<u>The Outlook: Sept. 11, 2020</u>

Conoco: "Truth is found in simplicity."

On a Friday it's good to begin with a quotation.

"Truth is found in simplicity, and not in the multiplicity and confusion of things."
Isaac Newton

That takes us straight to yet another Golden Rule of investing (courtesy of Outlook Capital Management): "If we can't say very simply why we own a company, either we shouldn't have bought it or we'll probably sell it when we shouldn't." That Rule is most especially true of "value" stocks, which have a habit of torturing their investors for shockingly long times before finally doing what they're supposed to do. We like value stocks very much at Outlook Capital Management—so we get lots of chances to remind ourselves, simply, why we own our companies. Here's a *<u>long</u>* term picture of Conoco.

Conoco, 40 Years: Stock Price (blue) and Oil Price (orange)

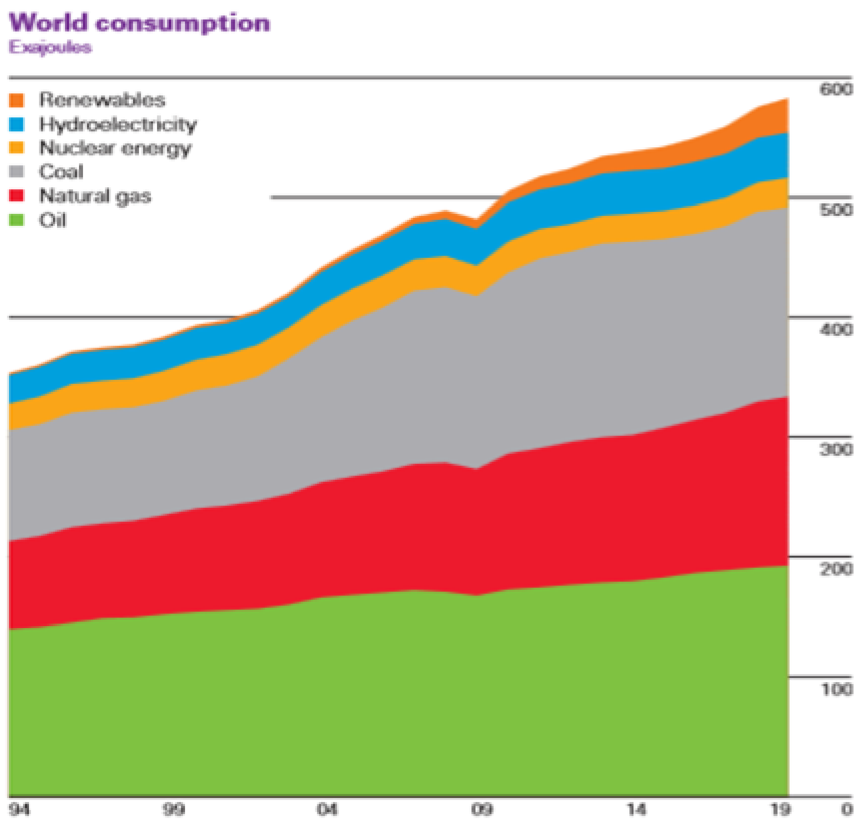
Conoco always dances to the oil market's tune, being a pure exploration-and-production company. Every dollar's change in the price of oil means a lot to Conoco. As simply as possible, why do we own such a wild roller-coaster of a stock?

Because we're waiting for supply and demand in the oil market to do what they always do.

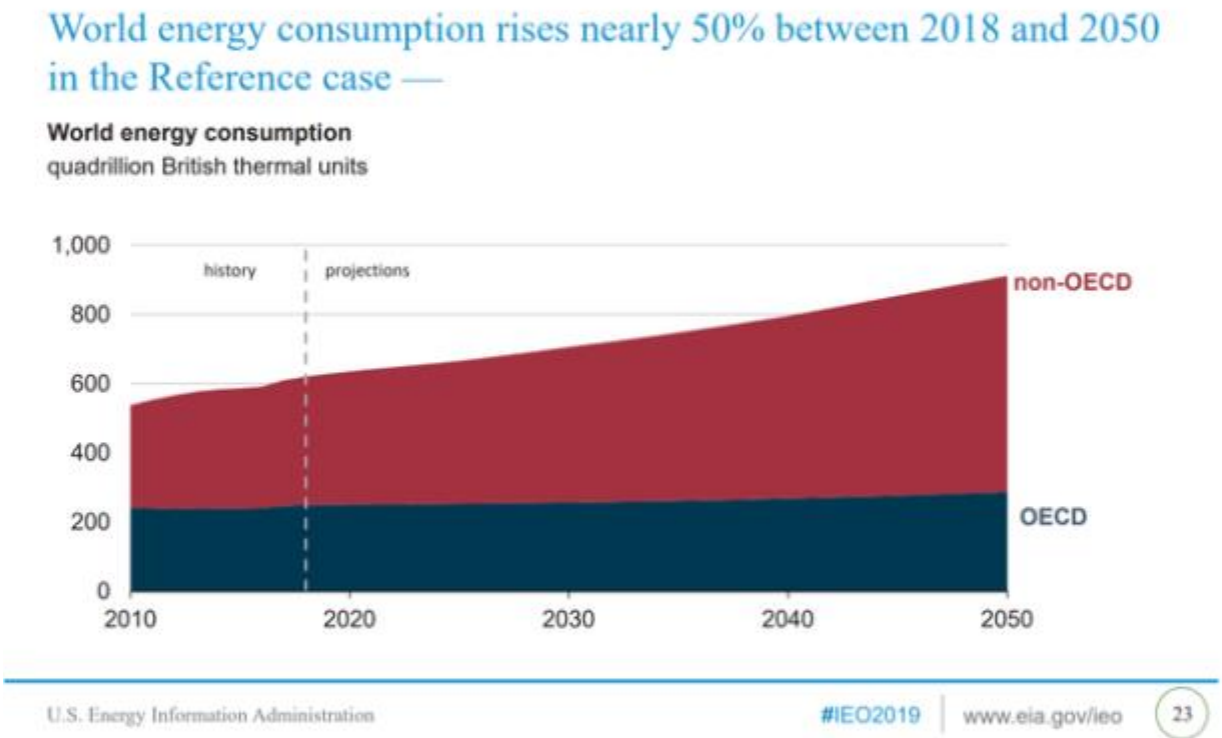
When a free market plunges, supply dries up and demand accelerates . . . eventually. When a free market rockets up, supply accelerates and demand dries up . . . eventually. They do those things because people (and companies run by people) do sensible, inevitable things in response to sharply higher or lower prices. But take their own sweet time doing them, with endless starts, stops, reversals of direction and periods of confusion . . . because that's how people react to "big things" which happen to them. So we investors are stuck with one of the harshest four-letter words of all: ***"wait."***

The market's vast crowd of daily speculators can't spell that word, when it comes down to it. They don't do "waiting." Those red circles above, which mark the last 5 plunges in the oil market, had one thing in common: most of the investment world—from speculators to hedge-fund gurus to economists and oil analysts—could not bring themselves to believe the oil market had any serious upside potential. (So neither did Conoco or any other business tied to the price of oil.) They shared this pessimism, despite a lot of expertise, because we are all powerfully inclined to feel that bad news, if it's in front of us today, will never fade away—so the "analytical" side of our brains finds the ever-present reasons for pessimism very persuasive.

They were wrong every time, of course. We usually are, when we let our doubts and fears do our thinking. Here's the simplest way to picture our thinking at Outlook, in support of our confidence in "waiting."



This chart shows 25 years of world energy consumption, and the sources of the energy we've used. The striking thing about this chart isn't so much the steady growth in energy consumed (driven mainly by growing prosperity in the world's formerly poor countries) but the massive share of that energy supplied by the old "big three": oil, natural gas and coal. All three simply keep growing, slowly but steadily,and the reason is also simple: because they give more energy, more cheaply, than anything else . . . and that's pretty crucial to people climbing from "poverty" to "getting ahead." That takes us straight to the picture below, which is the Energy Information Administration's forecast for energy consumption out to 2050.



The red section, non-OECD, is basically that "from poverty to getting-ahead" group . . . which is very large indeed.

Here's another simple thing to say about owning Conoco. Short of a decade or two of global depression, oil is irreplaceable as a cheap energy source to meet that massive, steadily-growing demand. "Renewables" like wind and solar are interesting and gradually improving . . . but the idea that they'll replace much of the "big three" of oil, gas and coal over the next couple of decades doesn't meet the test of arithmetic. The differences in scale are just too big to make that practical . . . and the cost to the global economy of trying to significantly accelerate that replacement would be simply staggering. That's why the "EIA," which is certainly friendly to the idea of renewables, still thinks the "big three" will be the major sources of global energy in 30 years.

So we "wait for the oil market to do what it always does." Conoco, however, has done nothing at all like "just wait." As we've noted pretty often, our company has approached the neighborhood of "amazing" in knocking down debt, cutting production costs, and focusing itself on the most-profitable fields for oil exploration and production in the future. Like all great companies which must follow some kind of cycle, Conoco has set itself up for explosively higher earnings (and cash dividend-paying potential) when that cycle finally turns up and runs up for a while. In the top chart, that green arrow at the "lower $40's" is where Outlook generally bought Conoco for clients, during the somewhat terrifying downcycle of 2014 – 2016. It wasn't the low. It never is, except for a lucky moment now and then. But we expect it to be very far indeed from the highs we'll be seeing in the next few years.

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