The Outlook: Dec. 5, 2019

Cummins, Texas Instruments, Micron: Cold War or Not, Main Street Adjusts.

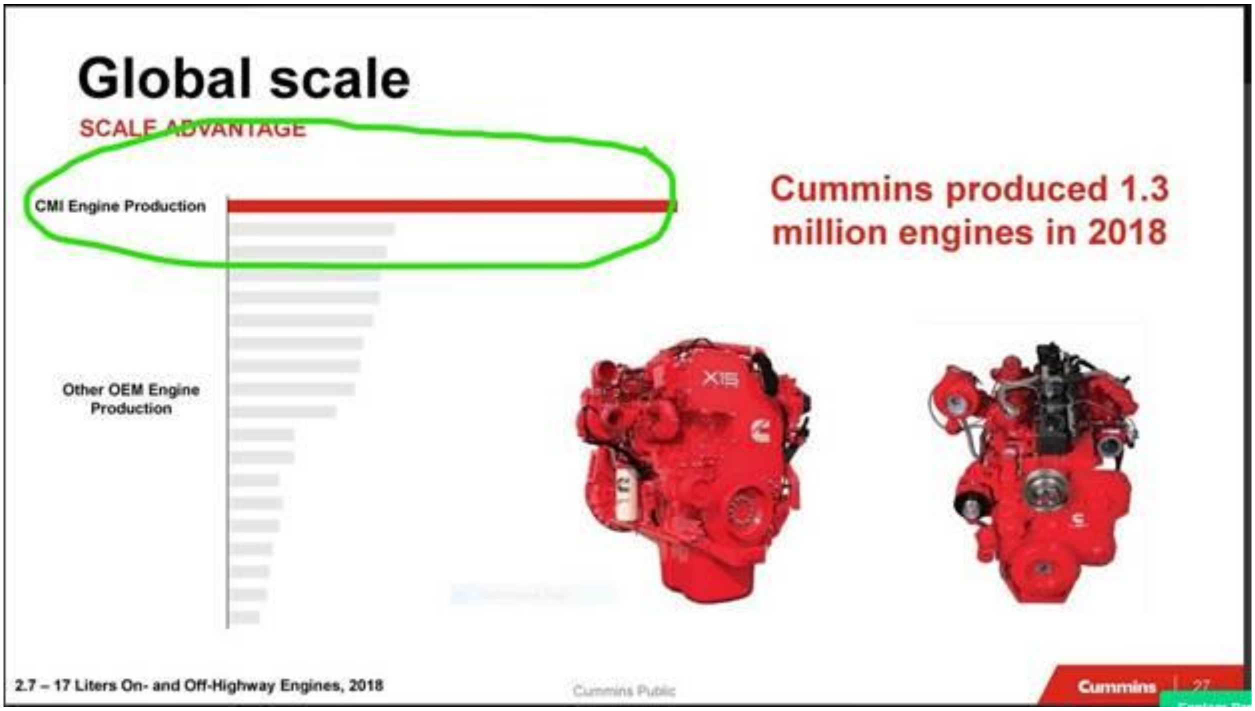
A couple of days ago we observed that the U.S. and China are in a new "Cold War;" that—like the old Cold War—the new war will certainly pull in most of the world, on one side or the other; and that, cold or hot, all wars are bad for economic growth and business earnings . . . but "bad" does not mean "end of the world," "end of the bull market," or "end of our life savings." The 2 saving factors are the market's emphatically cautious valuation of Outlook's companies and a host of others; and, especially, the ability of those companies to adjust to the new state of the world.

In just the past week or so, the CEO's of three of Outlook's core companies gave talks about the general state of their companies at this moment, and how the world ahead looks to them. Tom Linebarger (Cummins), Rich Templeton (Texas Instruments) and Sanjay Mehrotra (Micron) run very different businesses: heavy engines; sensory chips; and memory chips, respectively. The three bosses clearly share Outlook's view of the new "Cold War," though of course none used that term. They expect nothing but continued friction between the U.S. and China, regardless of the mild benefits of a "Trade Deal" which may or may not happen. They expect those frictions to be bad for business. But here is the key. Each of their companies is well along the "adjustment road." Each CEO has complete confidence in his firm's ability to adjust and thrive, Cold War or not.

How?

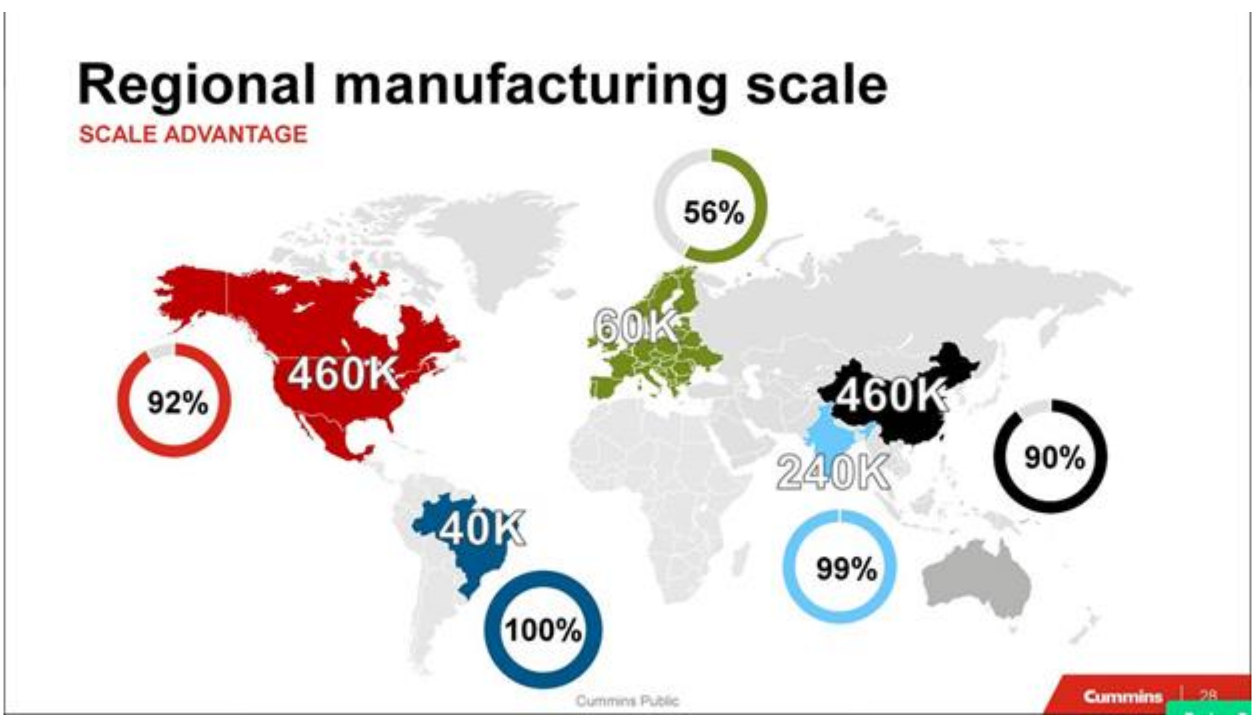
In essence, by making products which are so much better than the competition that the world, including China, ultimately can't pass them up—regardless of Cold War frictions. It's as sensible and obvious as can be, isn't it? Politics, tariffs and national hard feelings are an obstacle for both buyers and sellers . . . but the urgent need for quality and value never go away except in the kinds of absolute dictatorships which feel they can completely ignore the quality of life and satisfaction of their people. The Soviet Union and Eastern Europe were just such places during the original Cold War. It didn't bother the various dictators of East Germany that the only car their citizens were allowed to buy was the Trabant, which was made from cotton fibers, oil and rags imported from Russia and pressed into a kind of plastic. The Trabant's nicknames were "Running Cardboard" and "The Plastic Bomber." It spewed diesel fumes, made a lot of noise and broke down all the time. China is not a free country . . . but it's not East Germany. Its leader, Mr. Xi, is certainly frightened of the possibility of widespread economic dissatisfaction among China's billion citizens. They've tasted the quality and value delivered by even partly free, competitive markets and are not likely to forget them.

Cummins' illustrations of its adjustment strategies are typical of all 3 companies—and many more. Cummins is already the "King" of diesel engines around the world. This picture makes that fact jump right out.



When any company builds that kind of power and size compared to its competition, it usually has the tools (cash, cash flow, factory know-how and leading technology) to keep on crushing its competition for a long time. Some of those "Kings" don't use the tools wisely, and eventually falter. Not Cummins. The next picture shows where Cummins is spending its R & D money to build the most in-demand engines and systems for the future: batteries and electric-drives; combined diesel/electrics; and hydrogen fuel cells (which don't get all that much press, but are a "Wow!" possibility within the next 10 to 15 years.) As Mr. Linebarger remarked, the competitors (and also Cummins customers) with the short gray lines above simply don't have the money to spend on these waves of the future, <u>and</u> on their own core business (making the rest of the truck or other heavy transport equipment.) But the waves are coming in fast enough so that they must be ready—which means buying from Cummins rather than making them themselves.

Here's the last Cummins picture. It needs explaining. In a nutshell, it shows that Cummins <u>makes</u> its engines the same place it <u>sells</u> them, to an overwhelming degree. It's spent decades putting itself in this position . . . and nobody in the world can match it. Among other benefits, it has let Cummins cut its "tariff drag" on earnings in half, over the past 2 years (since tariffs are applied when goods are sold across borders.)



That is “Adjustment” with a capital “A.” In different ways, Texas Instruments and Micron are adjusting just as effectively—but with exactly the same driving goal as Cummins: to make products so much better that a lot of “Cold War frictions” will give way to their customers’ needs for quality and value.

We don’t see much of this picture when the media, eminent strategists and politicians trumpet sweeping, top-down judgments about the Trade War and its bad effects, do we? It is, as usual, Main Street working to fix whatever part of a problem is in its power to fix, and finding a way to bypass the rest. And that is, as always, exactly why we hang onto great companies like bulldogs, knowing the market itself must always recognize quality and value eventually.

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