The Outlook: Nov. 2, 2019

Friday's jobs report: a glimpse of Main Street reality for the market.

The market threw a party Friday, rising 300 points on the day's headline: "October Employment Up 128,000!" It was genuinely good news, of course—and genuinely surprising even to us optimists, because 42,000 jobs were "lost" last month due to the GM strike. Bearing the strike in mind, expert opinion thought the jobs growth number would be pretty weak: 85,000 or so. So the jobs report really blew the forecasts out of the water; especially because the prior 2 months' jobs reports were revised up by 95,000 jobs—which is not a small number.

Economist Brian Wesbury captured the real meaning of those revisions:

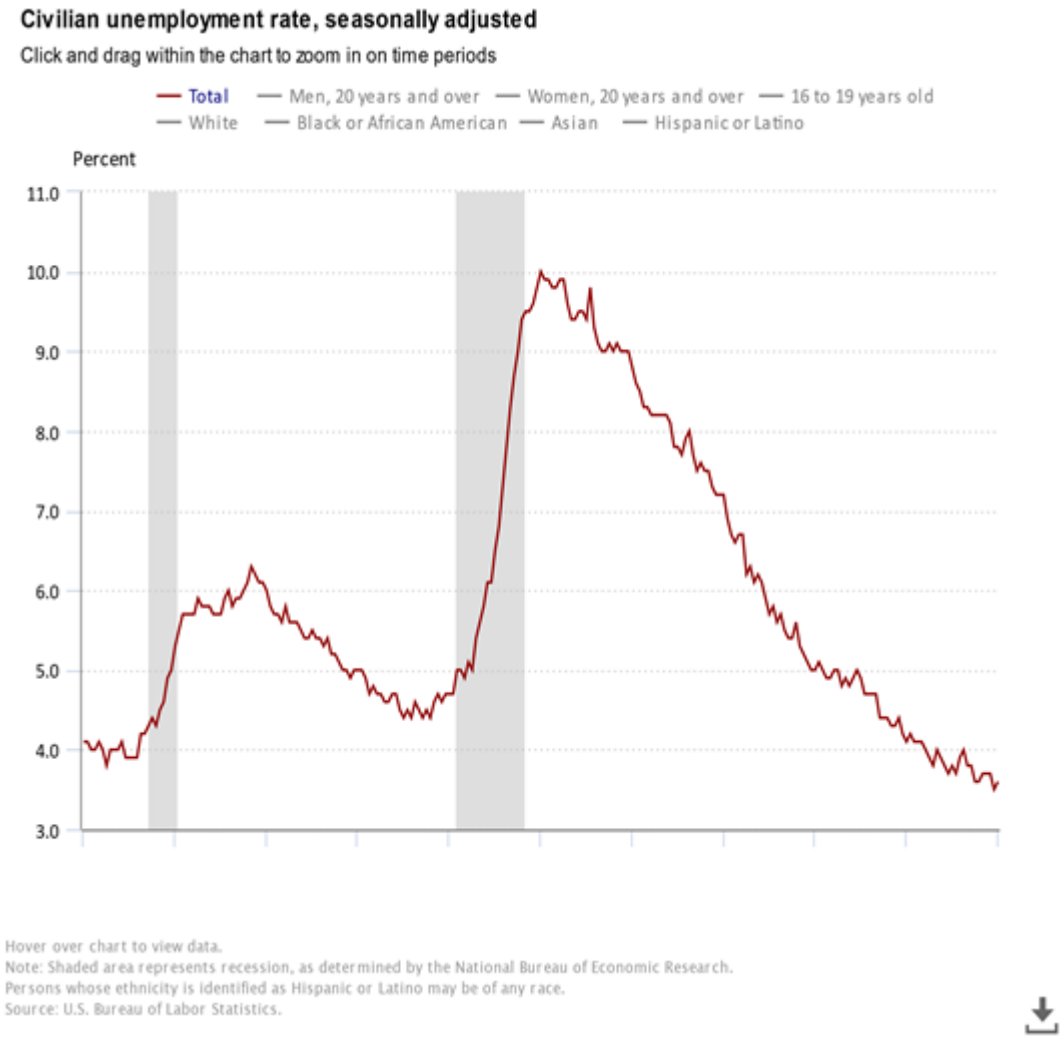
> "Remember 2 months ago, when August jobs were originally reported up "only" 130,000? That was considered "tepid" and some analysts feared a major slowdown. But that August report was revised up to 168,000 last month (from the original 130,000), and was again revised up to 219,000, today. Keep that in mind, next time we get a "soft" number."

At Outlook we've always called Quarterly Earnings Season "Reality Season," or "Facts on the Ground Season." Corporate financial statements tell us what people bought, how much they bought, and what the selling companies earned over the last 3 months . . . among many other valuable facts. The quarterly reports are facts, and they do not get revised. The government's monthly flood of economic statistics, though, are not facts. They are mostly some kind of estimate, often very rough, often based on samples and surveys—which are rather different than the dollars changing hands at cash registers which make quarterly earnings reports.

Everyone in the investment world knows all this. Everyone knows that economic statistics, trying to read the economy's current temperature, are all unreliable, and are very often significantly revised in the following months—so that it's quite common for a "tepid" or even downright "weak" figure to change its initial temperature reading from "kind of sick" to "healthy" or even "feeling wonderful" within a couple of months. Yes, everyone knows . . . but the market's giant crowd of daily speculators just doesn't care. If we were to interview a speculating "lifer," (someone good enough and lucky enough to have made a whole career out of betting on the general impressions triggered by daily headlines) he would say, "Well of course I know the statistics aren't facts. But as long as the rest of my crowd is willing to bet on the instant impressions those headlines make, I'm going to bet on them, too. And when the impressions turn out to be false, a month or two later, we'll bet on that, too."

Hence the nature of the market: a permanent roller-coaster ride; but a ride which points up over time, because the facts created on Main Street are the engine driving the train—not the initial impressions glommed upon every day by Wall Street's traders.

As those economic statistics accumulate over time, they eventually shine a pretty clear light on economic reality, as this chart shows:



That picture is one of the most amazing pictures we've seen at Outlook over the course of 42 years. It's the result of a 10-year series of monthly Employment Reports which—revised up, down or sideways—added up, finally, to a U.S. economic expansion and decade of job creation which no expert in the world thought remotely possible, 10 years ago. But that itself is not so very surprising. There is a deep and basic difference between the kinds of people who work on "Wall Street" and those who work on "Main Street." Main Street is defined by personal accountability, innovation and invention, and endless willingness to fix problems and keep competing for customers. A great many of those who live on Wall Street do not really understand how these things feel, and how life is lived, on Main Street. So they're understandably prone to reading the worst into the daily headlines, mostly; and occasionally prone to swallowing a "best" which is so far-fetched it's downright absurd (when it comes to "celebrity stocks and companies" whose valuations only make sense if they'll never face bad news or real problems.)

The practice of "reading the worst into the daily headlines" goes on until something makes it stop. That "October Jobs!" news was enough for one day, because it jolted the trading crowd into wondering if the "Trade War Killing the Global Economy" story might turn out to be more nightmare than reality. As Earnings Season has told its own story over the last two weeks, what we've seen in a nutshell is a lot of

strong companies feeling various degrees of pain from the Trade War . . . but nobody crippled. Nobody remotely close to "crippled," so far.

Last week, Cummins CEO Tom Linebarger told us how every corner of the world economy looks, at this moment, to his company and its diesel-engine, heavy-industrial customers. Almost every one of those global "corners" is in a cyclical downturn when it comes to buying Cummins' engines, Mr. Linebarger said. Then came something startling, as he went on to predict how much longer each cyclical downturn might last. We heard "one or two more quarters" a lot; we heard "two or three quarters" a few times; and we heard "maybe four quarters" once. The startling thing there was that Mr. Linebarger is the very definition of a grizzled veteran, with 30-plus years in his business, and countless cyclical upturns and downturns under his belt—he is the polar opposite of a starry-eyed optimist. Why the optimism, then? Why nothing but essentially short downturns?

Mr. Linebarger wasn't asked that question, but here is Outlook's answer. Deep, long-lasting downturns happen when too many people have been too optimistic for too long. Overly-cheerful businesses build up so much inventory, expecting endless continuing waves of buyers, that when those buyers run for the hills it takes a long time for all the inventory on the shelves to be sold or thrown away. Overly-cheerful consumers spend and borrow too much, expecting good times to last indefinitely, and when trouble arrives the spending gets cut to the bone and the debt takes a long, agonizing time to reduce to tolerable levels.

Outlook's clients and friends know that of all the unusual things happening during the last 10 years, "overly cheerful" isn't one of them. The tiny handful of "silly celebrity" stocks—Tesla, Twitter, Uber, Beyond Meat and so on—haven't been "overly cheerful," they've been "loony with happiness" . . . but despite all the attention they get, they don't count. They're exactly that "tiny handful" compared to most of the 500 giant companies in the S&P Index, and most of the thousands in the medium-sized groups. The reality on Main Street is big and medium-sized companies which have been emphatically careful since the Great Calamity ended in 2009. They built great financial strength, and they've kept it—as have U.S. consumers, whose debt-payments-to-income measures have achieved 40-year lows and stayed there, despite the spectacular employment picture shown in our top chart. We talk a lot about the endless weakness in Europe's economy, and in Japan's. The weakness is real, and it's a drag on world growth . . . but it's also meant that "overly cheerful" has been nowhere to be found in those locations either—hence no crises in consumer debt or business inventories.

That's why Mr. Linebarger is likely to be right about the mild length and depth of the cyclical downturns he sees around most of the world. Friday's U.S. jobs report just might have given the market a glimpse of the difference between its long "Trade War Nightmare" view of the world . . . and the solid strength which is perfectly obvious on most of the Main Streets of the world.

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