The Outlook: June 20, 2017

Oil: like CAT equipment, "most definitely" fixing itself.

Oil Falls Into Bear Market Amid Worries Over Glut!

Energy Sector on Track for Worst One-Day Drop Since March!

Since, at Outlook, we are emphatically betting on a Bull Market in oil, not a Bear Market, today's headlines prodded our nerves, testing to see if they might be stretched from merely "sensitive" to "raw" or possibly even "jangled." And just to pile on, one of the sub-stories quoted the usual hedge fund guru along these lines: "John Kilduff, founding partner at Again Capital, told CNBC that oil prices "most definitely" are heading to $40 and likely into the upper $30's."

When we investors hear someone use words like "most definitely" to make a short-term prediction, we know there are only 2 possibilities: either the speaker is young, and foolish; or the speaker is a veteran, and knows better, but wishes to sell the impression that his vision runs beyond what we mortals can see. Outlook's response to Mr. Kilduff would be a wishy-washy "maybe . . . or maybe not." Markets can do just about anything in the short run, even when they're proceeding up the long, undulating path of a Bull Market. And regarding that path, Outlook will not be wishy-washy. "Markets fix themselves. After falling long and hard enough, they will rise. Oil will do exactly that."

In the past we've talked about the specific ways in which the oil market is "fixing itself:" a galactic-scale cutback in global exploration-and-production spending; the physical law of nature which rules that oil-field production always declines (with the declines only slowed somewhat by the kind of big spending which has been cut so sharply); and the normal human (and worldwide) response to lower prices—more demand. All of these inevitable changes in oil supply and demand move not in smooth paths but in fits and starts—which always encourages those who think "This time it's different! This time, this oil market won't fix itself, and we might never see a bull market again."

Let's take a slightly different look at the "Bear Market! Glut!" headlines, this time, courtesy of HFI Research (probably Outlook's favorite energy-analysis firm.) Commenting on the second headline above, HFI noted the cliff-dives performed by oil company stocks—which made some degree of sense in a market whose momentary speculative opinion is "Sell and run for the hills"—but asked a great question: "Why on earth are the oil-and-gas pipeline stocks doing the same cliff-dive?"

Those are companies like Kinder Morgan and Enterprise Products, Outlook core companies which move oil and gas from U.S. shale fields, where they are pumped out of the ground, to Commonwealth Edison and friends, where they're burned. As HFI wryly observed, the whole idea behind the "Oil Bear Market and Glut" is that U.S. shale fields are running amuck once again, scattering mile-deep drilling rigs across every vacant acre in Texas and North Dakota, and possibly in people's back yards too, if the kids aren't playing there this afternoon . . . and the returning explosion in U.S. production will swamp any feeble attempts by OPEC and friends to cut back their production, to keep prices up. So, HFI asked, if that's how things are going to work, won't there be a tidal wave of oil and gas flowing through Kinder and Enterprise pipelines? Why on Earth would anyone be selling those companies as they tremble on the edge of a tidal wave of new revenue? (Pipelines, of course, simply charge a toll on the volume of energy flowing through their networks.)

The answer, as always, is that speculative bandwagons do not think, they just roll along—for a while—flattening anyone who stands against them. That is their nature, and the result is always remarkable bargains in the market which go unseized—for a while—because people are naturally afraid to pick up something cheap when it's rolling downhill, and Mr. Kilduff and friends are strident about how steep the hill is, and how much farther it has to roll. The value of HFI's observation is that it confirms that this bandwagon is acting perfectly in character: big momentum, small brain.

Let's close with a seeming sidestep. Every single month Caterpillar tells the world, in detail, how sales of its machines are doing all over the world. For a really ghastly period of time—3 years, maybe 4, merciful time blurs the memory of such pain—CAT's reports have been like watching a horror movie with no ending—just going on and on, each scene more gruesome than the last. We Caterpillar friends (and surely we're a thin little band) got to a kind of speechless admiration of how anything could be that bad, that long. CAT's sceptics and short-sellers (who numbered as the stars in the sky) vied, quarter after quarter, to write ever more pessimistic analyses of the company, whose general sense has been "No turnaround in sight, it'll take years to work off the global glut of used CAT machines at plunging prices, Caterpillar is a doomed investment from here to eternity." And here is CAT's monthly report, issued today:

Asia/Pacific	**UP 49%**	UP 47%	UP 46%
EAME	DOWN 6%	DOWN 10%	DOWN 3%
Latin America	DOWN 15%	DOWN 30%	DOWN 25%
North America	UP 2%	DOWN 7%	DOWN 13%
World	UP 8%	UP 1%	UP 1%
Resources Industries	**May 2017**	**April 2017**	**March 2017**
Asia/Pacific	**UP 34%**	DOWN 6%	DOWN 1%
EAME	Unchanged	DOWN 8%	UP 23%
Latin America	DOWN 50%	DOWN 69%	DOWN 53%
North America	DOWN 3%	DOWN 13%	DOWN 34%
World	DOWN 3%	DOWN 19%	DOWN 19%
Construction Industries	**May 2017**	**April 2017**	**March 2017**
Asia/Pacific	**UP 52%**	UP 59%	UP 56%
EAME	DOWN 7%	DOWN 11%	DOWN 10%

Latin America	UP 9%	UP 3%	DOWN 1%
North America	UP 4%	DOWN 4%	DOWN 6%
World	UP 11%	UP 8%	UP 7%

Just glance at the red numbers. "Total Machines" up 49% in CAT's Asia Pacific market. "Mining" up 34%, same place. "Construction" up 52%, same place. "World Total Machines" up 8%. They're only pieces of CAT's big picture, which still shows plenty of that terrible weakness, scattered around. But up until a few months ago (possibly up until this morning) nobody—including Mr. Kilduff and his countless peers—thought this could happen. But it did, and the reason why is perfectly clear. Markets cure themselves—oil, copper, tractors, mining trucks, chocolate, whatever. Buyers and sellers respond sensibly to sharply falling prices—in fits and starts, but always sensibly—and their sensible changes to supply and demand make the market turn around, after a while. The oil market will turn around, just like Caterpillar's equipment market turned around. The bandwagon-riders just don't like to wait . . . and so they hand the remarkable bargains to us.

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