

The Outlook: Sept. 15, 2021

Oil Supply and Demand, and the “Unstoppable” Forces of Nature.

Supply and demand are like earthquakes, hurricanes and other forces of nature: not just powerful, but unstoppable. Unlike nature, they’re basically very easy to understand, being created by normal, rational human behavior. Hence the simplicity of Outlook’s favorite saying: “The cure for low prices is low prices, and vice versa,” because low prices eventually trigger more demand and less supply, pushing prices higher.

So far so good. The trouble comes, for us investors, when we wish too hard that supply and demand would act *on schedule*; and we really wish the schedule would hurry up, for heaven’s sake, because our nerves are getting jangled while we wait.

That’s been the story in the oil market for a good while now, hasn’t it? We can see that total disrespect for schedules when we glance at Conoco over the last 21 months, from its Lockdown and Virus plunge to today.

Conoco: Lockdown plunge, then a long, jangled wait for supply and demand to behave.

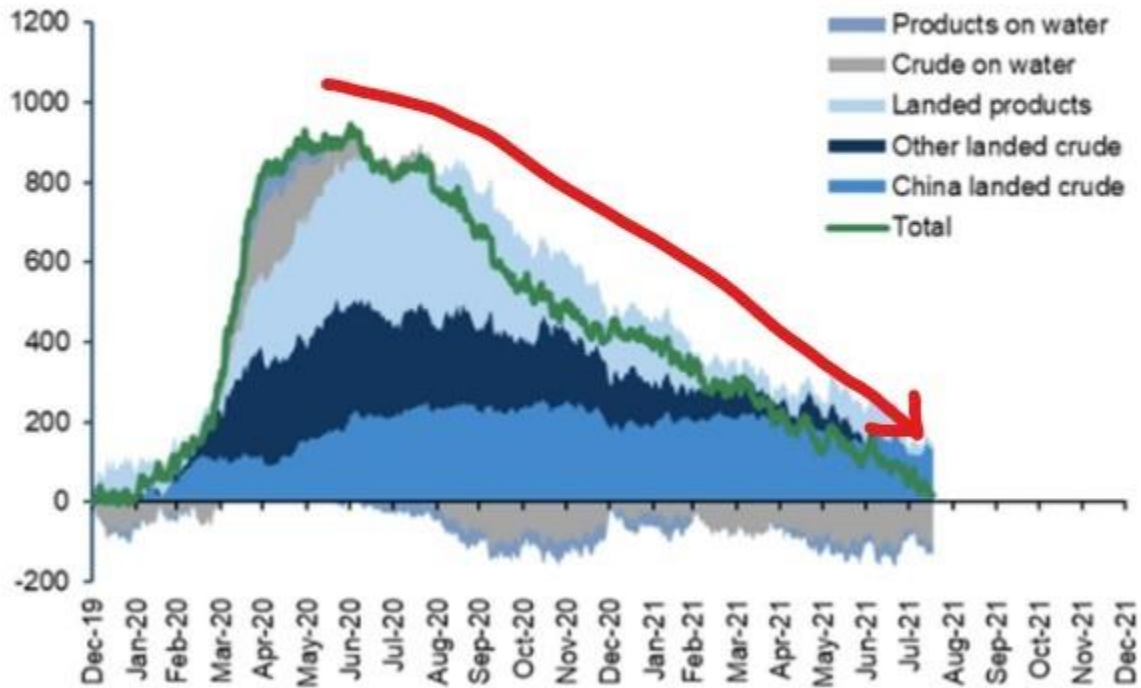


Of course Conoco has acted much like the price of oil—though not step-for-step, because Conoco’s people have been hard at work strengthening their company regardless of the price of oil. So the question is: “What have supply and demand been up to, all these jarring months, to have given us such a rough ride on the way to that “unstoppable” climb in the price of oil?”

Here's the story in a couple of charts.

Exhibit 12: ...leading to a complete destocking of the pandemic-induced oil glut

Global oil stocks vs Dec-19 (mb)

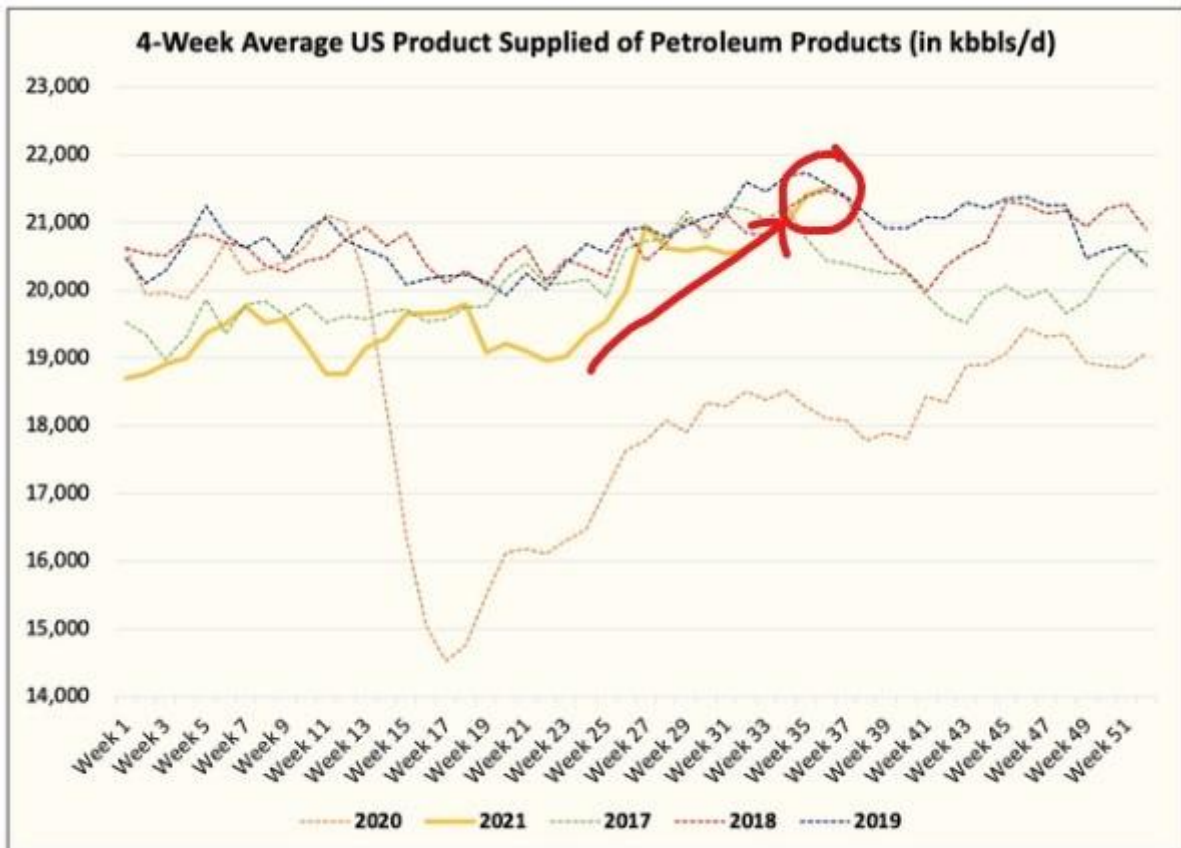


Source: Kpler, IEA, JODI, EIA, PAJ, Insights Global, IE Singapore, Fujairah, Oilchem, Goldman Sachs Global Investment Research

The Lockdown slammed the brakes on oil demand harder and faster than anything in history. Supply couldn't possibly shut down that fast . . . so global inventories of unwanted oil skyrocketed, as we see on the left side of the chart. That "inventory overhang" looked like Mount Everest to the world's oil experts, back then; and the Lockdown Recession looked like Doomsday for the health and growth of the world's economies—meaning plunging oil demand for the foreseeable future.

Courtesy of Goldman Sachs, up there, we see they were mistaken. Main Street around the world got back to work despite the Lockdowns, and steadily used more oil, month after month after month. On the supply side, that "cure for low prices" was pretty brutal: dozens or even hundreds of bankruptcies in the U.S. shale business; and jaw-dropping cuts in spending on oil exploration-and-production all over the world, among suppliers ranging from OPEC to Shell. So supply was tightened and tightened, not in a steady curve but in lurches (which is how the real world reacts to "unstoppable" forces); and demand trudged upward, also in lurches though a good deal smoother than supply.

Here's an interesting thing about how demand has been behaving:



Source: HFI Research

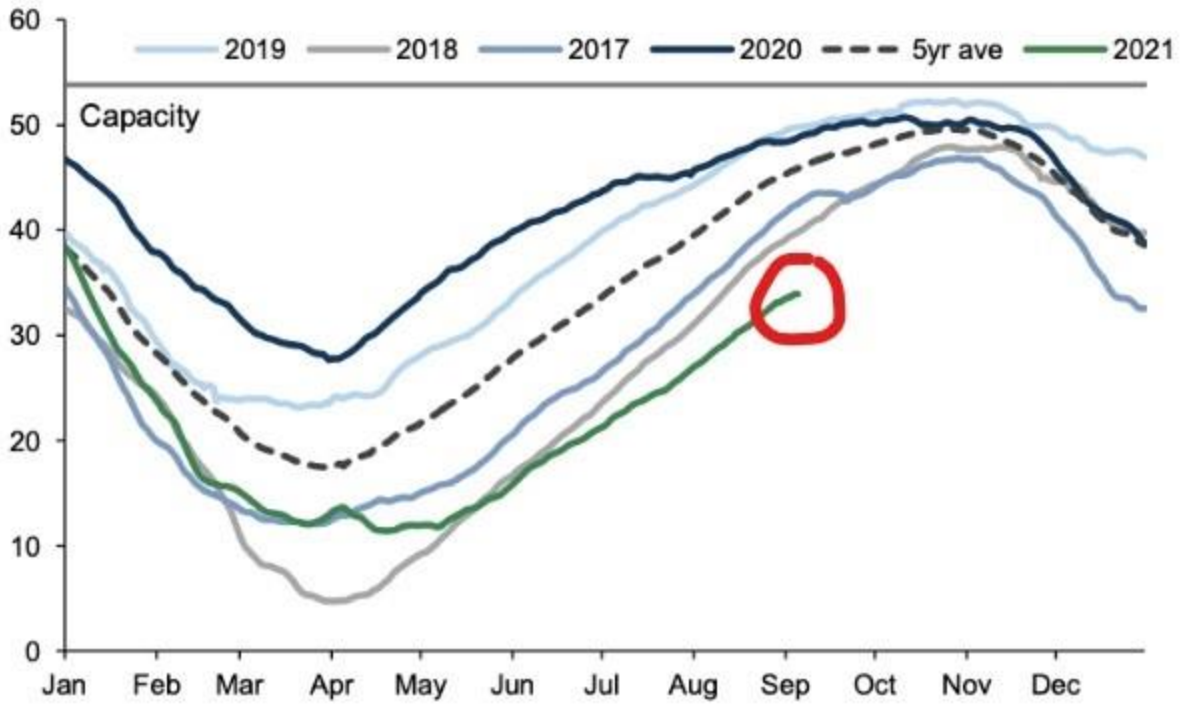
This chart says “Supply” but that’s jargon: it’s really oil bought and used, meaning “Demand.” The red arrow covers this year’s spike in COVID cases, more or less. That spike has, of course, given the media endless headlines . . . but notice how it didn’t dent or interrupt oil demand much at all. As Outlook has remarked once or twice, Main Street mostly glances at those endless “Sky is Falling!” headlines, shrugs, and gets back to work.

That’s the heart of the answer to “What have oil supply and demand been up to all this time?” They’ve been acting normally—just not on anyone’s short-term schedule.

Here’s one more glance at supply and demand, from a very different angle:

Exhibit 15: European gas storage is at critically low levels for this late in the summer

NorthWestern European Gas Storage, BCM



Source: Bloomberg

That red arrow is the supply of natural gas in Europe right now, standing far lower than any September in the past 5 years. In Europe the price of natural gas is 400% higher than a year ago. It's at an all-time high. Winter is coming—which is when gas usage rockets up, and inventories are used up . . . but they're already used up, so to speak, in 2021. The story behind all this is the same as for oil: recovering demand, restricted supply. (Only for political reasons, oil-and-gas supply in Europe is more like "throttled" than merely "restricted.")

Supply and demand are unstoppable, but they don't work on a schedule. We investors, if we choose, can put money on "unstoppable." (We certainly do at Outlook Capital Management: with oil and copper leading our list of "unstoppables.") Then our job is to be patient, understanding supply and demand's "total disregard for schedules." Our reward comes in jangling lurches, both up and down, as that Conoco chart up top shows so clearly. But it's OK to enjoy the lurches to the upside, like today's:

Symbol	Name	Price	Change	% Chg	As of (EST)
CAT	Caterpillar Inc	205.79	+3.46	+1.71%	09/15 16:01
CME	CME Group Inc	188.89	+0.04	+0.02%	09/15 16:01
CMI	Cummins Inc	234.41	+2.59	+1.12%	09/15 16:01
COP	ConocoPhillips	59.32	+2.38	+4.18%	09/15 16:01
FCX	Freeport-McMoRan Inc	36.75	+1.96	+5.63%	09/15 16:01
LMT	Lockheed Martin Corp	345.10	+0.76	+0.22%	09/15 16:01
MSFT	Microsoft Corp	304.79	+5.00	+1.67%	09/15 16:01
MU	Micron Technology Inc	73.81	+0.32	+0.44%	09/15 16:01
TXN	Texas Instruments Inc	197.53	+2.42	+1.24%	09/15 16:01
XOM	Exxon Mobil Corp	56.39	+1.81	+3.32%	09/15 16:01

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