

The Outlook: Feb. 22, 2017

Trotting plow horses, smoking steel factories.

Last week we noted the great value of asking ourselves, “What is the nature of this?” before making investment judgments about anything. We might call that “Golden Rule One” for investment success and even survival. Here’s Golden Rule Two: “Look at the whole picture—all of it—not just the corner of it which some fearful or exuberant expert happens to be showing us, at the moment. A very useful—and usually enjoyable—way to begin looking at the whole picture is to call up a genuinely long-term chart, and ponder it for a while.

Here are two such charts: 20 and 25 years, respectively.



U.S. versus European Stocks, 20 years



It may be that when the CEO's at Caterpillar, Deere, Kinder Morgan, Micron or Conoco—all Outlook favorites which have been coping with some rough times for the last several years—feel a little discouraged under the weight of their problems, they glance over at poor U.S. Steel, and think, "What on earth do we have to complain about?", then cheerfully take up their burdens again. Yes . . . there's a company which has been through the market equivalent of Europe's 100 Years War, which happened a few centuries ago and lasted forever, for reasons incomprehensible.

The blue line is U.S. Steel's stock price; the orange is quarterly earnings. With a magnifying glass we can see that over the last 25 years (100 quarters), U.S. Steel lost money in about 60 of them . . . sometimes a few dollars per share, sometimes a Mariana's Trench full. We can also see that genuine rocket ride, by the stock, to \$182 per share in mid-2008, which is remarkable given that the Great Calamity and financial crisis were already rearing their terrifying heads and snarling, by then. And we can see the screaming nose-dive that followed, ending at \$6.15 per share just 13 months ago, in January 2016. Next we can see the 550% rise which followed January's abyss, resulting in today's \$40 share price. And finally, remembering to look at the whole picture, we can see no special business performance at U.S. Steel to justify that 550% joyride, as quarterly earnings did a yo-yo between \$12 of losses and \$2 of profits (but mostly showing mild losses.)

Why, then? For two reasons, in Outlook's opinion. First, as always, the screaming nose-diving pessimism was overdone by the market, creating a stock valuation too silly for words. Second, and just as important, this stock market thinks the actions and policies coming out of Washington are going to be good for U.S. economic growth—distinctly good, rather than mildly good. The market can be as wrong about that opinion as about any other "consensus opinion" it adopts from time to time. But that's what it thinks right now, regardless of the remarkable volume of political and media noise surrounding every twitch of a political eyebrow in D.C. since Election Day. So the market has done what it always does after it's overdone the pessimism, and senses that facts on the economic ground might just back up a change of opinion: ignites the rocket fuel under its target stock, and enjoys the ride.

And what is the bottom chart telling us?

Since the awful bottom of the Bear Market of 2008 – 2009, U.S. stocks have emphatically outperformed European stocks . . . after spending the previous 13 years tracking each other like shadows. Why? Again, 2 reasons. First, as always, the screaming nose-diving pessimism of 2008—2009 was overdone to a degree approaching “insanity”—way beyond “silly.” Both markets were going to enjoy a ride after that, and they did. But why the departure from that historically normal shadowing behavior?

The answer to that, in Outlook’s opinion, was plain as day. The U.S. economy recovered and grew, not strongly at all, but fairly steadily. Economist Brian Wesbury coined the best possible term: “the Plow Horse Economy.” But in Europe, if we stick with the animal analogy, only one creature fits the bill. Europe has endured a “Turtle Economy,” since 2009, moving ahead so terribly slowly that a wildlife photographer would have long since set his equipment to “time lapse” to capture the fact that there has been, indeed, some movement.

What’s going to change? Will Europe finally accelerate and the U.S. stagnate, closing that gap? Not likely, in Outlook’s opinion; and not likely, in our stock market’s opinion. The U.S. market’s treatment of U.S. Steel clearly shows what it expects: accelerating U.S. economic growth, not stagnation. It’s extremely hard to see that U.S./Europe gap closing over the next several years. It’s much easier to see the gap widening even farther, when we reflect on the continuing inability, in most of Europe, to embrace the wrenching changes involved in pro-growth economic policies, rather than the slow-growth variety.

Our Bull Market has lasted 8 years now. That’s enough for the bean-counters among investment analysts to flatly predict its doom, since it’s far beyond the historical averages. But economies and markets are their own unique, changing things—no matter what they were ten years ago, or fifty. This Plow Horse of Mr. Wesbury’s has its head up, and acts as if it’s feeling its oats rather than trudging toward the glue factory. We plan to stay buckled in for the ride.

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