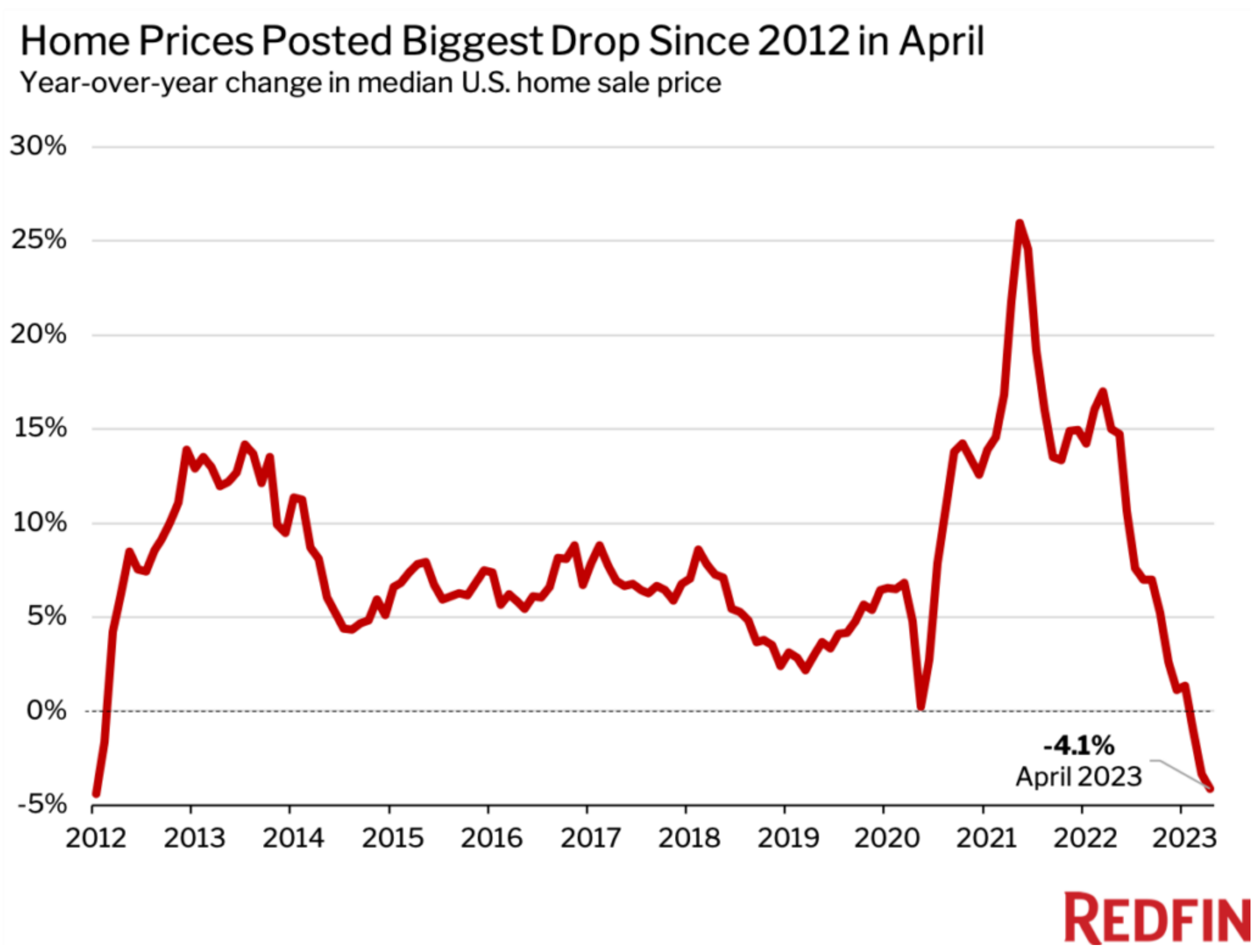
The Outlook: May 23, 2023

Nightmares and Anti-Nightmares

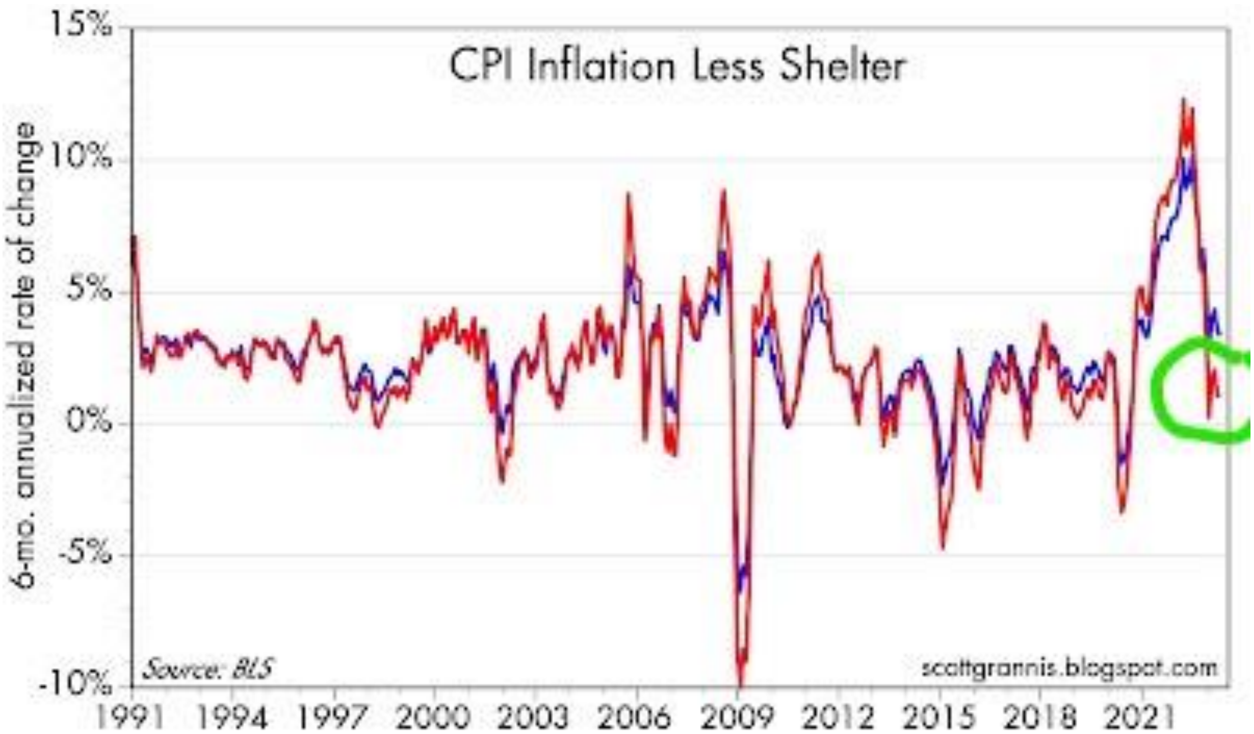
Nightmare of the Day: *"Europe's Economy Limps, Bitten by Interest Rate Hikes!"*

We investors face the market's (and the media's) "Nightmare of the Day" just about every single day of our investing careers. That's a lot of days and Nightmares. Since we're always way short of the time needed to scrutinize every Nightmare, we have to make up our minds ahead of time—for a lifetime, pretty much—which way we'll be: basically skeptical about Nightmares, or basically believers. The only possible thing to say to those who choose to believe is, "Good luck to you," as we might say to a young person who's just announced he's heading to Las Vegas with his life savings to turn it into a real fortune, but he'll also dabble in Bitcoin to achieve a more balanced investment strategy.

For the rest of us Nightmare Skeptics, to keep the Nightmares in their proper place it helps to glance at a few anti-Nightmare facts now and then. Here are a couple.



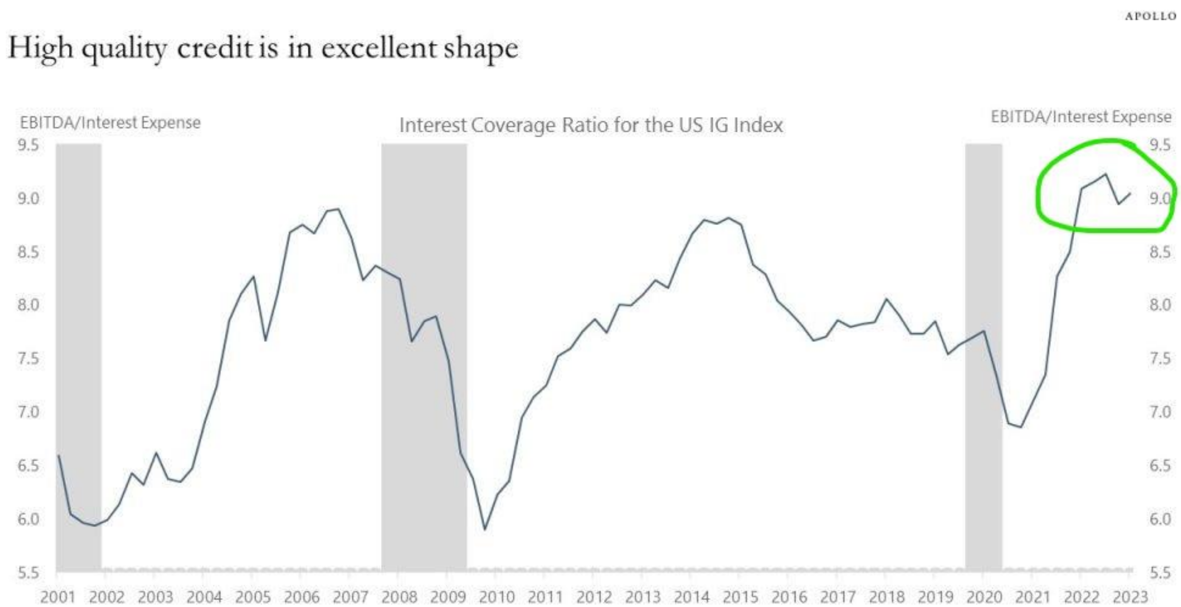
That's a historic plunge in home prices up there, and it's OK to ask, "Wow! How is that good news?" The answer will point us back at that "Europe Limps!" headline, eventually, by way of this familiar picture.



The “Nightmare of the Year,” so far, is “Inflation and Rate Hikes Forever! Or Until Main Street Rolls Over and Dies!” As we’ve noted once or twice, that green circle reminds us that by far the most powerful engine driving the inflation numbers is home prices, essentially (and a complicated estimate of rental costs based on home prices.) As the top picture shows, home prices went nuts in 2021—and so did inflation, with a lag. But it works the other way, too. That Redfin chart is just the latest vote for economist Scott Grannis’ forecast for inflation: down, down and down again . . . because that home-price engine is now running in reverse.

Eventually our Federal Reserve will accept the fact of dramatically lower inflation, and abandon its “Rate Hikes Forever!” policy. It will wait too long to do that, because it’s anxious to look like inflation’s mortal foe—having created that same inflation by grossly overdoing its 2020 – 2021 “Zero Rates Forever!” policy. Main Street will hurt, to a degree, until the Fed finally changes its mind . . . just as Europe’s economy (Main Street) is hurting to a degree for the same reason, per our Nightmare of the Day. But Main Street will not be hurt badly. Here’s the last picture.

Large U.S. Companies’ Financial Strength Near All-Time Highs



That picture shows "Big Main Street's" operating cash flows as a multiple of interest expense. The higher the better . . . and it's near all-time highs. As Outlook has observed once or twice, whether we're wondering about the survival of a hamburger stand or Microsoft during hard times, financial strength is the whole story, pretty much. When we're strong we can absorb a lot of punishment, fix problems and come back. When we're weak . . . well, we might as well take the road to Las Vegas and Bitcoin.

Main Street—and especially Outlook's kind of companies—will not be limping much or long, no matter when the Fed sees that the Inflation Nightmare is fading away under the sun. While we're waiting for that to happen, being human we always wonder if it ever will. The answer is always the same: "Yes, it will . . . and we'll be startled by the power of the upward ride, when it does."

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