

The Outlook: Nov. 9, 2016

Election Day: Galileo versus the markets.

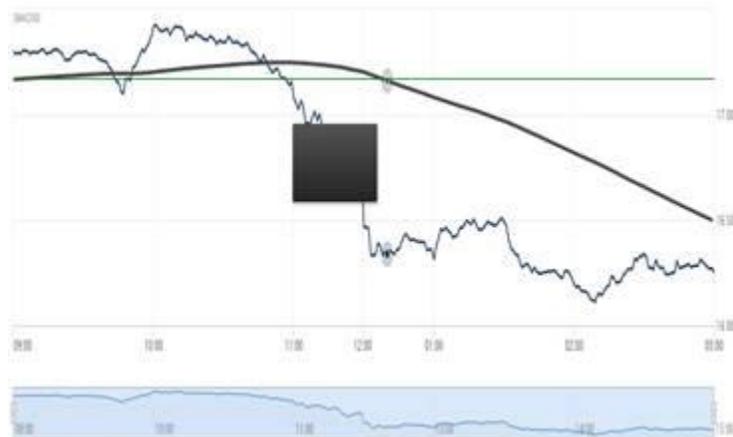
If we remember our history right, when Galileo wrote his first scholarly articles to the effect that the sun, not the earth, was at the center of the solar system, he didn't bother to lay out all the mathematical and visual proofs behind his claim. Those had already been done, by Copernicus and others, many years earlier. Galileo's own contribution was more along the lines of, "Ah, listen folks, it's just gotten too obvious to ignore. Why don't we call a spade a spade, and move on?" (It probably sounded more dignified in Latin.) And indeed, so many facts and astronomical observations had been noted, over the years, which simply didn't fit the "Earth at the center" theory, that its many defenders had been forced to create constantly-changing, incredibly elaborate new models of the solar system to account for all the contradicting evidence.

In other words, the prevailing wisdom had become so hideously complex that it defied common sense.

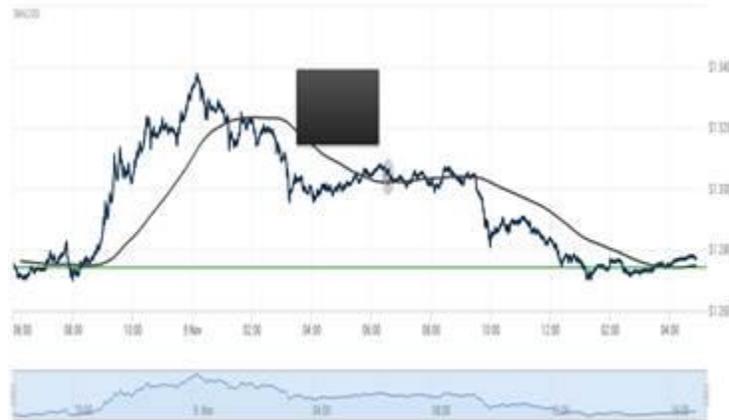
The behavior of quite a few of the world's markets, these past 24 hours, reminds Outlook of the investment world's version of the "Earth's at the Center" theory. That theory goes by many names: "efficient markets," "random walk," "capital markets theory," and more. It has been, well, "Holy Verse" in the investment world for decades now, since well before a young graduate student pondered dense, mathematical textbooks on the stock market, and wondered, "Is this *really* how investing works? I'll never make it!" Created by professors good at math and statistics, efficient market theory basically says, "The market knows all, sees all, tells all . . . and any individual is a fool if he thinks he knows better." And the theory's further implication and command is, "Nobody can identify superior values, so the whole world should just buy index funds and forget it."

If Outlook could say, in Latin, "You must be joking," we would. Efficient market theory basically asserts that a vast mob of anxious, uncertain human beings is the same thing as IBM's Watson super-computer: a cold-blooded, 100% rational calculator and weigher of evidence which continuously spits out the best judgments of value under the sun—or earth. Only a professor could still believe that, after even a few years of watching how the market behaves. Here's today's evidence that, indeed, the sun's at the center, not the Earth.

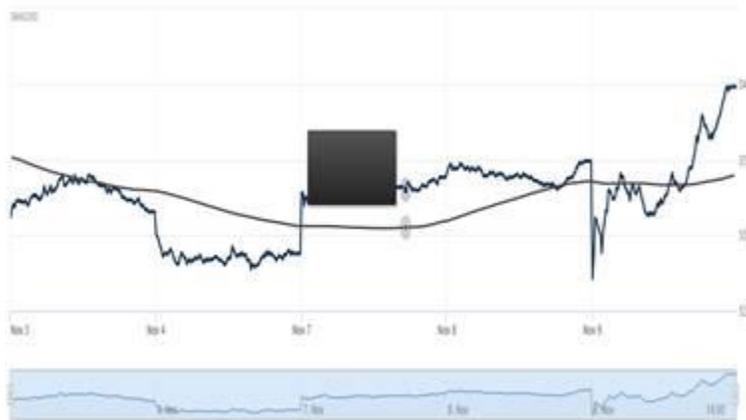
Japan's Nikkei on Election Eve



Gold on Election Day



Europe Stoxx 600 on Election Day



Yes . . . as the tide shifted toward Mr. Trump, the Japanese market plunged 7.5%; gold rocketed up 5% . . . then nose-dived the same 5%; European stocks in general cliff-dived 2-3%, then flew back up and added another couple of percent for good measure. The plunges were not quite as awful as the Brexit Plunges, but bad enough; but then the markets swung from “despair” to “giddy” before the day was out.

Why? What did the know-all, see-all, tell-all markets *actually* know? (Long silence, crickets chirping in background.)

We’ll use the defenseless Galileo’s imagined words in vain: “Nothing. It’s too obvious to ignore. Let’s just call a spade a spade, and move on.” The markets knew nothing at all about how Mr. Trump’s election might eventually affect the earnings of American, Japanese or European companies; or where gold should be valued given Mr. Trump; or oil, or any of the other markets which acted the same silly way. Knowing nothing, though, never stops us from making wild guesses, then spinning on a dime to change our minds, as long as the rest of the giant crowd seems to be feeling the same way. As we can see, that is precisely what all these markets did . . . except for Japan, which will have to wait for tonight to spin on a yen and change its mind.

This was a carbon copy of the market’s silly Brexit behavior, except that almost nobody had time to take advantage of the silly values, because the reversal happened in an hour or three, instead of two

weeks. That's progress, we guess. But it would surely be kind of fun to ask the investment world's numerous anti-Galileans, or anti-Copernicans, exactly how they reconciled Monday's ecstatic rally because Mrs. Clinton was going to win, with Wednesday's ecstatic rally because Mr. Trump won. As genuine investors we should not wait for a sensible answer. Instead we'll hang on to outstanding companies at solid values, and keep looking to buy more of them.

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