time. The bottom line, for this pain and suffering phase, is that the facts just aren't justifying it yet. Instead, it has been all about the vague possibility that several worries which have been in the crowd's mind all year, might turn out to be real economic disasters, or near-disasters. Here are the main items causing the "fear of vague possibilities" which has been driving this market, since September.

- **China: trade war and/or economic slowdown might hurt the whole world economy.**

  As Outlook has noted before, the whole subjects of "China" and "Trade War" are perfect for the role of "market nightmares," because nobody understands them very well. What we don't understand is twice as scary as what we do understand. Here are the most important facts about them:

  1. China is a giant, broad-based, diverse economy . . . it's not a Potemkin Village. (Prosperous-looking but fake town, like a modern movie studio, originated in Russia to fool foreigners.) It's certainly riddled with problems and weaknesses, with the heavy hand of the central government doing harm instead of good most of the time; but it's not built of paper, ready to collapse. Nobody actually knows how fast it's been growing, or how much it's already slowed down, because China's economic statistics simply aren't trustworthy. But the engines driving China are partial market and personal freedoms. Those engines did create a Chinese growth miracle; and have created

an economy which ebbs and flows like every other major economy, but is much too broad and strong to collapse.

Just this morning along came two more "facts" which the market instantly took as bad news: China's retail sales "only" grew at 8%, last month; and industrial production only grew 6%. 8% and 6% would be spectacular numbers, of course, for the rest of the world; but they're the lowest growth numbers for those 2 items in many years . . . according to China's statistics. The market, naturally, seized upon "lowest in years" and ran with it. When the market crowd is seeing how far and long fear can run, it tries hard to ignore such perfectly obvious logic as "8% growth on a giant base is a lot of growth." Like so much of the market's behavior, it will keep ignoring such logic for a while, but can't keep it up indefinitely.

2. Thanks to Brian Wesbury, here's perspective on that "Trade War!" threat. In October (the latest month for data) the total volume of U.S. trade hit an all-time high. Year over year, exports grew 6.3%, and imports grew 8.5%. Those are seriously good numbers. Where is the trade war? The answer: it's still a possibility haunting the imagination of the speculating crowd. It's impossible to remove a possibility, or anything else, from our imaginations; but possibilities and imagined threats are not facts. They're quite strong enough, even so, to support a multi-week or multi-month wave of fear among the market crowd—but they're not strong enough to make it last. Facts are needed for that, and so far neither "China Slowdown!" nor "Trade War!" are providing them.

- **Europe's economy is stagnating, and might even slump into recession.**

It's hard to resist the witty response to this: "And if Europe did slump into recession, would anyone notice?" As Outlook has observed a few times, for the past couple of decades—and certainly since the Calamity of 2008 – 2009—Europe's economy, as a whole, has defined the term "stagnation." Economist Brian Wesbury often called the post-Calamity U.S. economy a "Plowhorse" for its slow but steady growth. If so, Europe has been the Plowhorse's lame grandfather, by comparison. It's regularly teetered on the verge of "slumping into recession" these past 10 years—and the market has slumped and swooned just as regularly, but usually less sharply than these past 10 weeks.

Repeatedly slumping or not, Europe is not teetering on the verge of another financial panic and economic calamity, a la 2008. Neither is China, and certainly neither is America. But the market's 10-week pain-and-suffering phase is acting as if such things aren't just possibilities, but reasonable probabilities. And that kind of judgment is almost as silly as valuing Micron at 3 times earnings, Apple at 11 times earnings, and all the hundreds of strong U.S. companies bearing the same certainty of future growth and present strength.

- **Rising interest rates might kill growth.**

Unlike China's growth, or the trade war, when it comes to rising interest rates the facts are perfectly clear: yup, they're going up. Not long ago at all, we were scrutinizing US and European interest rates in the tenths and hundredths of a percent, above or below zero. Over in Europe

they're still in that Alice in Wonderland neighborhood . . . but in the U.S. we've finally left the realm of the historically bizarre (near-zero rates) and arrived at 2% to 3%.

The simplest thing we can say about 2% to 3% interest rates is that there has been no time in economic history in which those rate levels have been economy-killers—nor 4% to 5% or 6%, Outlook would bet. In an economic climate featuring historically unbelievable rates of employment; steady growth in consumer incomes; spectacular growth in corporate profits; 30-year lows in household debt burdens compared to assets and disposable income; and a crowd of other signs of economic health, 2018's interest rate hikes and those likely in 2019 and 2020 just don't deserve to haunt anyone's dreams. They're doing that anyway, lately, for the market crowd . . . but they are not going to produce the facts they need to survive, in the haunting business.

- **Corporate earnings might sharply slow down, finally.**

  This one is simple. A few FAANG stocks (the Tech Celebrities) have shown long-overdue signs of slowing, with growth ebbing from "galactic" to merely "good" in most cases. Those few stocks were priced for perfection, and when imperfection arrived, down they went . . . and the market crowd, following its nature, sold off *everything* in response. Almost every other industry and leading company, though, has kept up its solid growth. Caterpillar gave us the latest, typical example just yesterday, announcing 3-month rolling machine sales up 16% (with its mining client base running at 47%.)

Like Caterpillar, most of corporate America (Main Street) has simply forged ahead, these past 10 weeks, in its business operations. A market wholly focused on trying fear on for size has been uninterested in this fact—as always, during such phases. The market crowd's focus has been on finding out just how long and far it can push "fear of vague possibilities," of which the 4 items above are the leading examples. That's the nature of the market crowd, and successful investors must understand that, and endure it. "Fear of vague possibilities" has already created valuations and buying opportunities, for outstanding companies, which have changed from September's "excellent" to December's "ridiculous." They can go on being ridiculous for a time; and they can get more ridiculous. They cannot keep it up, though. As happens every single time, after such phases, we will look back and wonder, "How could the market have been so wrong?" Outlook's core companies will produce astonishing returns, from today's levels, over the next several years. We're holding, and buying more shares whenever possible.

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