<u>The Outlook: August 11, 2021</u>

Believing in nonsense . . . or making money.

The more frightened we are, the more likely we'll believe in nonsense—especially if the nonsense is cloaked in high-sounding language; and especially if "everyone else" seems to believe it.

That truth gets at the heart of one of the two things we <u>must</u> understand to succeed as investors: the nature of the market. The other thing we must understand is the nature of the real, operating businesses we own. Within the vast crowd of speculators and investors which <u>is</u> the market, most understand neither of these things. They get along OK, even so: until one day they round a corner and are hit by a market bus, or fall off a market cliff. Then, lacking the understanding, they mostly make things worse by doing just the opposite of what they ought to do.

All these profound thoughts came floating up from storage, the other day, when we glanced at this picture:

Conoco and the Price of Oil for the Last 20 Years

Oil is orange. Conoco is blue. It kind of looks like the picture of a 20-year war, doesn't it—with the wreckage of speculators' fortunes and investors' dreams strewn all over the battlefield. And the green circles? Yes . . . that's where the Two Things really mattered: understanding the company; understanding the market.

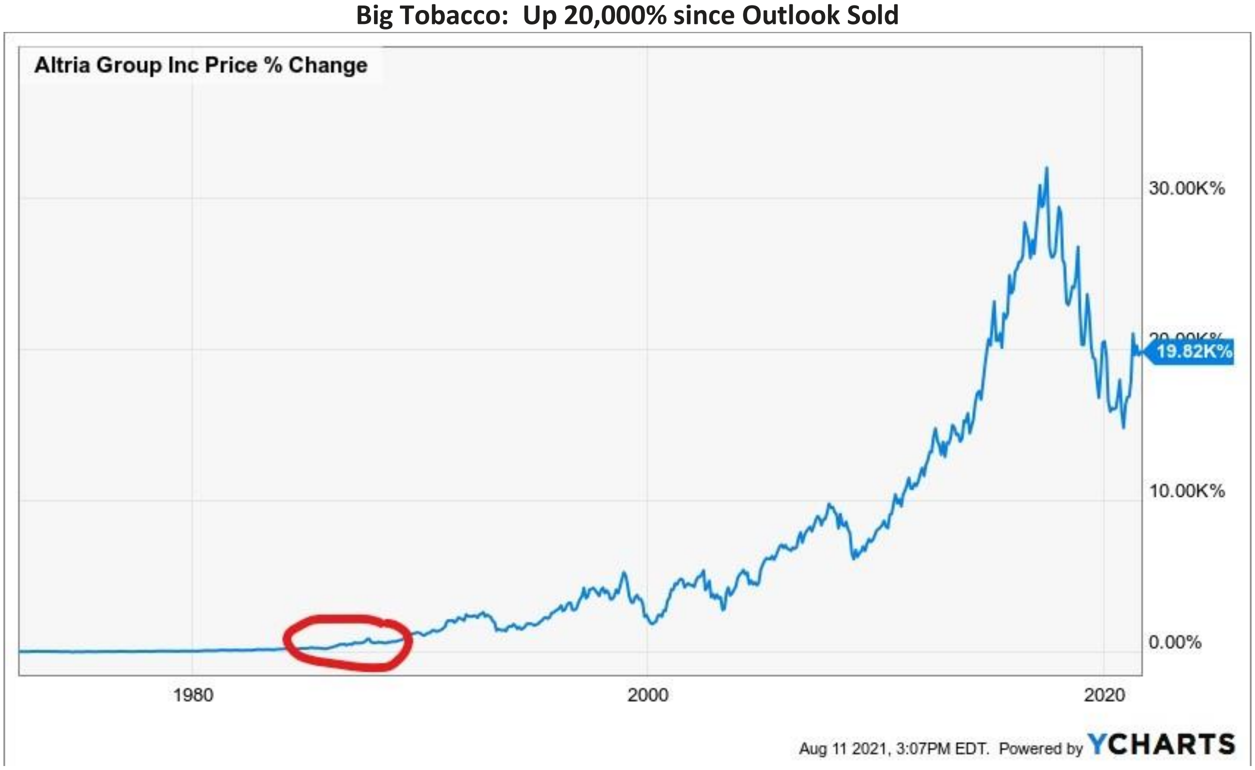
Theresa released her "Inside Conoco" report today. It showed that Conoco is an Olympic gold medalist at running a business. There is no word but "remarkable" for the tremendous financial strengthening, cash flow producing, and cost lowering which Conoco has performed for its investors, these past 5 years. CEO Ryan Lance took a decisive position several years ago: "Conoco means oil. We'll be profitable at high prices and low prices—and we'll set this company up to make tremendous profits at high prices, and return tremendous amounts of cash to our investors." He has done what he said he'd do.

That leaves us investors thinking about "Thing Two:" the oil market, and the nature of markets in general—especially within those "green circles from hell" episodes.

The market's big crowd of people has been frightened, mainly, about one thing for quite a few years now: the "end of oil" due to the waves of political clamor about its evils. This wave began as more like a trickle of talk about green energy, 20 years ago; but has reached tidal wave status lately, with nations, their leaders and many of their giant companies out-shouting each other about what they're doing to eliminate oil and save the planet. It rings a bell, for a veteran investor, recalling the all-out political assault on tobacco around 30 or 40 years ago: which may strike us laymen as a more obvious "evil", perhaps, than oil. Revealing very high greed for profits and very low morals in that distant past, Outlook owned Phillip Morris before the assault began—and sold every share as the attacks got rolling, on the grounds that owning a company under the thumb of the politicians for the rest of its life didn't seem like a good idea . . . to Outlook, or to "everyone else."

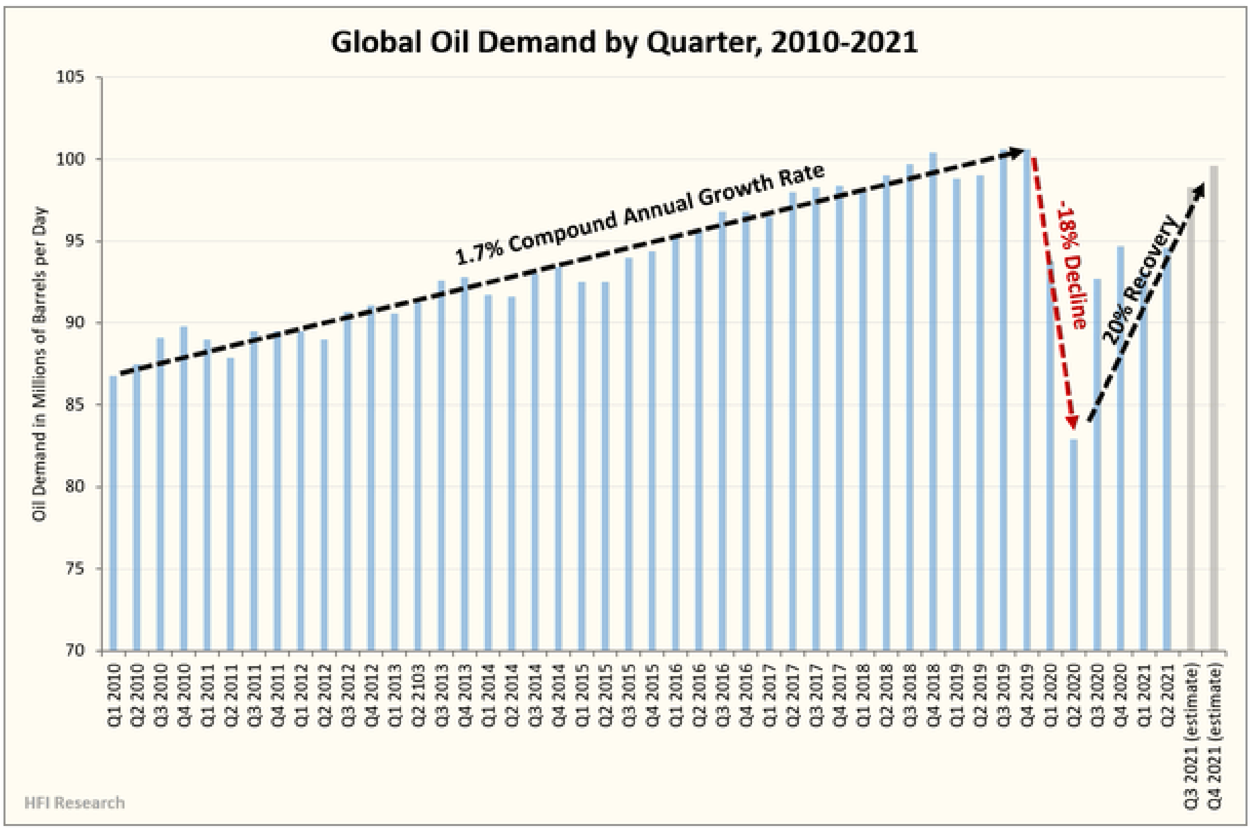
We know what happened next, don't we?

Big Tobacco: Up 20,000% since Outlook Sold



No, we didn't understand the company or the market, back then. But along with many lumps and bruises, we might have gained a little of both in the decades since. So what's going on up there with Conoco and the oil market?

Conoco, as mentioned, has made itself a Rock of Gibraltar. The crashing waves of the oil price cycle just can't hurt it much, anymore; and when that cycle turns up, cash flows into Conoco like a tidal wave. That leaves the oil market itself. Does the bad name given "oil" this last decade or so mean the world has turned its back on it—so now it's just a matter of how fast the world runs away? Hmm. Here's another picture.



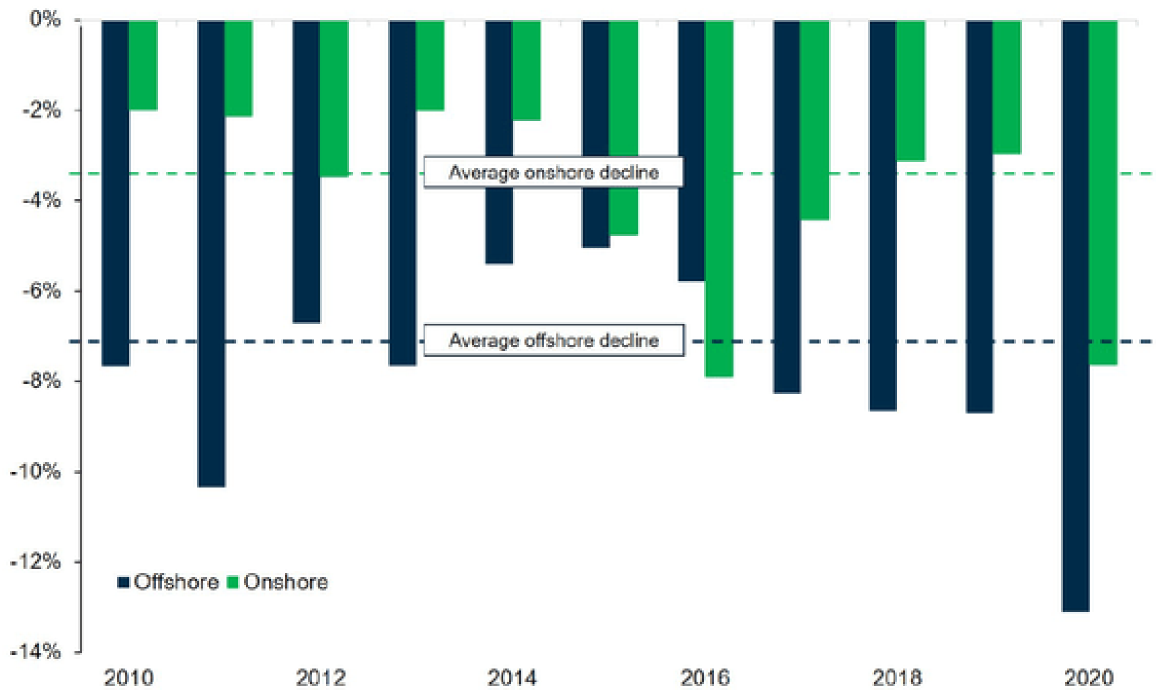
We might call this picture: "What the world does, rather than what it says." (That label fits us human beings in all kinds of ways, doesn't it?) Until the Virus and Lockdown Crisis, the amazingly slow-but-steady rise in the world's use of oil was its own Rock of Gibraltar: never up a lot, but always up a little every year no matter what. Then the world jammed the brakes on oil usage and everything else—and the speculating crowd, the political crowd and the media were very quick to shout that "Peak Oil Demand" had been seen, and the rest would be nothing but decay, thank goodness.

That was within the last green circle on the right, up top. The rocket recovery in oil demand (and everything else) has been one of the Wonders of the Economic World, historically speaking. It's as nearly certain as anything can be that the recovery is not over by a long shot. When we peer at the details within "global oil demand" (industrial output; auto travel; global air miles booked; jet fuel consumption and many more) we can only conclude that neither the Delta Variant nor anything else is likely to dent it, for a good while.

But when we peer at the details within "global oil supply" we see the opposite. Here's just one such detail, but it gets at the heart of the problem:

"Loss of $300 Billion in Oil Production Spending Will Have a Lasting Impact," says Rystad.

Figure 5: Average global decline rates for mature oil fields*



*Mature fields are defined as conventional assets which have produced for more than four years. Excludes Iran, Iraq, Kuwait, Neutral Zone, Saudi Arabia, Qatar, UAE, Libya, Nigeria, Venezuela and Russia.   Source: Rystad Energy UCube

When oil prices plunged toward zero and below, during the Lockdown Crisis (and the Saudi/Russia Price War, at the same time), oil producers did what they simply had to do: *stop spending money*. Those who were weak went bankrupt, by the dozens and then the hundreds. The trouble was, early 2020 was not the beginning of the "Stop Spending!" panic. It had gotten rolling after oil's peak in 2014, as the price fell from $105 to $30 per barrel. That kind of thing will shell-shock the toughest oil boss, and oil's spending on production and exploration never recovered. The 2020 Lockdown Crisis was just the latest hammer blow, not the first.

The picture above shows what happens when producers stop spending to find and lift more oil. The flow slows down; in most fields, it slows down with appalling speed. The world is now in Year 6 of these spending cuts, and as oil consultant Rystad says, up there, "it will have a lasting impact." Oil supply is getting tougher and tougher. Oil demand is like a glacier sliding downhill: very hard to reverse or slow, once we understand how deeply it's entrenched in global economic activity, for a rather long number of years to come. Sounds kind of like copper, doesn't it? At Outlook we think so—and we aim to own these companies for a good while.

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