<u>The Outlook: April 4, 2019</u>

The Big Picture

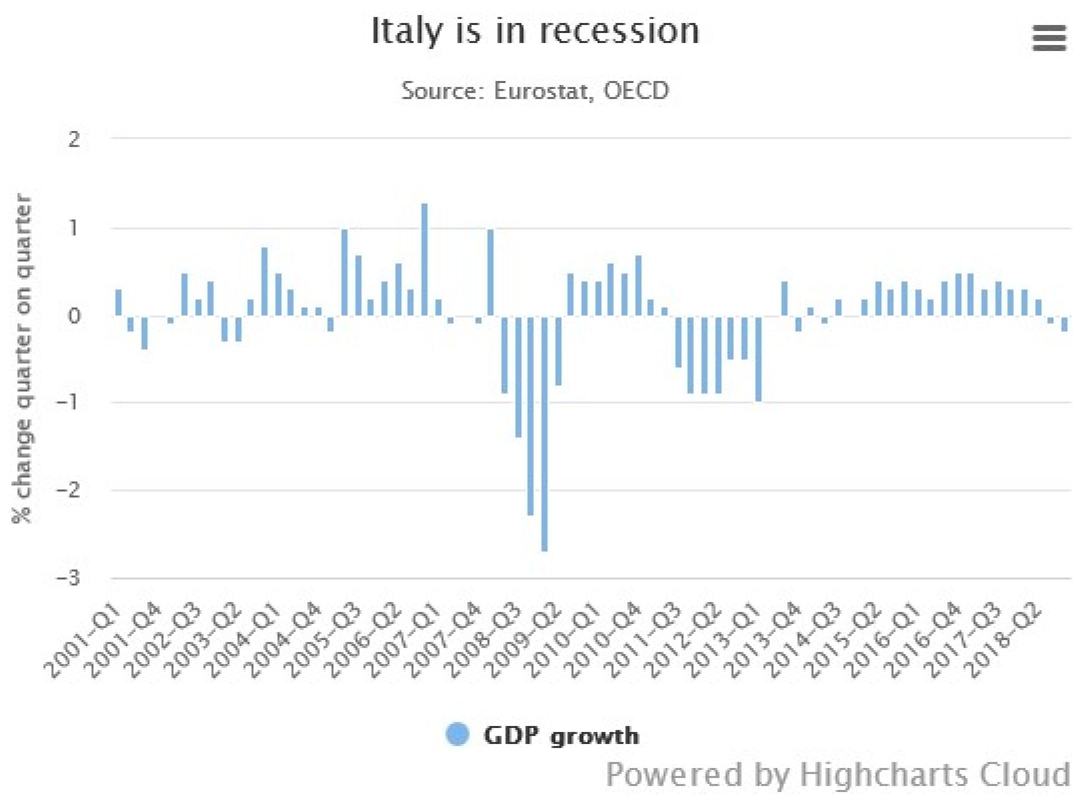
Most of the time, the "Big Picture" shows us whatever the market is worried about, and whether it <u>ought</u> to be worried about it. That's because the market spends the vast majority of its time acting a lot more worried about its current nightmares than it ought to. We can only understand that truth if we take a good look at those current nightmares. We'll do that today, while keeping another truth in the backs of our minds: that once in a great while, the "Big Picture" shows us what the market is <u>not</u> worried about . . . but darned well should be. That was the situation in 1999 – 2000, as the Dotcom Bubble neared its gruesome end; and in 2007, as the Bad Mortgage Bubble did the same.

"15 Minutes to Midnight! US and Global Economies Tipping into Recession!" and "Synchronized Global Growth Collapses into Synchronized Global Slowdown!" Those two headlines capture the market's current nightmare. The first, from analysts at Citibank, was a lot more fun than the second, which surely triggered a "Synchronized what?" reaction from normal people.

Here is the Big Picture. The U.S. economy is emphatically strong, regardless of its normal trickle of mildly weak economic news. That trickle has been offset by a river of distinctly strong news for the past 10 years—and that river is still flowing. The European economy, on the other hand, is emphatically weak—slightly weaker than its 10 to 20-year normal state of weakness. And the Chinese economy can only be described as "somewhat weaker than it was a year or two ago." We don't know—and neither does anyone in China know, most likely—whether that means "sinking into recession" or "still growing decently, just slower." And we never will know, because the Chinese government wouldn't tell us even if they knew.

Pictured below is Italy—the weakest of the "big four" economies in Europe—but it captures the essence of most of Europe over the past 14 years. If we peer at the chart, we see that when times are good, economic growth in Italy runs at 0.2% to 0.5% per year. Europe as a whole is only a little better.

Italy, and Europe: Economic Growth at +1% to -1%, Forever.



This picture, and the facts behind it, are one of the saddest stories in the world. The Big Picture illustrated by this chart is simple. It shows what happens when the weight of anti-growth politics (in taxation and regulation) gets so heavy that the normal human energy and drive to improve themselves (and their businesses) can't overcome the burden. Through most of Europe, consumers and businesses have been made to carry such a heavy burden, for so long, that two bad things have happened: even the most energetic of people and businesses struggle to stagger forward; and a great many people and businesses lose the will to try.

So when today's headlines shout with alarm about "Italy in Recession!" or "German Manufacturing Sector Weakens!" along with "Brexit Uncertainty Stifles European Economy!", we must keep Europe's perpetually-weak economic background in clear view. Oddly enough, that background may be sad, but it's also slightly reassuring. For the European economy, as a whole, stagnation is a long-standing way of life. The energy and growth of the U.S. is simply beyond it—particularly because the small improvements to its anti-growth politics are moving so slowly they're hardly visible, like a glacier inching down the valley. But at the same time, every participant in European economic activity has become rather good at inching forward, somehow, despite carrying those tons of taxes and regulations on their shoulders. When the Calamity of 2008 – 2009 struck, we can see the pain above . . . but the follow-up banking crisis of 2012 may have stopped the inching ahead for 12 – 18 months, but it certainly didn't send the economy to the hospital.

We do live in a global economy. Economic sickness in Europe or China is contagious, and can infect the U.S. That, of course, is precisely the nightmare haunting the market right now. Today's Big Picture ought to make it clear that such infection can certainly happen, and would certainly weaken sales and earnings at many American companies—by an unknown amount, for an uncertain time. But the Picture also ought to remind us that “weakness in Europe and China” is a long way from “hospital time” for most U.S. companies and the U.S. economy. That 2012 – 2013 recession in Italy, also reflected in emphatic weakness through Europe, gave the U.S. economy a minor cold, at worst.

Why? That is the Big Question; that is the heart of the Big Picture.

Because, as Outlook’s clients and friends have heard so many times before, there remains a galactic difference between the vitality and financial strength of U.S. companies, as a whole, and European or Chinese companies, as a whole. It is a difference which is so remarkable that only an investment world which, by its nature, is usually obsessed by nightmares could overlook it.

This picture (from economist Scott Grannis) gets to the heart of it. Since the Calamity of 2008 – 2009, the U.S. market and the U.S. economy have tremendously outperformed Europe. The U.S. market has done so—and here’s the final part of the Big Picture—because while merely keeping up with the strong, steady growth in corporate earnings and cash flow. Except for the usual silly handful of cases like Tesla, Netflix, etc., our market has responded to those strongly rising results with anxiety, doubts and outright fear . . . keeping valuations emphatically low or reasonable, at the least. The U.S. market has been priced for disappointment for most of these 10 years, and it still is. It’s so much higher than it was a decade ago because rising corporate cash flow and earnings have simply forced it higher, regardless of its obsession with current nightmares.

That is a prescription for a long-lasting bull market, and for outstanding investment results for investors who look at the Big Picture rather than the nightmares.

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

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