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Climbing out of the abyss.

Climbing Out of the Abyss: Caterpillar, 12 Months

A very experienced commodities analyst named Andrew Hecht reflected, today, on the remarkable last 12 months in the world of commodities. One year ago, around February 11th, saw abysmal low points reached among a startlingly wide range of commodities: from oil to lumber, from copper to wheat, from soybeans to aluminum. The Bear Markets which led to that awful day had lasted from 18 months (for oil, roughly) to 5 endless years (for copper.)

Looking backwards, with 20/20 vision, it's easy to see that early February marked the bottom. Sitting at our desks <u>that day</u>, though, such clarity was nonexistent. Instead it felt as if the only possible direction was even more "down," and as they always do, a tremendous number of experts came to that dismal conclusion with each passing day, supported as usual with much sophisticated analysis. Caterpillar, a long-time Outlook core company, was down in the abyss together with all those commodities. That makes sense because the global mining and energy industries are giant customers for CAT's heavy equipment, and the company was reporting the longest and most spectacularly-bad series of monthly sales declines in its entire history.

What happened next? This past year Caterpillar is up 55%, as we can see above. Oil is up around 100%, copper around 50%, agricultural items from 20% to 40%, and on and on. That's been fun, of course, for us patient investors who try to own what the market hates, but why did this happen? Did economies all over the world suddenly pick up the pace, accelerating from the painful crawls which characterized most of them? Did construction explode in the U.S., so that lumber became scarce as desperate builders bid up its price? Did long-suffering Caterpillar suddenly turn the corner, with mining and building firms lining up at the doors in Peoria, waving checks for the latest excavators?

The answers, of course, are emphatically "No!" There've been mighty few signs of any global economies perking up; and CAT is still adding to its grim but remarkable string of consecutive months of falling sales. Then why, for heaven's sake, did everything shoot up? At the risk of looking a gift horse in the mouth, why did we make so much money on Caterpillar last year?

Mr. Hecht had the answer, which is an old truth about all investing. "Speculators," he essentially said, "always drive prices down lower and longer than they have a right to go; then they always drive prices up higher and longer than anyone dreams they can go."

Oil, lumber, copper and Caterpillar reached the point, one year ago, which marked that almost imperceptible shift in thinking (if we can call it that) in the collective minds of the vast speculating crowd. We might as well describe that shift this way: "Hmm. Are these prices finally just too silly for words? Wonder if the rest of the crowd might be wondering the same thing. Right. Time to buy."

And, as always, the simple fact of rising prices helped to cast a clear light on where those prices had been, down in the February abyss, and change that first shift in thinking toward, "Well obviously those were unrealistically low levels, impossible to sustain in the long run. Obviously the actual facts of global supply and demand will push prices higher for a good while."

For patient investors, willing to use their heads and study markets and cycles (and, for example, the actual operating condition of Caterpillar), those "obvious" statements were in fact obvious long before February 11, 2016. Like it or not, we patient investors are stuck with the mob of speculators, and must endure the sometimes endless-seeming months and years before the mob decides to see the"obvious." It always does, though, in the end—and we do very well when we understand that truth.

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