# The Outlook: April 21, 2020

***"Oil Below Zero!" The oil kings begin to follow Micron's footsteps, from 2012.***

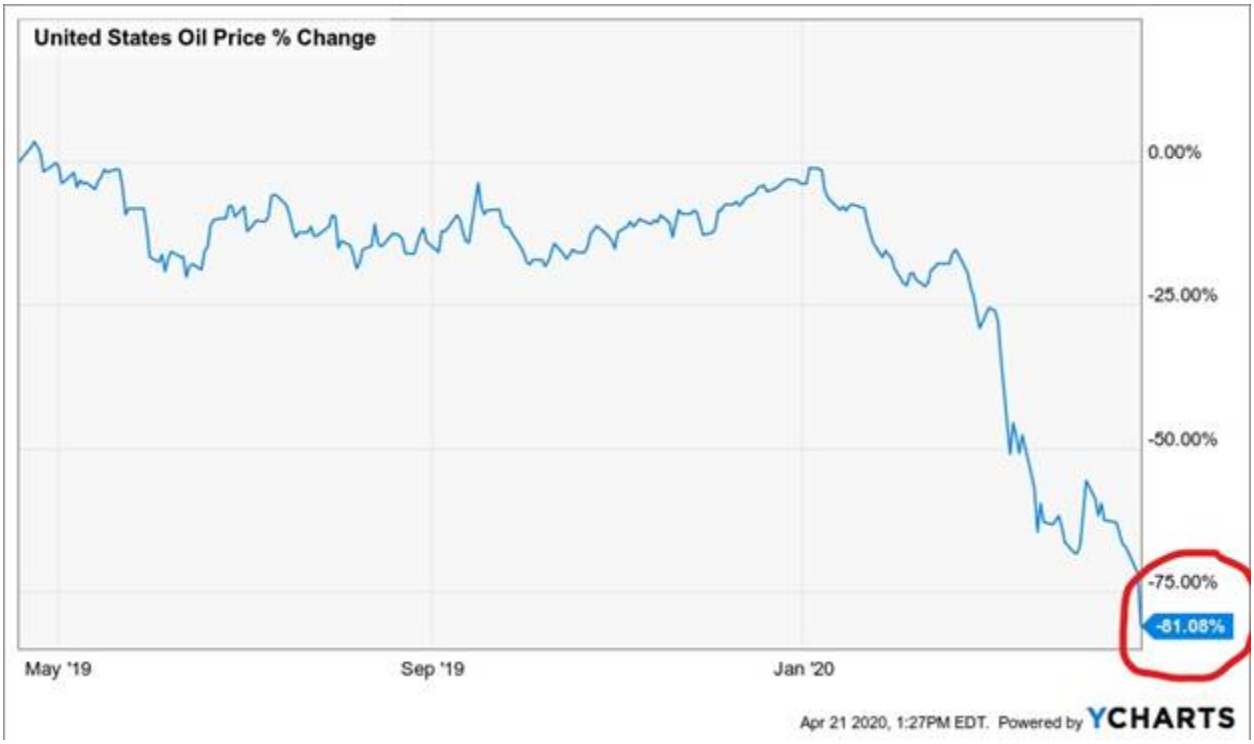
"Oil Dives Below $0 for the First Time in History!" That was the headline of the day just about everywhere in the investment world, today. And the stories under the headlines have been highly interesting and almost fun, as long as we don't care what our oil companies are "worth" at the moment.

The stories painted pictures of oil tankers wandering the oceans, stuffed with oil right up to the hatches, being turned away at port after port by former buyers telling the captains, "Where do you think we're going to put this stuff? In our basements? Nobody's buying! Go sail around somewhere!" Or of Texas shale-oil producers having, yes, "Twilight Zone" conversations with oil brokers and pipeline companies: "OK, look. I'll pay you $35/barrel to take my oil off my hands!" only to be shoved aside by the next shale man, "Don't be a sucker! He's trying to rip you off! I'll pay you $40/barrel to take my oil!" (Just as a guide through this Twilight Zone, those conversations are supposed to go the other way around. Buyers do normally pay sellers for things, not the other way around.)

But strange things happen in strange times, and if these aren't "strange times," we might as well drop that word from the dictionary. The global Virus Shutdown has caused world oil demand to fall like a boulder off a cliff. Stunned global oil producers instantly cut costs in almost every possible way except "shutting off the taps" themselves, so to speak—because once shut, many taps will never re-open, or only be able to produce a trickle compared to past torrents, if they do re-open. But with taps still open, and oil still pumping out of the ground and ocean, but nobody buying, storage tanks and empty oil tankers began filling up with terrifying speed. Pretty soon, the only storage space left will be the buyers' basements, more or less. In a nutshell, that's why the "the buyer pays the seller" concept went upside down in Texas yesterday. (For purists, there is more to it than that, involving near-term futures contracts reaching settlement date, and speculators holding those contracts suffering the same fate as the Duke brothers in *Trading Places*, watching their financial empire go "poof!" as frozen orange juice futures fell off a cliff. But the heart of the story is simply "Too much oil to sell, nobody buying.")

That's a dramatic story all right. But there were one or two parts of the picture which were pretty strange, even for a picture as strange as this. This first part of the picture sets the stage.

**West Texas Oil: Down 80% Year to Date**

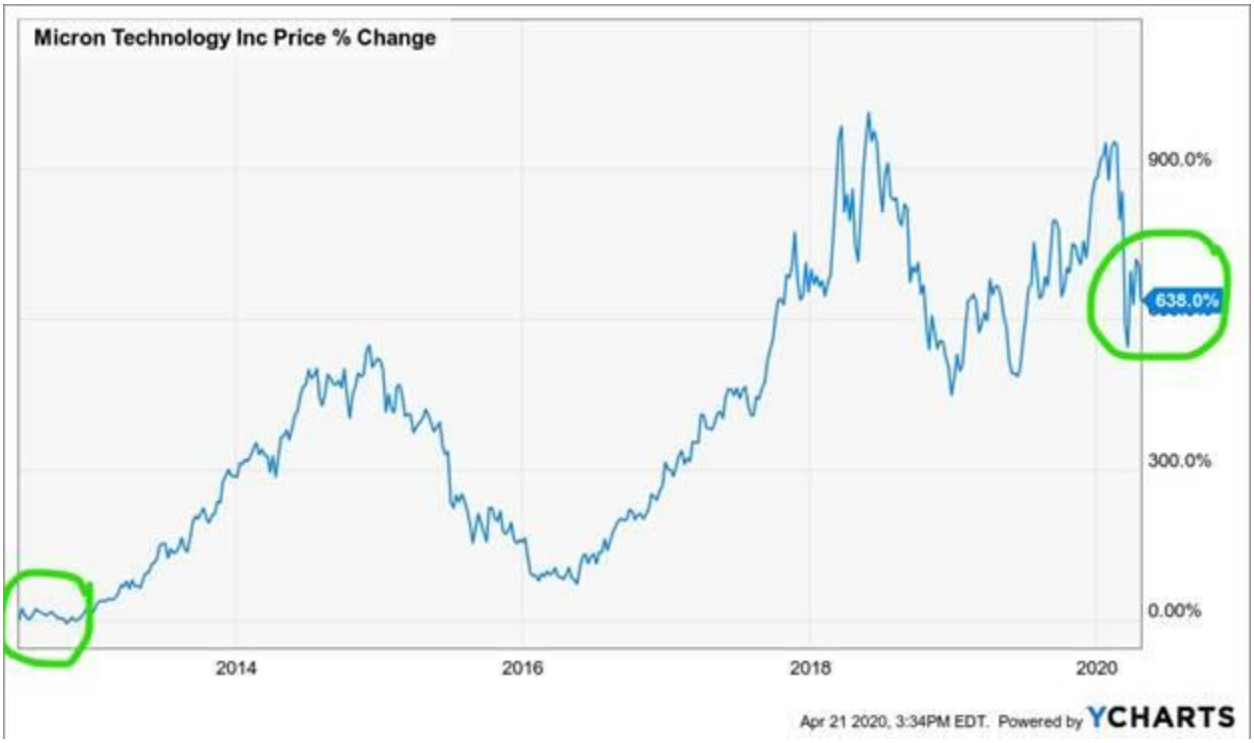



That's not too strange; it fits the story under those headlines. Now let's glance at the next one:

| Symbol | Name | Price | Change | % Chg | Y-Rating |
|---|---|---|---|---|---|
| CAT | Caterpillar Inc | 110.69 | -3.91 | -3.41% | Neutral |
| CME | CME Group Inc | 178.85 | -5.77 | -3.13% | Neutral |
| CMI | Cummins Inc | 142.66 | -3.44 | -2.35% | Neutral |
| COP | ConocoPhillips | 33.46 | -1.11 | -3.21% | Neutral |
| FCX | Freeport-McMoRan Inc | 7.45 | -0.57 | -7.11% | Avoid |
| LMT | Lockheed Martin Corp | 375.02 | -8.19 | -2.14% | Neutral |
| MSFT | Microsoft Corp | 169.61 | -5.45 | -3.11% | Neutral |
| MU | Micron Technology Inc | 41.77 | -1.63 | -3.76% | Neutral |
| RDS.B | Royal Dutch Shell PLC | 32.16 | -0.55 | -1.68% | Unrated |
| TXN | Texas Instruments Inc | 107.56 | -3.97 | -3.56% | Neutral |
| XOM | Exxon Mobil Corp | 41.37 | +0.19 | +0.46% | Attractive |

Outlook clients will recognize this list of stocks: a collection ranging across several industries. We've gotten used to the "sea of red" since the Shutdown Bear Market began, and today was typical, with the mind-boggling behavior of oil prices making the whole market feel bad . . . almost. But there (near the end of the trading day) was Exxon, at the bottom: up a half percentage point, which is nothing to write home about until we ask, "With oil doing its nuclear implosion; with hundreds of overflowing oil tankers wallowing all over the ocean, hoping a storm doesn't blow up and the supply of toilet paper doesn't run out; with Texas shale companies waving fistfuls of cash at their normal buyers, begging them to take the black gold off their hands; and with a general feeling in the market and the investment world, today, of "Woe is us! Will we ever actually see the first green shoots of economic recovery? . . . <u>why</u> did Exxon have the gall to go "up" this afternoon, even a bit, even temporarily?"

For the answer to that, let's look at . . . Micron Technologies. Micron, our memory-chip king, has nothing to do with oil, of course.




This chart begins at the first green circle, in the middle of 2012. Micron traded around $5 per share, and it had just bought a bankrupt Japanese memory-chip company named Elpida, paying pennies on the dollar for first-class manufacturing facilities, and the bankrupt company's relationship with Apple as a buyer. The Big Picture in the memory industry, from the 1980's until the 2010 – 2012 era, when Micron bought Elpida, was "too many memory makers, mostly operating at a loss, but making life miserable for the strong memory companies by over-producing chips when prices were high, guaranteeing "boulder off a cliff" price implosions when global chip demand softened for a while—as it always did, from time to time."

That sentence makes the light bulb go on, doesn't it? Those 30 or 40 global memory makers—who kept doing the wrong thing and losing money while doing it—had to be weeded out for the memory business to make any sense for the good companies. And they were, with Elpida's bankruptcy one of a great many examples. The "weeding out" left exactly three big, strong manufacturers in the DRAM part of the memory business: Samsung, Micron and Hynix. We see what happened over the next 8 years to Micron: up and down cycles, as always in the industry, but remarkable growth in earnings at the tops <u>and</u> bottoms of the cycles, and a stock price <u>640%</u> higher than June of 2012 . . . even in the midst of our "Virus Shutdown Bear Market."

The U.S. shale industry is having its "Elpida moment" right now. The only outcome will be bankruptcies galore, among companies which kept borrowing to stay on the "shale production treadmill" (which requires accelerating spending on new wells to replace the fast-falling production from old wells.) They all gambled, and they lost, like Elpida and friends.

But companies like Exxon won't lose. They'll win, because they have producing strengths in many worldwide baskets—not just shale—and because they have the financial strength to endure the "Elpida moment." (Same with Shell and Conoco, regardless of their "red" days today.) When the dust clears from the Virus Shutdown calamity, the survivors in the shale corner of the oil world will be wiser, stronger and fewer . . . and very inclined (like Micron, Samsung and Hynix) to avoid over-supplying the future oil market, so they can enjoy the eventually dramatic rise in the price of oil in the long run.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