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When the news turns awful . . . the golden rule.

"When the news is bad, cheer up. When the news turns downright awful, laugh and reach for your wallet."
(Yup, Outlook Capital Management.)

That's Outlook's contribution to the investment world's long list of quotable remarks . . . and we won't hold our breath waiting for someone to publish it. Of course, it expresses the golden rule of "value investing" (that is, "good investing"), which we can put this way: "Know the business operations of some strong companies very well. When they inevitably stumble and fall, or even break a leg, the market will always act as if they'll never get out of the hospital, and knock their stocks down to levels which will seem unbelievably cheap in a few years . . . for those companies which mend their legs, get up and run again."

So many financially strong companies do exactly that—mending themselves and getting back into the race, eventually—that one of the most startling aspects of the investment business is the remarkable money-making opportunities simply handed to us investors . . . if we can just stand against the crowd for a time, doing the opposite of what the crowd does, when the news is still bad.

At Outlook we were reminded of that Golden Rule more than once this week, by 3 different companies. Here are their pictures:

Kinder Morgan, 5 Years . . . Then 5%, Yesterday.

IBM, 10 Years, Dividend and Stock Price

Netflix, 5 years: Rising Stock, Falling Cash Flow

And here, briefly, is the meaning of these pictures:

- Up top, that Kinder Morgan picture looks like a broken leg, doesn't it . . . if not multiple compound fractures. But it was no such thing, to investors paying attention to this company's business operations. It was only a stumble. But the market treated the company as if its future was first the hospital, then a nursing home, and because of the peculiar nature of gas pipeline companies (for whom the stock market is also the bank, from which they get fresh cash to invest in more pipelines) the market's action meant Kinder had to spend several years changing the way it runs its business, so that it no longer needs that "bank." During those years, CEO Rich Kinder

had one basic message for investors: "OK, we have to make this change, and it'll take a few years. But we'll certainly succeed, and if you've been patient you'll get some big rewards." The market's reaction to Mr. Kinder was perfectly in character. "Patience" is a four-letter word to the market, which also means "Run for the hills and don't look back."

Then along came yesterday's quarterly earnings report. Mr. Kinder announced a 60% dividend hike, this fall . . . to be followed by 25% further hikes, the next 2 years. That means a dividend 150% higher than today's, a little more than 2 years from now. On today's stock price, that future dividend would be an 8% annual cash return. So the stock jumped 5% today, which we can see if we scrutinize the far right corner of the picture. And that circle above is where the orange dividend line will be, if Kinder Morgan makes good its promise.

- In the middle is IBM, which this week announced its 21st straight quarter of declining company sales. The stock price, in blue, tells us very clearly what the market thinks of this performance: "hospital, then nursing home." The dividend line, in orange, tells us exactly one of two sharply different things: either IBM's CEO, Ginny Rometty, is denying reality while desperately trying to salvage her stock price with dividend growth despite the company's multiple compound fractures; or she is correct when she says much the same as Mr. Kinder's been saying: "OK, we must shift our giant company toward its best chances for renewed growth. It'll take a few years, but we'll certainly succeed, and if investors are patient they'll keep getting today's cash rewards, and something better in the future." And there's that four-letter word again, "patience," and there is the market reacting in character.

"We must just stand against the crowd for a time, doing the opposite of what the crowd does, when the news is still bad." No Golden Rule is infallible; but if we insist upon following them we'll do very much better than if we ignore them, when it comes time to sit back and add up the score. And there are not many companies which better meet our Golden Rule's first condition: "financially strong companies."

- And there at the bottom is Netflix, which is sort of symmetrical since Netflix has been one of the FAANG stocks (Facebook, Amazon, Apple, Netflix and Google) skyrocketing ahead of the market for a few years. Scrutinizing the top right blue line, we see how the market passionately loved Netflix's quarterly report, in which it announced 2 million more subscribers . . . and another $500 million in quarterly cash burn (negative cash flow.) Most analysts were impressed, but one of the sour sceptics did the arithmetic this way: "Hmm. 2 million new subscribers, each paying $150 per year. The stock market gladly added $10 billion to Netflix's market value, on the news. That means the market must think each new subscriber is worth $5,000 to Netflix, which the company will indeed collect after 30 years of those $150 payments."

There are always some companies which operate this way when they're young, spending every dime they can get their hands on to build an impregnable castle for the future . . . and succeed so amazingly in the long run that they're justified in doing so, and investors end up feeling justified in buying the stock at sky-high valuations. But most don't succeed in the end. Unlike our Golden Rule, which tells us the odds are strongly <u>with</u> us when we buy strong companies while the market hates them, the Golden Rule for companies like Netflix would tell us the odds are stacked <u>against</u> us, when we buy any stock while the market loves it to the point of insanity. When we do that, we're not standing against the crowd, but diving right into the middle of it.

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