The Outlook: Nov. 14, 2018

When the market acts frightful: the lesson of the orange arrows.

A natural question, when the market acts frightful, is: "What's Outlook's plan? How long might we hold our stocks, as they plunge toward oblivion?"

Here's the answer.

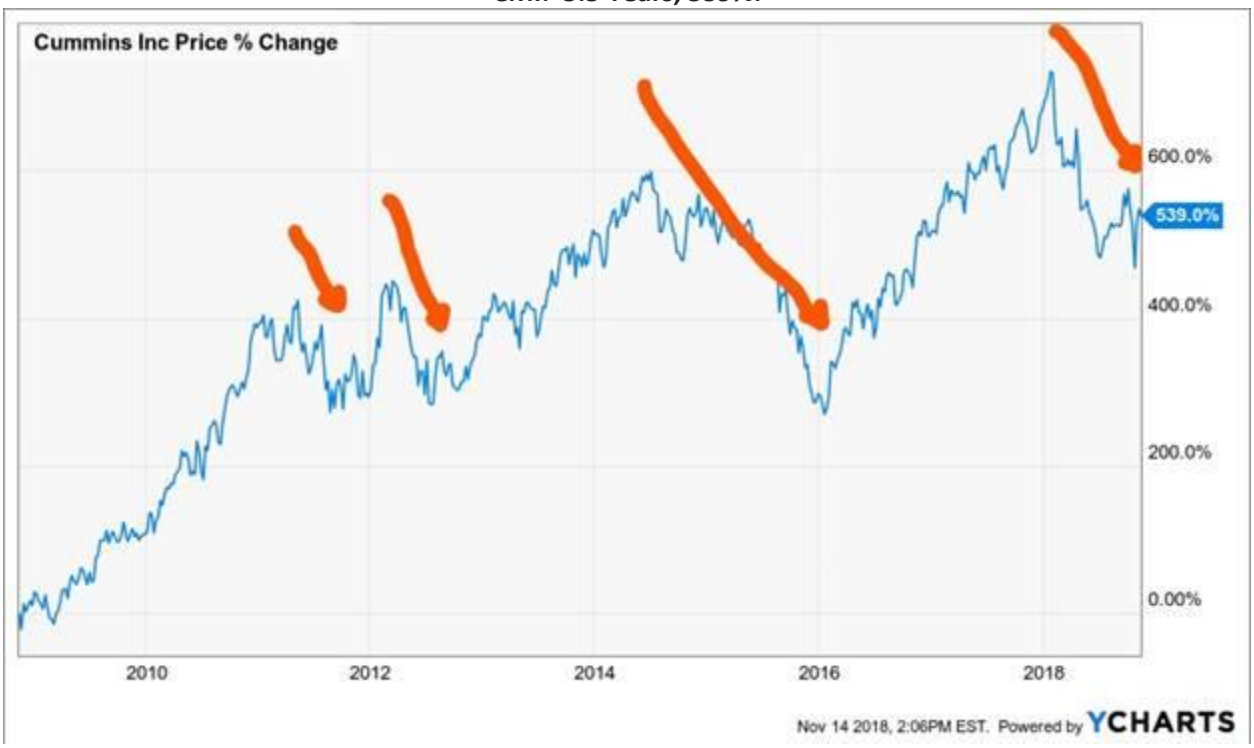
We expect to hold every one of our companies for a long time to come: 3 to 5 years at least, probably much longer. We expect to hold them because we fundamentally don't care what the market is doing at the moment, or how many more months it lasts.

The market may very well keep punishing them. Just as we did in October, when we sold Schlumberger in order to add more shares to several of our other positions, we may do the same kind of thing if and when the market knocks the price of one or more of our stocks down to even "sillier" levels. The only reason we would be likely to drop one of our current companies would be for the same reasons we used Schlumberger as a source of funds: selling an excellent company, whose stock price was a solid long-term value, to raise cash to add more money to other companies, whose stock prices were even better values.

When the market is down and great values are available, but an investor does not have idle cash available for investment—which is the case most of the time—then good investors rank their current assets from "good" to "outstanding" values, and shift some funds to take advantage of the market's behavior.

It might help to look at a few charts, which tell the stories of some of the companies which we've held longest, among our group. (Pardon the amateur art work, in orange.)

CMI: 5.5 Years, 539%.



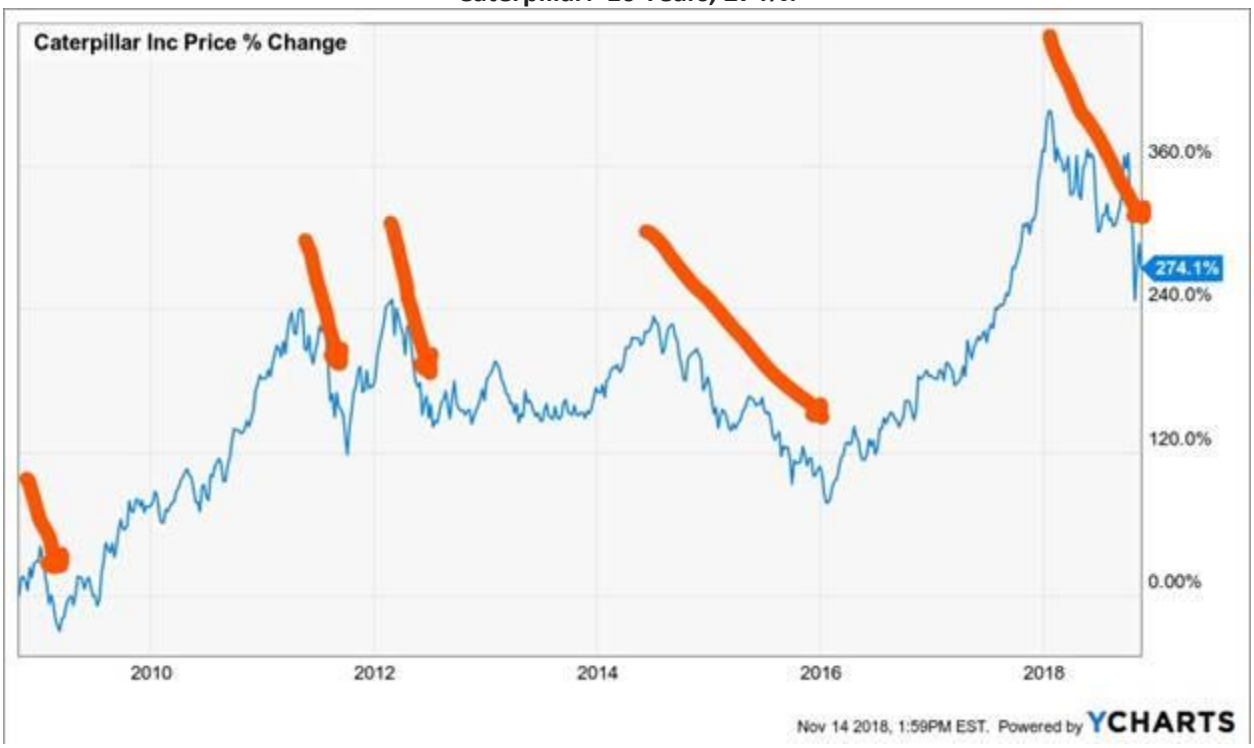
We've held CMI for our clients for 5 ½ years, since May 2011. Those 4 orange arrows show the 4 most painful downturns in CMI's stock price. From left to right: 3 months, down 21%; 2 months, down 31%; 18 months, down 48%; 10 months, down 23%. During each of those market frights, we bought more shares of CMI whenever we possibly could. Why? Because we understood what we owned . . . and we understood the nature of the market, which fairly often goes to silly extremes in stock valuations: both high and low. On the subject of "understanding what we owned," we knew Cummins' great financial strength meant it could endure any recession; and we knew Cummins' worldwide market must grow steadily over the years; and we knew Cummins was the industry's quality and technical leader (by quite a bit) in diesel engine manufacturing.

Knowing those things, <u>we are determined to capture ***all*** of Cummins' investment performance, over many years</u>. *All of it*. During these past 5.5 years, the broad market is up 140%. From our <u>initial</u> investment, we've captured all of Cummins' <u>539%</u>. There is no way whatsoever to do that, except the way we've done it: holding on regardless of the market's periodic frightful behavior; buying more shares when that frightful behavior "punishes" the stock price so much that it makes a "good" value into an "outstanding" value. We've added plenty of money to Cummins since the beginning, at higher prices, which haven't earned as much as our first investment . . . yet. We'll give them time, and stick with the same plan.

Texas Instruments: 8.5 Years, 259%.

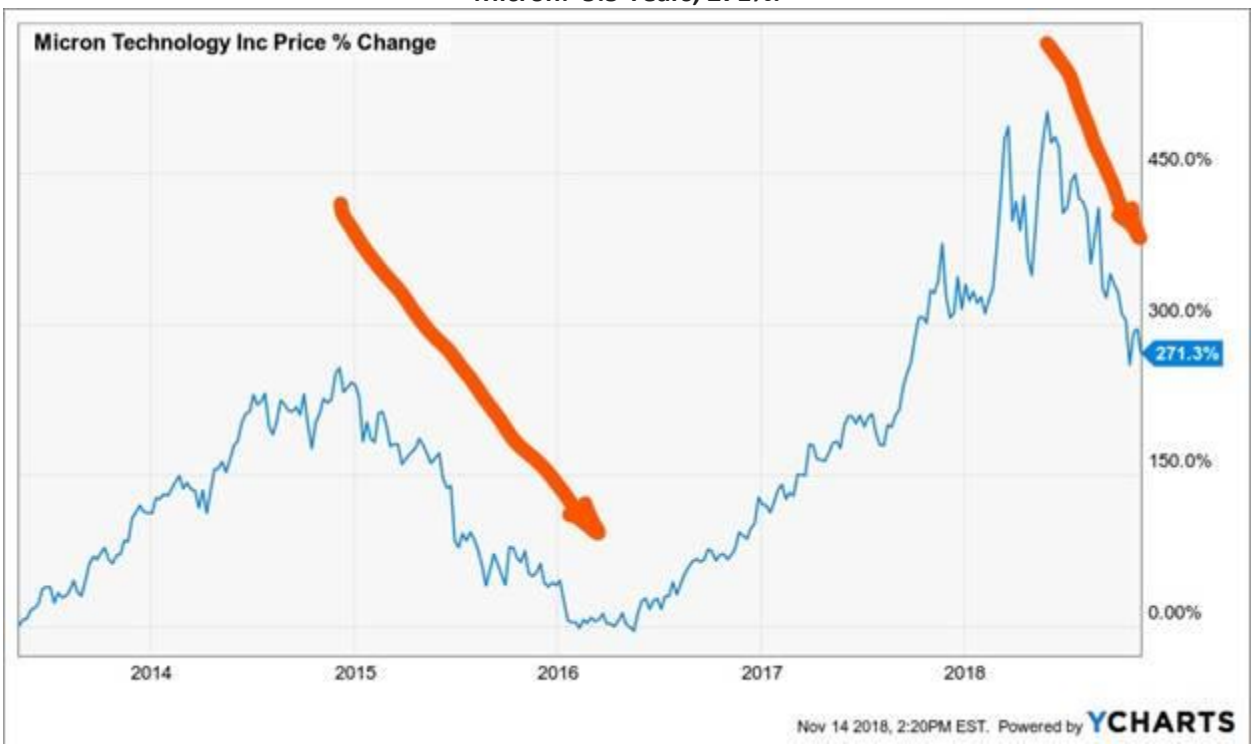
5 episodes of frightful behavior, since we've owned Texas Instruments: 4 months, down 31%; 2 months, down 24%; 5 months, down 29%; 15 months, down 27%; 5 months, down 20%. Just as with Cummins, we've earned all of Texas Instruments' 259% return in 8.5 years, from our initial investment. The market earned 168% during the same 8.5 years. And just as with Cummins, we bought more shares during most of those plunges.

Caterpillar: 10 Years, 274%.



More briefly, CAT's plunges were 32%, 36%, 31%, 47%, and 24%. They ranged from 2 months to 18 months (that 47% plunge.) We always held, and bought more—because we understood our company, and we understood the market. As a result we've earned all of CAT's 274% return, from our initial investment. The broad market has actually slightly beaten CAT, at the moment, with its 281% return—though it lagged well behind CAT early this year, when our 8-year return on CAT stood at 405%. It will stand there, again.

Micron: 5.5 Years, 271%.



Finally, Micron. "Only" 2 major frightening plunges in Micron, during the time we've held it . . . but they've been doozies! 18 months, down 72%; 6 months (so far), down 39%. We know this company. By the end of that first plunge, the market valued Micron as if it were a bankruptcy candidate. We use the word "silly" quite a bit, to describe periodic market behavior, because that word is an accurate label at those times, not an exaggeration. Any investor with even a slight knowledge of Micron's financial strength, in 2016, would use the same word. If the investor understood a little more about the company—the dramatic changes for the better in Micron's memory industry; and the dramatic improvements in Micron's product manufacturing quality and technology over the preceding 5 years—she might have searched for even stronger words than "silly" to describe the market's behavior . . . but she'd have been better off just reaching for cash to buy more shares.

Even at the bottom (we hope!) of the current frightful episode, we've earned all of Micron's 271% returns, on our first investment, over the 5.5 years. The market has earned 83%. We've never stopped buying more shares of Micron, during "orange arrow" periods and all the rest of those 5.5 years.

That's the plan. We haven't yet owned Freeport and our oil companies long enough to make the same point with their long-term charts . . . but we will act with them exactly as we've acted with these examples. When the market behaves in a genuinely silly way—and it's a fact that it does so, periodically—investors succeed when they ignore the market's "judgments," and instead do the opposite of whatever the market is doing. Investors fail when they decide the market's silly behaviors are telling them something worthwhile, and ought to be copied. That is the lesson of the "orange arrows" up there. It's the same lesson, whether the arrows covered only 2 months, or 20 months. It's just harder to keep standing against the market's so-called "judgment," the longer the arrow lasts; but it's even more important to keep standing that way, the longer it lasts.

Understanding what we own, as investors, requires hard work and good judgment; but standing against a frightful market requires nerve. It would be nice if investors could succeed with only the first of those qualities—but they can't. We need them both. The orange arrows remind us that no matter how frightened the market acts, we always see—looking back over the years—that there was hardly anything "real" behind it.

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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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