

The Outlook: Oct. 31, 2020

From Exxon, the Halloween spirit.

Halloween is about one of the grand things in people, no matter our many flaws: the spirit of sheer, lighthearted fun. In that spirit let's look at a few horrifying pictures from the investment world, knowing in advance that they'll turn out to be the market's version of ghost stories, which mostly turn out to be as completely fictional as anything coming out of Hollywood.

The Plunging Red Arrows

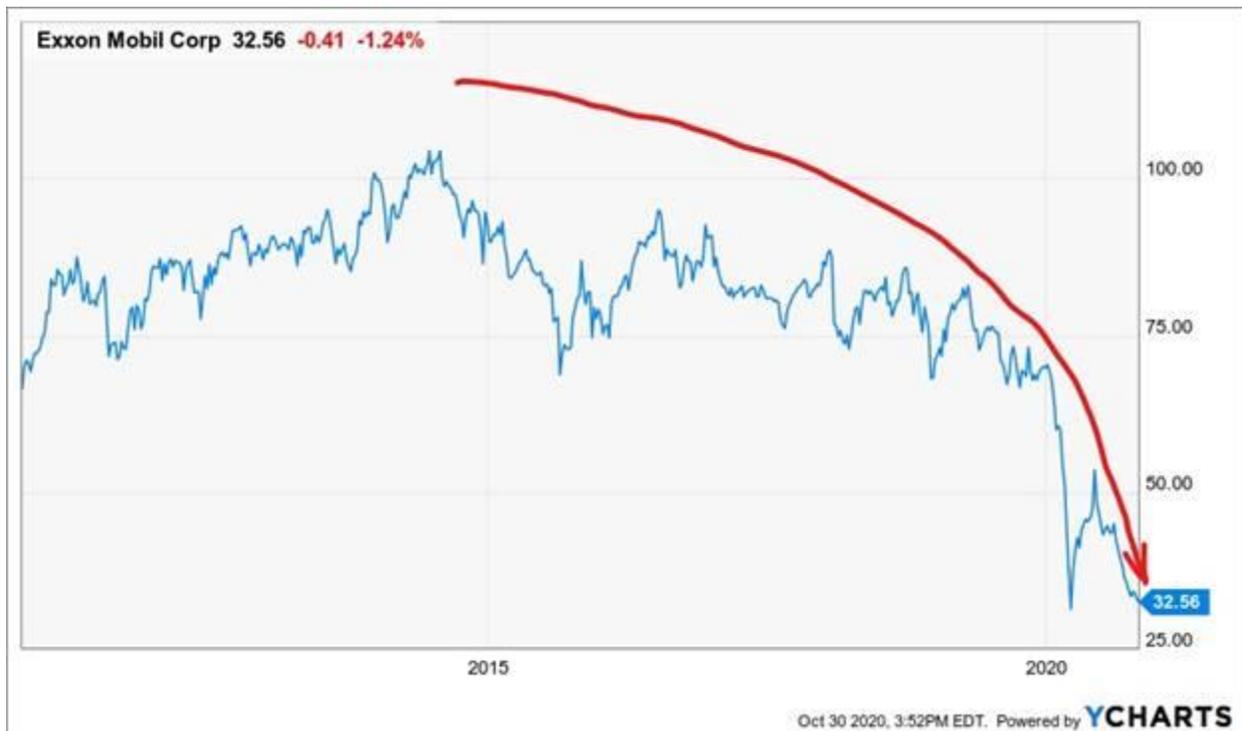
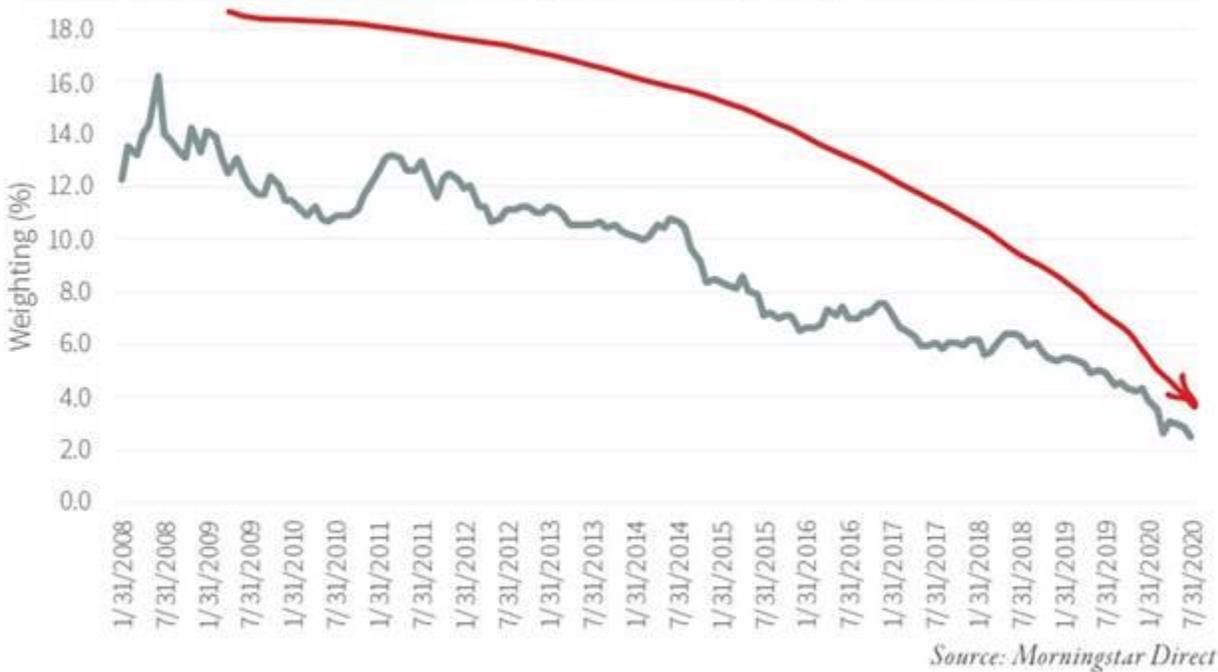


FIGURE 4 Commodity Prices Relative to the S&P 500 Index



FIGURE 1 S&P 500 Index Energy Sector Weighting 1/31/08 - 7/31/20



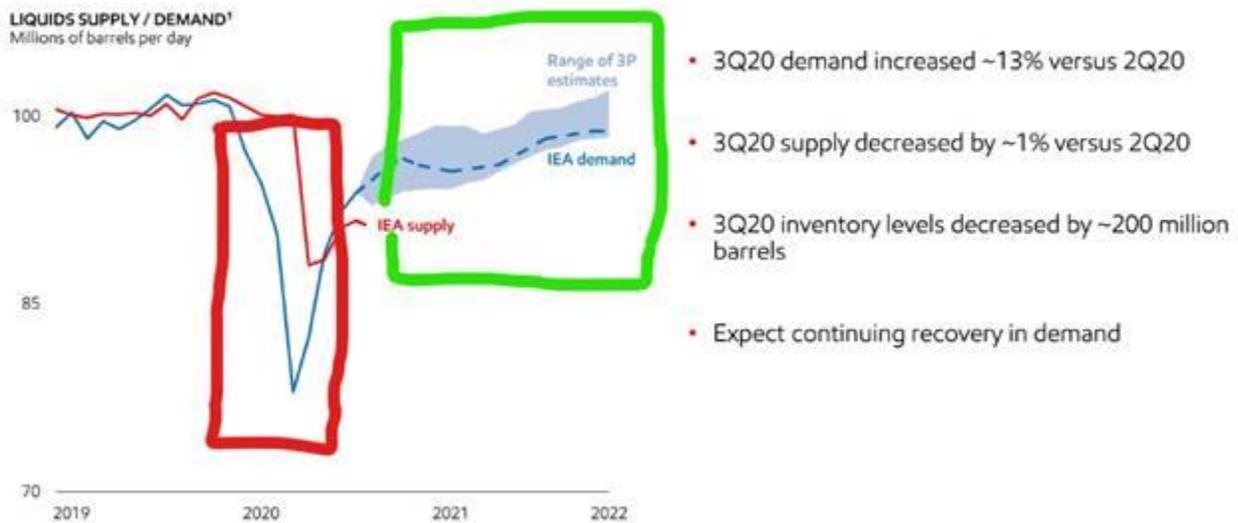
If we're normal human beings, our first reaction to those pictures of awful, endless losses is "Get me out of here!" If we're investors in Exxon, oil or commodity-related companies, our spirit of lighthearted fun has to work pretty hard to make us chuckle at the idea of our fortunes screaming downwards with the red arrows, doesn't it? No . . . we don't feel a bit like chuckling; but much worse, we also don't feel much like thinking. In the investment business, though, the deepest *meaning* of plunging red arrows is: "If we're ever going to stop and think about something, now's the time."

A famous investor once said, roughly: “There are only two rules. Rule One is, “Everything follows cycles, eventually.” Rule Two is, “The biggest chances to make or lose money come when people forget Rule One . . . which they often do.”

So that spectacular bottom chart, which tells us that in 12 years, energy stocks have plunged from 16% of the value of the whole market to only 2%, might trigger one thought: “Hmm. Has some Grim Reaper of Halloween *killed* the cycle, for energy stocks? Now that energy is only 2% of the market index, is it really going to keep plunging, to two tenths of a percent possibly? Of, just possibly, are normal cyclical forces at work, even after all this time, which will point that arrow up, believe it or not?”

Exxon released its earnings last week (which Theresa will tell us about), and it had something to say about those red arrows.

LIQUIDS SUPPLY/DEMAND BALANCE **RECOVERING**

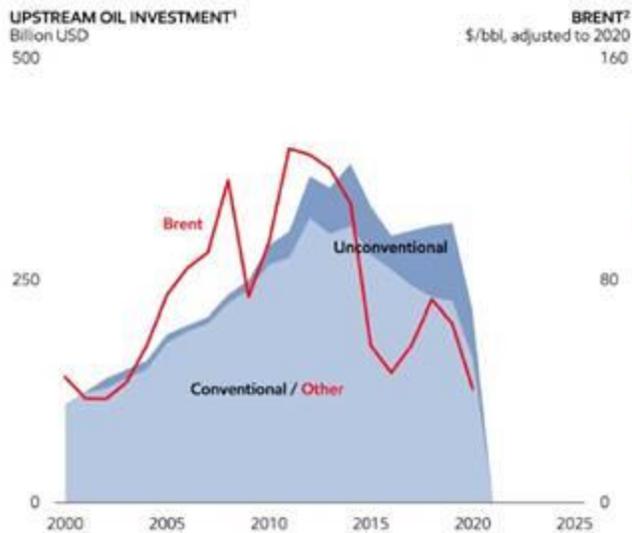


Let’s skip the complicated parts up there, and look at the red square. It shows oil demand falling like a boulder off a cliff in 2020: the Lockdowns, plus the OPEC price war. Demand fell so much faster than supply that very strange (even Halloween-like) things happened, like oil priced at minus \$20/barrel. Then what happened? In the red square, we can see oil supply dropping like a rock, after a lag. In both squares, we can see oil demand beginning to rocket up again . . . but supply stuck in slow-motion, with the barest upward bump.

There are lots of interesting things behind those lines of supply and demand, but they come down to “Low prices cure low prices, eventually, because buyers and sellers of oil react sensibly to them, eventually.” As always, the devil lies in that word “eventually”, which is also why that famous investor reminded us that people often forget “Rule One” (cycles never go away.)

Here's Exxon’s last contribution:

INDUSTRY INVESTMENT DOWN



- Investment responds to price signals
- Five year decline in supply-development spend
 - Shift to short-cycle unconventional
 - Significant further reduction with pandemic
 - Exploration at multi-decade lows
- Underlying production decline continues

“Five year decline in spending on oil supply” it says. The shaded picture, up there, is truly “horrifying.” It shows the corpse of future oil supply lying at the bottom of a 5-year cliff. Spending on new wells has been killed, and there will be a grim consequence . . . period. Just as the green square suggested, oil supply will be trying to dig itself out of the cemetery for a good long time.

With today’s Halloween headline shouting “England Locks Down Again!”, the market’s speculating crowd has its betting impression for Monday morning: “Sell! Because obviously the global economy (and oil demand) are going off the cliff again!” But they won’t, and more important, even if they did they will not stay there. The actual deadliness of the Virus is the *only* engine which could sustain the politicians’ “Lockdown Fever” and *nothing* we’ve learned in 2020 about that deadliness supports the nightmare vision of the Virus.

Not too much “lighthearted fun” up there, after all! It is easier to laugh when we’re riding green arrows, pointing up. We will.

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