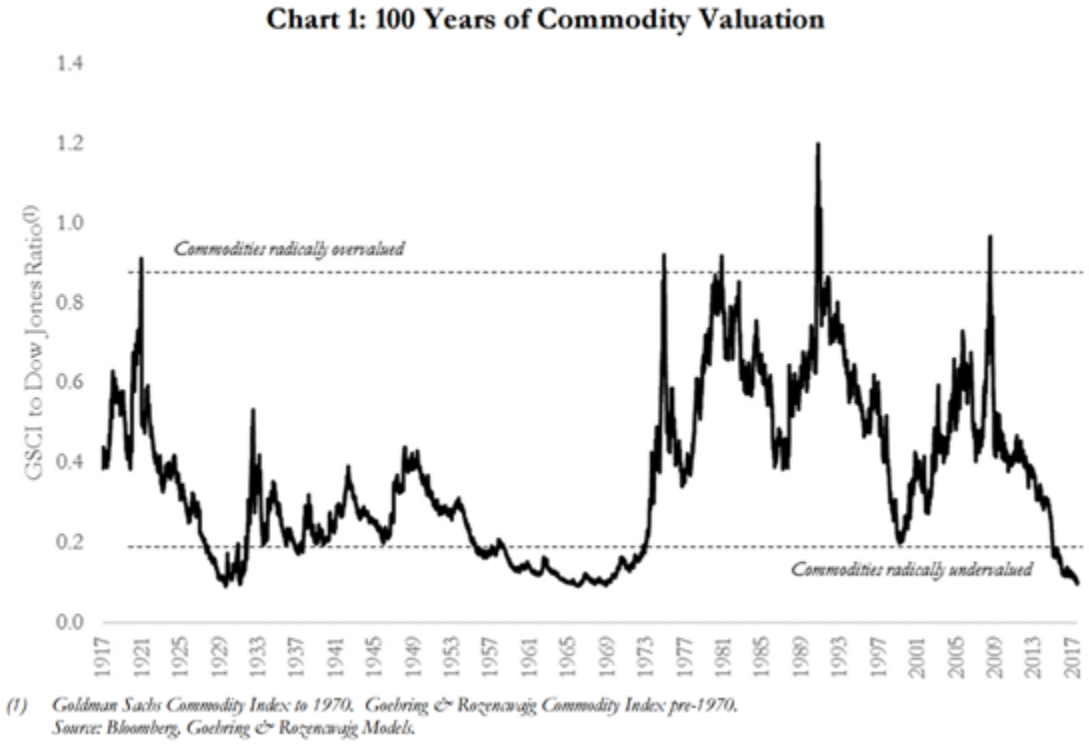
The Outlook: August 2, 2017

Cummins: can't see the turn coming . . . can see what to do.



Here's a chart which reminds us of an eternal truth: markets move in cycles. They do so because markets are just people—many people—who behave in perfectly sensible, obvious ways when prices change for things which matter to them. A stark challenge for us investors is simply to keep believing this absolute truth when it's taking an unknown amount of time to prove itself again, this time . . . and when we're naturally frightened about the personal pain we'll feel, if for some reason "this time" it doesn't work.

The chart shows the 100-year performance of commodity prices versus stock prices. The sharp spikes show insanely enthusiastic commodity prices versus stock prices; the deep valleys show the opposite. Neither peaks nor valleys last, do they?

As Outlook clients and readers know, Outlook thinks many commodities will be climbing out of their valleys over the next few years—and we're investing that way, especially with oil, copper and mining-related companies. These markets reached their abysmal depths about 18 months ago, and they're distinctly higher today . . . but we'll need them to climb very much higher, indeed, to justify our strategy. And that brings up today's $64,000 Question: "Does the real-world evidence back us up? If we study supply and demand with the biggest magnifying glass we have, and with all the expertise we can dredge up from our memory banks (or borrow from someone else), does that evidence prove, today, that we're going to be right about tomorrow?"

Here's Outlook's answer: "Nope. It strongly suggests we'll be right—but only to us, and certainly not to the big crowd of people, in the investment world, who disagree with us."

And that, in a nutshell, is why Warren Buffett's partner Charlie Munger said, a while back (roughly): "To be a great investor, it's not enough to be very smart. Of course you have to have good judgment and work hard at understanding the nitty gritty details. But you need something else, and there's no way around it: you need nerve. And that's what is rare."

To understand why Mr. Munger said this, let's take a mental sidestep. First we'll recall John Chambers, retired CEO of Cisco, who had his share of spectacular success and painful lumps over the years. Mr. Chambers was answering an analyst's question about just when an upturn in Cisco's business would happen, and his reply went something like this: "I've been at this for a few decades, now. I know my company and industry, and at Cisco we have a lot of very smart, very experienced people who probably know them even better than me. And I'll tell you this: in all those decades, we've never called the turns. We never have known, ahead of time, when either a bust or a boom will end. And that's been true despite all our inside knowledge of both our company and our customers; despite all the time we spend talking to each other about how things are looking next quarter or next year."

"Big Men" at "Big Companies" sometimes also have "Big Egos," as we've all noticed, possibly, with respect to a few of the "Big Tech" and other darlings of today: Tesla, Amazon, Netflix, Uber and plenty of others. So when a boss like Mr. Chambers makes that kind of remark, we more humble creatures do tend to nod with approval and think, "Now there's someone I might like."

Just like Mr. Chambers, the CEO's at a good many long-suffering Outlook companies—Caterpillar, Conoco, Freeport-McMoRan, Micron, Deere, Cummins—have been saying the same thing: "We don't know just when the turn will show up, just when the customers will start calling again, and plunking down cash to buy what we're selling. But we know they will eventually, because they must; and we certainly know how to get our company ready for them, with more speed and better products than before."

Cummins' CEO, Tom Linebarger, faced the analysts the other day with his company's quarterly report:

> "We're now forecasting 2017 sales to be up 9% to 11% . . . compared to our previous forecast of 4% to 7%. In China we now think sales will be up 26%, versus our previous estimate of 3%. Truck sales in China look like they'll be up 28% from last year, and 25% higher than we predicted."

Cisco's Mr. Chambers, if he were listening, would have smiled at this, because Mr. Linebarger's "previous" forecast dated all the way back to . . . three months ago. Three months ago Mr. Linebarger was saying, roughly, "We might be somewhere near the bottom of the cycle. But we just don't see any signs of a strong recovery, yet, and we don't think we'll see any for a good while."

The best people, running the strongest companies, cannot see the turns coming. When they're down in the Valley, they can only be determined to act the right way: building and strengthening for the future, because though they don't know when it'll arrive, they have absolute confidence that it will arrive. If we're wise, we investors will act exactly the same way.

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