<u>The Outlook: September 7, 2022</u>

The will to endure . . . and the cycle.

The investment business—and life itself—<u>constantly</u> test our "will to endure," don't they? We run into problems in life, and if we're lucky we get to the point where we see them pretty clearly, and we know there's only one good way to face them . . . and we'll need to stick with that way no matter how bad it feels at times. That's the "will to endure." At Outlook we warn new clients—especially younger ones—that investing means they'll feel bad a lot more often than good. They'll be worried most of the time; discouraged pretty often; terrified now and then . . . but they must endure anyway, never giving in to the feeling that it's not worth it, or there must surely be a lower-stress way to make money, and so on.

Yes: the market roller-coaster never quits swerving, plunging and rocketing . . . but it also never stops climbing higher in the long run. Human ingenuity, determination and freedom guarantee that fact. Those are the things we're investing in, if we understand this business.

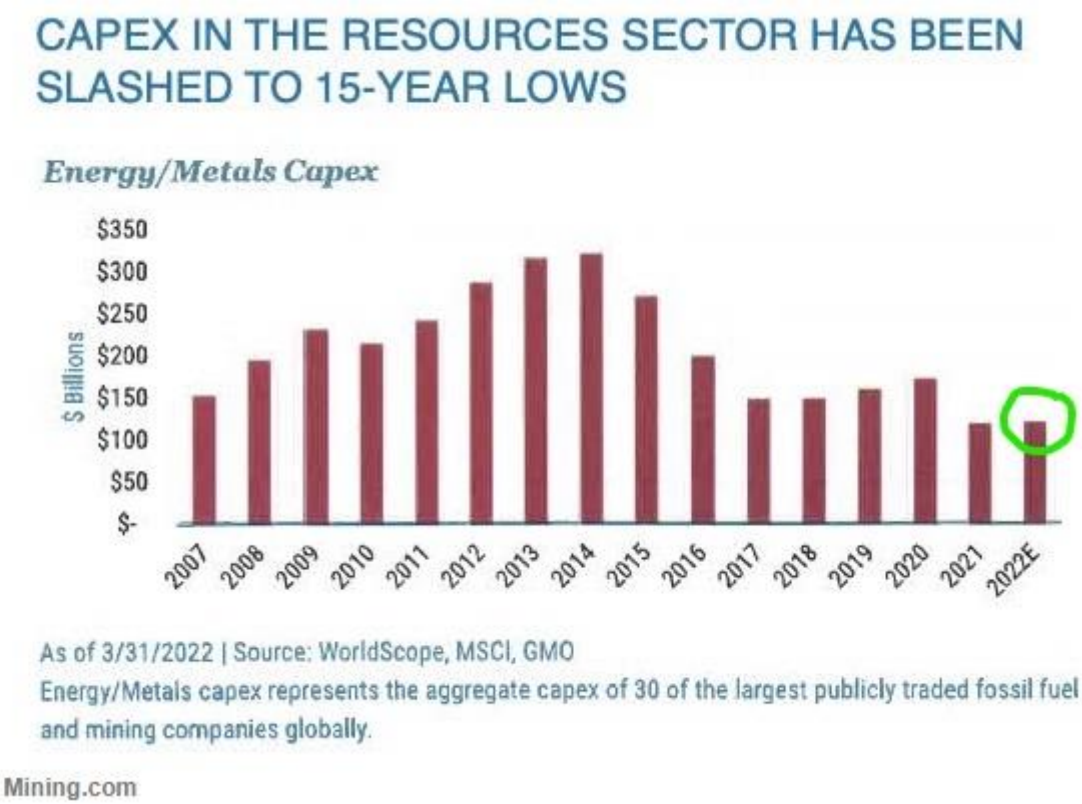
But even if we buy those principles lock, stock and barrel we all need help with our "will to endure" sometimes. We're in one of those times now: a bear market all year, pretty much, and a strengthening "impression" in the investment world that bad news is snowballing to the avalanche stage: where global recession (or worse) is impossible to avoid, and we're in for a long bear-market test of our endurance. From China's seemingly teetering economy, to "Inflation!" all over the place, to Europe's seemingly unavoidable plunge into stagflation, to America's housing market, maybe heading from "cold" to "frozen" . . . the snowballing problems already sound like the oncoming roar of an avalanche, as far as the market's betting crowd is concerned.

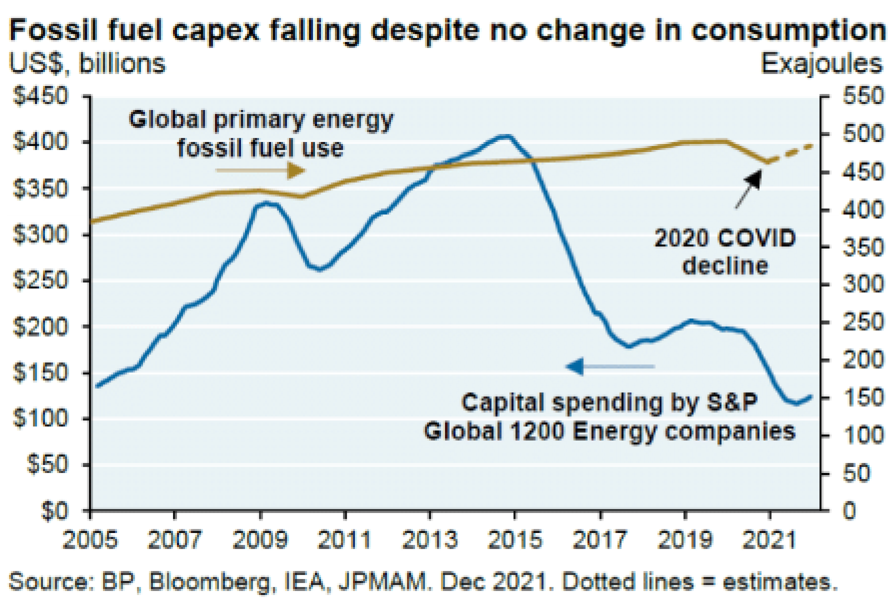
What might help us endure? Let's try one word today: the "cycle."

The cycle dominates everything we know: markets, the business world, nature itself. Yet we always have trouble believing cycles will endure, especially when we're in the "down" part of one. Then we're always surrounded by voices telling us this time it's different; this time our particular problems are so new and so bad that the old rules are broken—and we'd better not think an "up" cycle will show up to push aside today's "down." That is always nonsense . . . because cycles are in the nature of the world, and certainly in the nature of us human beings. We make them by being ourselves: acting with caution when our news is bad, because we're more worried than we should be; then "getting back to work" when the news begins to turn better, because most people just won't settle into a state of permanent despair.

Transocean is one of the world's "Drillship Kings." It was a smaller Outlook investment a while back . . . and an Outlook mistake, small or not. The company was reasonably strong, financially—but not strong enough to justify our investment. So as oil-and-gas companies slammed the brakes on deep sea drilling (which costs a lot of money) after 2014, Transocean entered its long years of trials. But this year, for the first time in all those years, Transocean sees a light at the end of its tunnel . . . because the cycle of oil-and-gas exploration is turning up.

Let's glance at a couple of pictures of that cycle.





The top picture shows the 8 years of brake-slamming in the energy and mining industries combined. The bottom one is the same thing, but only looks at oil, gas and coal. Quite a challenge to that "will to endure," wasn't it? The up cycle was long. The down cycle has been even longer.

But cycles must turn. "Must" meaning not "probably turn" but "will turn." The world needs power, especially electricity. It needs an unthinkable volume of power, when you get down to it. There is no way to meet that long-term demand for power except with more fossil-fuel energy, and with more of the commodities (like copper) which move and convert the energy. During the 8 years of stomping the spending brakes on creating more energy, the world's companies and governments were living on borrowed time. Some of them—especially the politicians in governments, naturally—persuaded themselves that they needn't worry, that renewable energies would come to the rescue, that the world's people would deny themselves some of the economic betterment which is driven by energy and power, thereby saving the planet, and so on. They're now seeing they were mistaken. "More" power and energy are so basic to human welfare—especially for the vast proportion of the world's poor—that the cheerful forecasts of the 8 dry years, which predicted flat-to-falling global energy demand, are looking, well, delusional.

And the companies in the energy-creating business know very well they face a life-and-death choice: forget the brakes and jam down the gas pedal on spending, or doom their companies to running out of anything to sell in the not-too-distant future. Here's what Transocean's CFO said on that subject:

> ***Our customers (the energy companies) are approaching us with urgency these days, quietly negotiating with us to secure the assets (oil and gas drillships) they'll need ahead. Because they know if they don't, they're not going to have anything—their competitors will have locked everything up for themselves. So they're all paying more for our ships, and we think those prices will keep rising.***

Micron is a business a galaxy away from Transocean: memory chips versus drill ships. Micron plunged into today's memory-chip downcycle without much warning earlier this year . . . which is par for the course. Suddenly all kinds of customers slammed the brakes on spending, because they'd seen the same brake-slamming process among their own customers (from cellphone makers to car companies.) Micron shrugged, having been through this too many times to count, and made some careful adjustments to its costs. "Careful" adjustments, not "dramatic" adjustments (like the energy companies after 2014) because Micron knows "the cycle will turn." Like fossil-fuel-driven energy, the world cannot do without more memory chips for very long. It will need them much sooner than the 8 years endured by the energy companies: more like 8 to 16 weeks than 8 years.

Cycles aren't just a part of economic life. They drive it. They never go away, and they never change. "Down" will be followed by "up." Strong companies make more money each "up" cycle than they did in the last one. That is why we endure.

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