The Outlook: Dec. 19, 2018

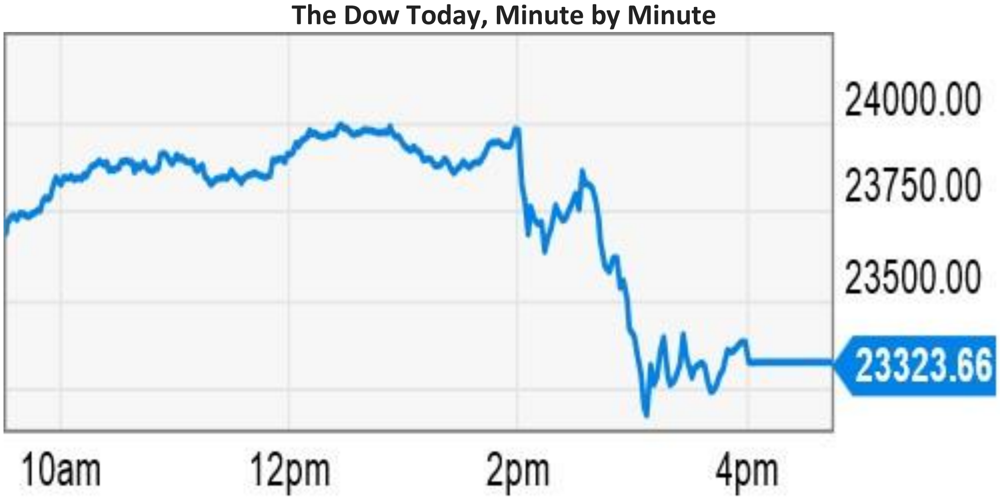
What to do in the Twilight Zone.

The only way to understand this stock market is to know that it's not about making difficult judgments about the real-world future. It's about something much easier to understand than that: the power of fear, when it's felt by big crowds of normal people. We are being told, all day long and by too many supposed experts to count, that it's about the first thing: bad real-world facts signaling a lot of bad news ahead—and anyone who doubts that is kidding himself. That's what we're always told when the market plunges and, being human, we feel more like listening at those times because every single day's plunge brings another injection of fear. As Outlook has noted a few times, it's at least twice as hard to think calmly and clearly when we're afraid.

The key to thinking straight is simply knowing that the market crowd wholly gives in to fear, now and then. At those times its actions are so far removed from good sense that we must dismiss them; or at least firmly remind ourselves that at such times we're simply taking one of the periodic rides through the Twilight Zone. Those rides are an unavoidable part of earning the market's extraordinary eventual rewards. We're right in the middle of one of those Twilight Zones, as 2018 ends. But they never last all that long; it always ends, and they're always replaced by much longer periods during which the rewards make the temporary losses look silly.

Two pictures, today, offered good examples of the market's current Twilight Zone behavior.

The Dow Today, Minute by Minute

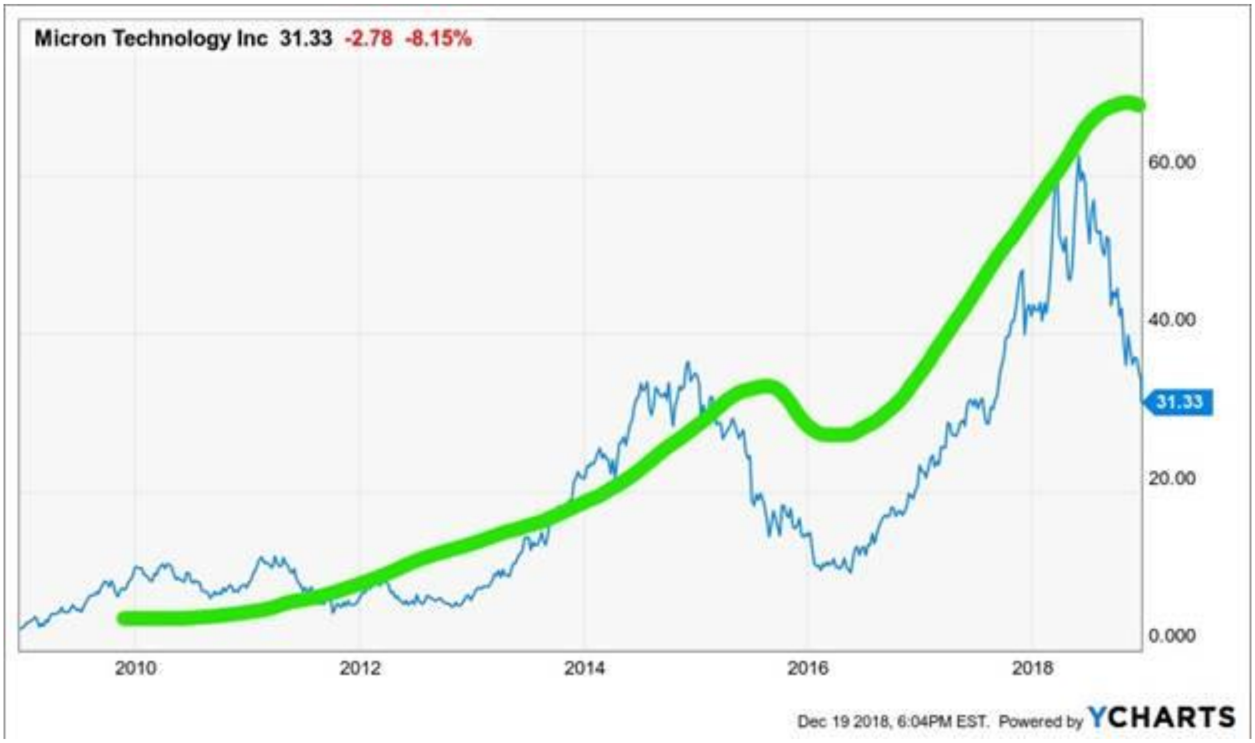


See the first screaming cliff-dive, at 2:00 pm? That was right in the middle of the Federal Reserve's remarks about its periodic interest-rate setting meeting, today. The Fed bumped short-term rates up one-fourth of a percent, to 2.5%, exactly as it has planned to do (and said it would do) for months. But this market crowd, under the thumb of fear, had secretly hoped the Fed would say something like this: "We're canceling our planned rate hike today, because we feel bad about the market's plunge and we know you all need a pat on the back." A few million fingers poised over "Sell" buttons (where they've been poised every day since October 3rd) jammed them down before Chairman Powell had finished saying "rate hike today," and we see the 2 pm result. It was followed by a brief interlude of second thoughts, maybe even of returning sanity, before the penetrating fear took charge again and the "Sell" button took more punishment.

2.5% interest rates won't hurt the U.S. economy. It's much too strong. Neither will 3% or 4% rates, and probably not 5% rates . . . which aren't even visible in the Fed's forward-looking binoculars, in the years ahead. That is the real world . . . but the market isn't in the real world this quarter, it's in the Twilight Zone. So down we went for another 350 points, which is beginning to feel like a normal day, lately.

Here's our second picture from the Twilight Zone:

Micron: Ten Years



Micron announced its quarterly earnings this afternoon. (It's on an offbeat fiscal calendar.) At the far right, that last plunge to $31, today, was how the Twilight Zone reacted to Micron's results and forecast. The company's results showed wonderful financial strength and profits, just beginning to show minor weakening from softening memory prices and demand. Here's CEO Mehrotra's summary:

> *"We're just going through an air pocket here related to primarily inventory adjustments as well as some seasonal, weak mobile demand, including mobile demand on the high end smartphones that is impacting some of our near-term visibility as well as the near-term outlook."*

"Inventory adjustments" means Micron's customers have tapped or even slammed the brakes on buying, because they're feeling their own clients' demand slow down. Mr. Mehrotra offered the opinion that Micron's customers had done the normal, sensible thing earlier this year, when memory prices were shooting up: stocked up, to some degree, on memory inventory—figuring prices would only be higher later. Maybe. We'll never really know. The "inventory cycle" of overbuying followed by underbuying is as much a part of normal business behavior as water is to the ocean. Sometimes the underbuying phase lasts a few months (Mr. Mehrotra's forecast) and sometimes longer; and sometimes it feeds into a broader economic downturn, and sometimes it doesn't.

The market's speculating crowd thinks the nature of any particular inventory cycle is all that matters. If it's heading down, sell. If up, buy. (We might as well say, "the nature of any cycle, period, is all the market cares about.") But good investors cannot act that way. They will fail, if they do, because diagnosing the particular status and character of such cycles is something nobody does well, even those inside affected companies like Micron, who are much closer to the situation than any of the market's players. We investors have just one way to think and act: putting all our energy and actions into our understanding of the fundamental nature of our companies, and their long-term futures.

That last part is the green line, above. It's a "heart of the matter" line. It portrays Micron's progress as an operating business these past 10 years, compared to its stock price in blue. As our green line suggests, Micron has simply transformed itself: from weak to immensely strong, financially; from a prisoner of a vicious memory-commodity pricing cycle to a long-term leader in an industry which <u>must</u> grow strongly, in the years ahead, because of the clear direction of the Tech Revolution in those years. As Outlook has also noted before, it might be hard to find market players, speculators or others, who disbelieve Micron's long-term future or its extraordinary 10-year transformation. They're too obvious to disbelieve. But the "heart of the matter" is not what drives the market crowd's actions. Today and tomorrow do that . . . and the strength of the fear injections received lately.

So down went Micron again: from silly to sillier in valuation. <u>That is the nature of the market, now and then, and it will never change</u>. At Outlook we've scraped up cash month after month, buying more shares of Micron and its many cousins, trapped with it in this Twilight Zone. That's the only thing for good investors to do, in Twilight Zones. The payoff will be tremendous, as it always is.

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