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The edge of a cliff, and a mile of air below: shale oil, and Tesla.

A great many people in the investment world—including the professionals—feel that the rules of common sense and normal human behavior can't be trusted to work in that world . . . kind of like the rules of nature, which stop working correctly inside the galaxy's black holes. This feeling makes people—including many professionals, again, though they rarely admit it—feel both helpless and anxious . . . and desperate to find some source of truth, some guide to the future, which "works." Hence the great popularity of "systems."

There are thousands of "systems." No—tens or hundreds of thousands of them. For Wall Street's clever crowd, they're likely to be "quant models" dreamed up by a flock of Ph.D's. For most of the investment world's professionals and non-professionals alike, the "systems" which replace their common sense often come down, in the end, to some variation of this: "The market knows all, sees all, tells all. The market is wise and we must always listen to it. If it's acting contrary to our personal judgment and common sense, ditch the common sense and follow the market's lead."

It sounds at least slightly questionable when we say it out loud, doesn't it? And so we don't say it out loud—at least, most investors don't. But they believe it, deep down inside where we all try to keep fear tucked in a cage next to greed (which tends to roam around free, on good behavior.) When our stocks drop like a rock, and when somebody's else's stock flies like an eagle, we're all mighty tempted to toss our good judgment and common sense in jail without a trial, and do our thinking not with our minds but with our fear or greed—all the while feeling that the market is patting us on the back, whispering, "Now you're seeing the light! Run with me and you'll win. Don't fight me, you'll only lose."

"Systems" do not work. Common sense and good, uncomplicated judgments do work. We doubt them only because they so often take much longer to work than we expected.

Today's Wall Street Journal ran a story on the U.S. shale industry. It was a follow-up to one written a couple of months ago. The first story observed that a great many oil-and-gas producers in the shale sector had fallen far short, over the past few years, of the claims they'd made to investors about the vast volumes of energy-in-the-ground which they'd discovered. Today's story looked a little more narrowly at current results from shale drilling. Only a couple of years ago, all the rage in the shale world was the "new" technique of saturating a shale field with many fracking wells—far more, packed much closer together, than the techniques of even 5 years ago. In a nutshell, the shale drillers who spoke to the Journal all said, "Hmm. We appear to be shooting ourselves in the foot, when we do that. Oil production-per-well is falling faster than ever."

That last sentence is saying something, because the nature of shale wells is, to put it technically, "Whopping great fall-off's in production after Day One, essentially." The U.S. shale business has always been a hamster-on-a-treadmill operation. The faster it runs, the faster it has to run to keep the treadmill (actual oil production) going the same speed.

That fact is a mystery to nobody. Responding to that fact, our common sense and good judgment, we might think, would tell us "Hmm. The U.S. "shale fracking miracle" has been wonderful, no doubt about it. But my goodness, what a job it must do to keep it up! As we all wonder, for example, whether America's ability to supply the world with oil is so powerful it can overcome anysupply problems in the

rest of the world (supply problems in Venezuela, Mexico, Nigeria, Brazil, and most of OPEC), does our good sense tell us "Sure, indefinitely, can't see a hitch between today and the far horizon;" or does it tell us, "The ever-growing challenge of that shale-production treadmill will be a big problem, someday."

We know the answer: number two. It's not the least complicated; it's just good judgment about an obvious fact of life in the shale world. So why hasn't the oil market or the stock market agreed with us? Perhaps more accurately, why have those markets swung so wildly between grudging agreement and total disagreement?

Outlook's answer is simple: because U.S. shale production has kept going up . . . so far. No matter how educated or clever we may think we are, as investors, we're powerfully inclined to believe in whatever direction things are going, today. If they're going up, we filter our judgment through our greed, so to speak . . . and what comes out of the filter may still be "judgment" but it sure isn't "good." If they're going down, we filter our judgment through our fears, and what comes out isn't just "not good," but downright bizarre—when we look back a few years later and wonder what on earth we were thinking. Pardon the use of poor Tesla as Outlook's favorite example, but it makes the point: that stock is Wile E. Coyote riding his Acme rocket-cycle off the edge of the cliff . . . <u>before</u> grasping that between him and the hard ground is only a mile of air. It's still going up, more or less, (or at least it's high) because it's always gone up, and always been "high." Between Tesla at a couple of hundred times the earnings it might someday produce, and Ford at 6 times the earnings it's producing today . . . is only a mile of air. Like Tesla, the market is looking at shale oil's "big problem" for global oil supply with its <u>filtered</u> "judgment" today, rather than plain good judgment.

That's the market's nature, and it will not change. Also in the market's nature, though, are eyes which always finally "see" the mile of air for what it is. That never changes, either—which is exactly why we earn such extraordinary rewards for exercising our plain good judgment <u>and patience</u>, in the investment world.

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