

The Outlook: May 29, 2019

“Due to the current crisis, the light at the end of the tunnel has been switched off.”
(Sign over the counter at a local diner.)

There’s not much more “Main Street” than a 24-hour diner, and the people who eat there, work there, or own it (who spend most of their daily lives there, generally.) Such people aren’t much like people from Wall Street; nor like people from Washington D.C.; but it would do those crowds of clever types a lot of good to spend a day or two on their feet, working 10 or 12 hours a day . . . and noticing the owners and employees cracking jokes regardless of their aching feet. It just might teach a bunch of the clever ones not to take themselves so seriously—well, one or two of them, possibly.

“The light at the end of the tunnel has been switched off” perfectly describes the tone of the market these days. “We have massive problems, and they’re all going to end badly!” sums it up. So the market as a whole has been depressed, if not downright suicidal, concerning each new bit of awful news; and within the general market, a lot of specific companies have been hammered down toward “end of the world” levels—especially any company which seems vulnerable to “the current crisis:” namely “China Trade War!”

Nearly 100% of the market’s episodes of “deep pessimism” turn out to be silly. Let’s contradict just a couple of the market’s current gloomy beliefs, which might help us recall that the light at the end of the tunnel comes from the sun, generally, which is somewhat difficult to switch off.

- ***No Trade Deal with China Means Long, Deep Economic Stagnation for Everyone!***

Nope—not even close. If “China Trade War” continues and worsens—and it might—the worldwide market for goods and services will find a multitude of ways around it. “China Trade War” is not “Global Trade War.” It’s a 2-country war. It is, at bottom, the world’s economic powerhouse (the U.S.) against a very big but much weaker antagonist (China), with the rest of the world looking on, ready to benefit from the “multitude of ways” the market will adjust to the War . . . and mostly cheering on the U.S., while they do so. (Cheering secretly, of course.)

That is not a prescription for global economic stagnation; and it’s certainly not a prescription for global depression as was supposedly triggered by the Smoot-Hawley tariffs of 1930. It might be a prescription for slower growth, briefly, as companies all over the world adjust. (As the most clear-sighted and hard-nosed among American companies have already begun to do.)

- ***China Will Shut Off the World’s Rare Earth Supplies! The World’s Tech Sector Will Crumble to Dust.***

Highly unlikely. The “world’s tech sector” runs supply lines through China and sells finished goods to its market, so China would be crumbling alongside it. Now, that does not mean China’s dictator, Mr. Xi, is sensible enough to know that. An almost-universal principle from history is that dictators often look clever from a distance, but often look remarkably dumb up close, under the lens of history. They make mistakes no sensible person would make; sometimes giant ones. And Mr. Xi has already made the most profound mistakes in his battle with President Trump: showing China’s true face to the world’s business community in such a stark way that it’s become impossible for the world to look the other way anymore, talking itself into believing the face is

basically friendly instead of basically hostile. People do that, from humble men and women in the street to supposedly sophisticated business leaders. But they also see the truth, eventually, when the veil has been lifted dramatically enough.

Mr. Xi's combative actions have lifted the veil. At Outlook we think this is the worst of the damage to China from the "Trade War!" It will last a long time; hurt China's growth potential for a long time; and help many other "developing" countries' growth potential for a long time. India's Mr. Modi—its most growth-oriented leader since Independence in 1947—has just won reelection in a landslide, giving him the political power to boost India's economy even more strongly. Outlook suspects that Mr. Modi knows the kind of opportunity China's mistakes are giving India, right now. And throughout the part of the world we call "developing Asia," which will be a driving engine of global economic growth for decades ahead, Outlook would also bet that the dominant political and business attitudes toward China are now "fear and distrust." Those attitudes will not be spoken—but they will be permanent, thanks to the face Mr. Xi has chosen to show the U.S. and the world. A revealing but also typical recent news item, reflecting those anti-China attitudes, was a story about India and Japan working together to build out a modern port in Sri Lanka . . . which happens to be "around the corner" geographically from a different port in Sri Lanka being funded and built by China—with its usual expectation of monopoly power over that port.

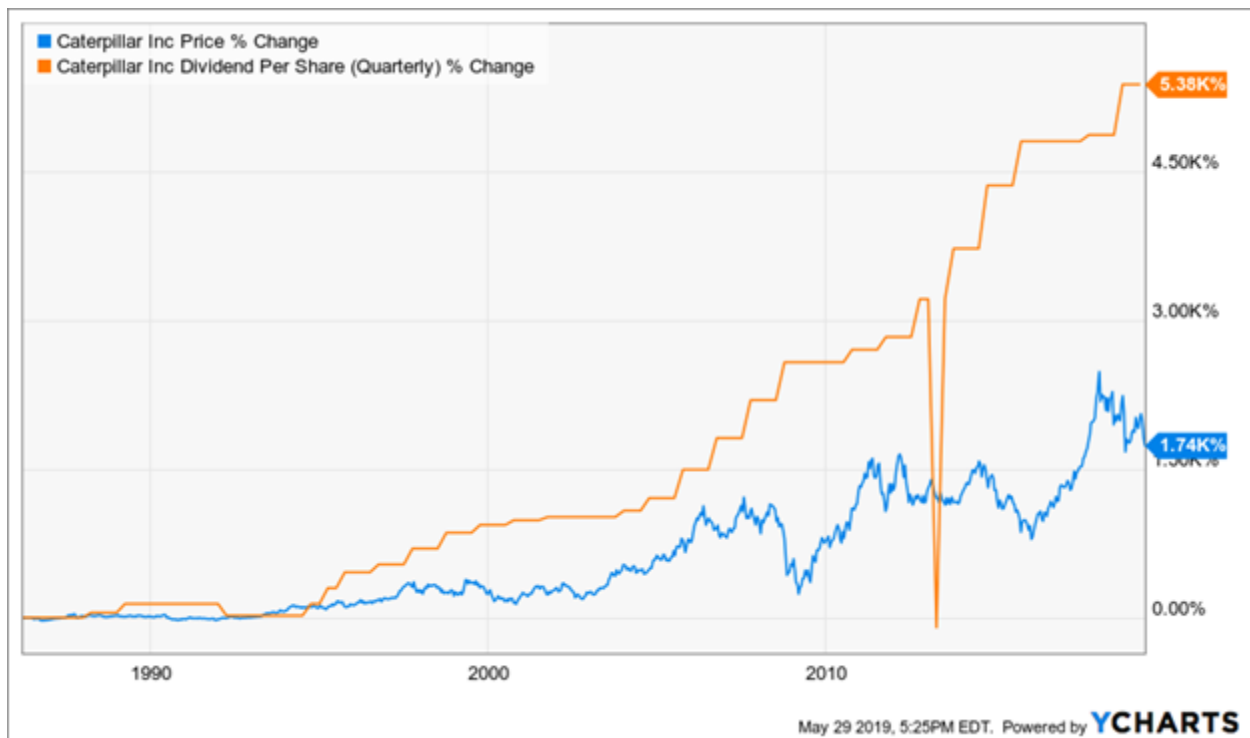
Yes . . . whether you're a political leader in Sri Lanka or the CEO of Apple, you don't feel the same way toward China as you might have felt a few years ago. Hope and confidence may have tipped the balance in your attitudes back then. Not now. Now it's emphatic caution, at best.

So, the market's deep gloom is overdone, once again. But as our two examples of overdone nightmares show, up there, "overdone" does not mean "no problem at all." The two-way trade war has already caused economic and business pain: pretty trivial in the U.S., so far; sharp enough to pinch, in China. And the business caution triggered by the nightmares, overdone or not, is always a wet blanket damping down the fires of economic growth to a degree, for a while.

Hence the Big Question for investors: "When we know there's some degree of economic pain coming down the tunnel, even if the light at the end is still shining, what do we do with the companies we own?"

And the Big Answer: "If they're cheap, hold 'em. When the market doubts and fears them, buy more of them." That's the whole answer. It's all the answer we ever need, if we grasp what the market is all about, and how good investors use the market's endless vulnerability to nightmares to make a great deal of money. When Andrew Carnegie bought stock for the first time and received his first dividend check, his famous reaction was "Eureka! Here's the goose that lays the golden egg!" Let's close with a glance at one of our geese, below. Caterpillar recently hiked its dividend 20% (too recently to show up in the chart below) right in the teeth of the market's China Nightmare. It trades at 9 times earnings (yes, *nine*!) a valuation which deserves the word "silly" if anything ever did. The picture below is exactly why Mr. Carnegie said, "Eureka!"

Caterpillar, 33 Years: Stock + 1,700%; Dividends + 5,400%.



Over those 33 years, Caterpillar has endured, survived and thrived beyond a great many nightmares more terrifying than “China Trade War!” That recent 20% dividend hike said something exceedingly direct to anyone in the market willing to listen: “Indulge in nightmares if you like. We’re making money and building our future, as usual. You’re welcome to come along for the ride.”

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