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Trade War Nightmare: Under a Floodlight, with a Magnifying Glass

What shall we think about the market's current Nightmare, which one headline-writer summed up this way after the President dropped a tariff bomb on the supposedly-imminent U.S./China trade deal: "Economic Cold War Begins! U.S. versus China!"

Let's remember, first, that almost all the market's nightmares—day after day, year after year and decade after decade—are shown to be gross exaggerations by the passage of time. That's due to the nature of the daily market crowd and how it hopes to make its money, as we've noted a few times. Yes . . . almost all of them. And let's remember, next, that the portion of the market's nightmares which we can label "Politics" is especially likely to be "more smoke than fire" . . . almost always.

But not always—which is why we look at every single Nightmare under a floodlight, with a magnifying glass.

When "Politics" is the nightmare's label, we must remember that despite Politics' ability to puff out mushroom clouds of smoke over a matchstick's worth of actual fire, the truth about even the strongest free-market economy is that the only thing which can truly wreck it is indeed . . . "Politics." When anti-growth Politics is determined and long-lasting enough, it will eventually hamstring any economy, as Europe could testify, if only it understood itself.

So the Big Question today is, "Instead of "Trade Deal" will we have "Trade War?" If so, how bad will it be for the Whole Picture: the global and U.S. economies; the markets and the whole investment world; and, ahem, the companies to which we've committed our capital? That sounds like the introduction to a book, or at least an inch-high thesis—but here's the short answer.

Our companies—and in fact, almost every big U.S. company—would react to a real "Trade War" by slowing down for a while, as they adapted; then they would gradually gather steam once again. The magnifying glass shows us that, because that is exactly what has been happening since the first round of "Trade War!" tariff salvos, last year—and has been confirmed by company after company as they've discussed last quarter's results. Their stock prices, meanwhile, might very well take a short-term beating from the next rounds in the "War," but will not stay down for long . . . because their valuations are, and have been, "anxious, cautious and/or downright pessimistic" for years and years, as we have clawed our way up this rocky, 10-year bull market. Theresa looked at Caterpillar the other day, which rang up all-time record earnings in the middle of mixed, troubled business conditions. CAT's price/earnings ratio is 10. Cummins' p/e is 11. Royal Dutch Shell's is closer to 9. (The market as a whole is around 20.) They're just three examples of almost every one of our companies—and many others—which are demonstrating remarkable business results in tough times, on foundations of great financial strength . . . but which are being valued by the market as if they're derailed trains lying alongside wrecked tracks.

They're at the other end of the galaxy from the handful of "celebrity silly" stocks: Lyft, Tesla, Netflix, even Amazon, and others. Those stocks are balloons waiting for the needle's prick. Ours and many others are massive chunks of granite—not very worried about needles.

The Wall Street Journal ran a pretty good article yesterday, which surveyed a collection of big American companies, all doing business in China. The question was, "What are you doing about China—the trade

war risk, and all the other risks of doing business there? (The risks which have been plastered on billboards all over the world this past year, so to speak, rather than being almost hidden, and easily ignored, in the fine print of company's internal analyses.)

The answers were perfectly typical of a collection of normal human beings. They ranged from decisive ("We've already shifted any important operations to Mexico, Indonesia, etc.") to genuinely worried but cautious ("We've put lots of China plans on hold") to the inevitable Pollyana's ("We're sure there will be a deal soon . . . well, pretty sure, anyway.") But there were emphatically fewer such Pollyana's than, say, 6 months ago; and emphatically more responses somewhere between "decisive" and "cautious."

This is a permanent change in the economic world. It is permanent, and bad, for China; and it's permanent, but nowhere near as bad, for the U.S. As Outlook has noted before, over this past year China's ruthless leadership has shown its face, permanently shaking up the complacent attitude in much of the world's business community. ("Sure there are risks and problems, but we can manage them . . . think of the opportunities!") Regardless of how today's "Trade War!" turns out, that complacency is not coming back. That will hurt China; it will inconvenience the U.S. and Europe for a while; and it will help a good many other "developing" nations (India, Mexico, the Philippines, Vietnam and others) which have plenty of opportunity to offer, themselves, and a lot fewer threats. It will also help the U.S. economy itself, where productivity in modern factories has surged over the past years, and been recognized by a remarkable inflow of investment dollars from all over the world.

The question of how much fire lies at the bottom of all this Political smoke comes down to valuation, as usual. Our companies, and most others, are valued so cautiously that there just isn't much room for the daily market crowd to stomp them down, and certainly not to keep them down. So we hold. President Trump does actually hold the cards in this poker game, and he has just tried to show China that he has the nerve to bet on them. We can only wait to see how China plays its weaker hand . . . but while we're waiting, we will not let the market's current Nightmare scare us out of the game.

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Outlook Capital Management, LLC
125 S. Wilke Road, Suite 200E
Arlington Heights, IL 60005
847-797-0600

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