The Outlook: Oct. 10, 2018

Choosing, once again: Is the market a good thinker, or an awful thinker?

When we lose 800 points and a sickening number of dollars in the market in one day, we might as well wallow in our misery with just the right chart. Here's the Dow Jones Average for the past 5 days, as it racked up 1,230 points downhill.

The Dow: 5 Days, 1230 Points Downhill

If this picture isn't quite wallowing enough, the media is helping us out, with gusto. At Outlook we stopped watching the evening news decades ago (or anything else on TV, actually) . . . but we still grasp the nature of TV journalism (and every other kind), and the most sincere advice we can offer investors who feel tempted to tune in, in search of a good explanation for today's market plunge, is . . . <u>don't</u>. We will not find the truth about the market—or much of anything—in the media; and thefact that everyone else seems to be watching and listening does <u>not</u> bring the media's story one inch closer to that truth. The media will be a very long way from thetruth—though not as far away as the market itself.

As Outlook has remarked once or twice, our fundamental choice as investors is this:

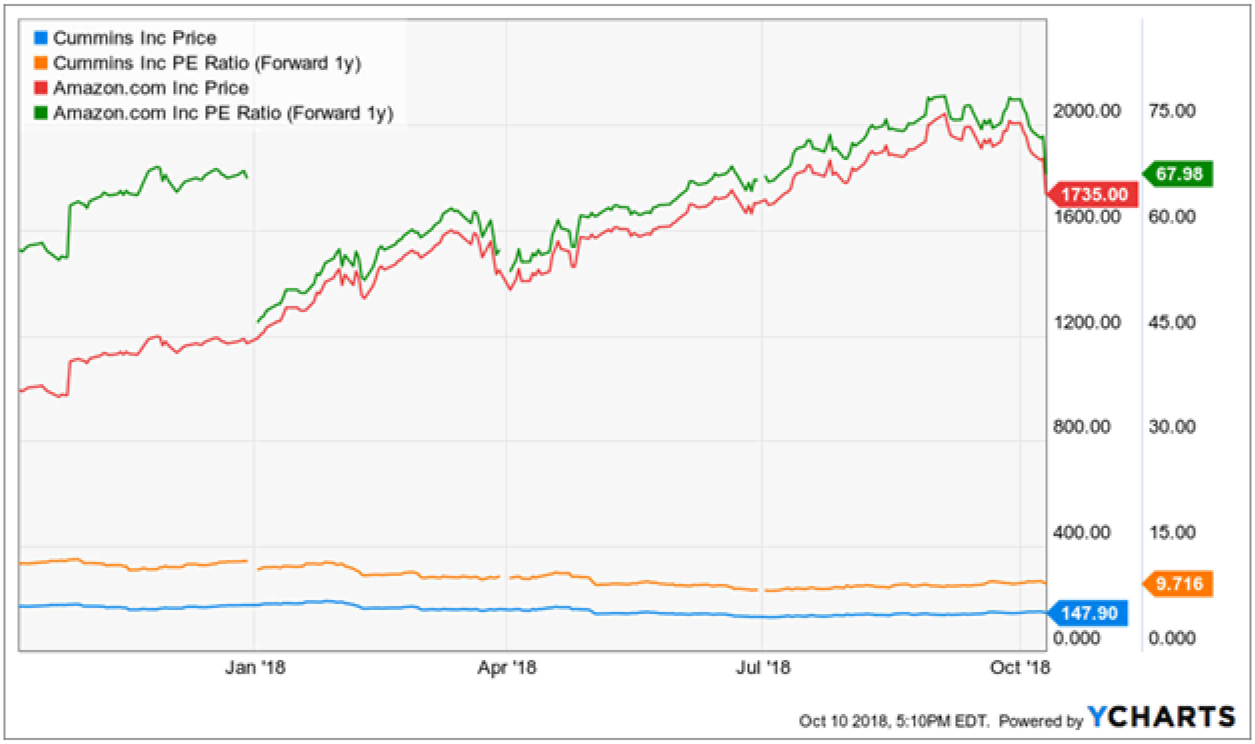
- Either we basically respect the market's "judgment," hence let the market's behavior do our thinking for us;

- Or we believe the market is a truly awful thinker, and we'll eventually be ruined if we let it guide our judgment.

There is hardly anything more important than understanding that choice. There is no compromise; no in-between ground. We must decide which statement is actually the truth, and act accordingly. Let's glance at a few more pictures, which might help us decide.

One Year: Amazon (up 100%); Cummins (down 14%)

The top (orange) line is Amazon: up 100% in a year, until the current slaughter which has hammered it down so hard that it's only up 75%. We picked Amazon by itself, up there, to keep the chart simple; but if we'd added Netflix, Salesforce, Twitter and the other wildly popular "New Tech" stocks, their message would be thesame. The bottom (blue) line is poor old Cummins—the diesel-engine king, and an Outlook core company—down 14% in the same year. While our minds are still under their first impression, which is probably a thoughtful "Hmm," let's paint more of the picture.



Here's an even more dismal picture for poor Cummins. Those flat, stagnating lines at the bottom are Cummins' price, and also Cummins' price/earnings (P/E) ratio. In judging whether a stock's valuation is so low it's a giveaway, or so high it's the Brooklyn Bridge, the P/E is almost as flawed as every other way of valuing stocks—but it's quite good enough to make our point, today. Up there in the stratosphere we see Amazon's P/E, which touched 80 times earnings before the slaughter began last week and ended at 68 after Custer's Last Stand, today. (Hmm. Let's strike the word, "ended!")

Every now and then along comes a wonderful company—which has just invented sliced bread, or the internet search engine, or something else—which grows sales and profits explosively, and keeps it up for an amazing number of years; and which gets a P/E valuation of 50 times earnings, or 80, or 100 . . . and never rides into its Little Bighorn. But for each one like that, there are a very great number (50, 100, 1000?) which also look wonderful until they meet their Armageddons . . . and don't make it out alive. The galactic-scale mob of speculators who dictate the market's daily behavior—whether that behavior is an afternoon snooze, or the Little Bighorn—know these figures perfectly well. When they pile into an Amazon rocket—or a Netflix, Salesforce, Tesla or any other rocket—they are concerned with exactly one thing, looking ahead: *"When will the mood change, in the rest of the mob?"* They have little concern for underlying facts; nor with the difference between valuations in the neighborhood of common sense, versus valuations in the neighborhood of insanity. So much money can be made by riding the coattails of that galactic speculating mob, when it has identified a "rocket," that they're always willing to gamble that they can jump off before the rocket blows up.

Many don't make it . . . but we seldom hear about them.

What are we to think about this past year's market and its astonishingly different "judgments" concerning the right valuation for Cummins, compared to Amazon and friends? We might think, from that picture by itself, that poor Cummins is a carthorse headed for the glue factory, pretty much: stock down 14%, P/E ratio less than 10. In any market in history, a P/E in the "10" neighborhood means the market thinks the company is the Seventh Cavalry, playing "Garryowen" for the last time as it trots down into that Montana valley. So let's look at our last chart, which will tell us all we need to know when it comes to deciding which to believe: "Is the market a good thinker, or an awful thinker?"

Here is 15 years of Cummins, and 15 years of the market. (Both the Dow and the S&P 500—and isn't it interesting that the 30 stocks and the 500 stocks ended up in the same place?) Hmm. Cummins: up 1,630%. The market: up 189%. Let's end by scrutinizing the many cliff-diving plunges in Cummins, over the years. What might we guess was Cummins' P/E valuation, by the clear-thinking market, at each of those abysmal bottoms? Yup: 10 times earnings, or thereabouts. Every time Cummins experienced a temporary, cyclical downturn in its truck-engine business, the market decided it was the Little Bighorn again, and awarded Cummins with a rock-bottom, world-is-ending valuation.

Was the market right? Shall we let the market do our thinking for us? Would we have made our fortunes buying low, when the market wasn't thinking at all, much less thinking straight? We needn't answer; but every time the market treats us to a day like today we must choose, once again: "Is the market a good thinker, or a terrible thinker?" Outlook's clients know the answer. We are buying, not selling.

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