The Outlook: Oct. 3, 2018

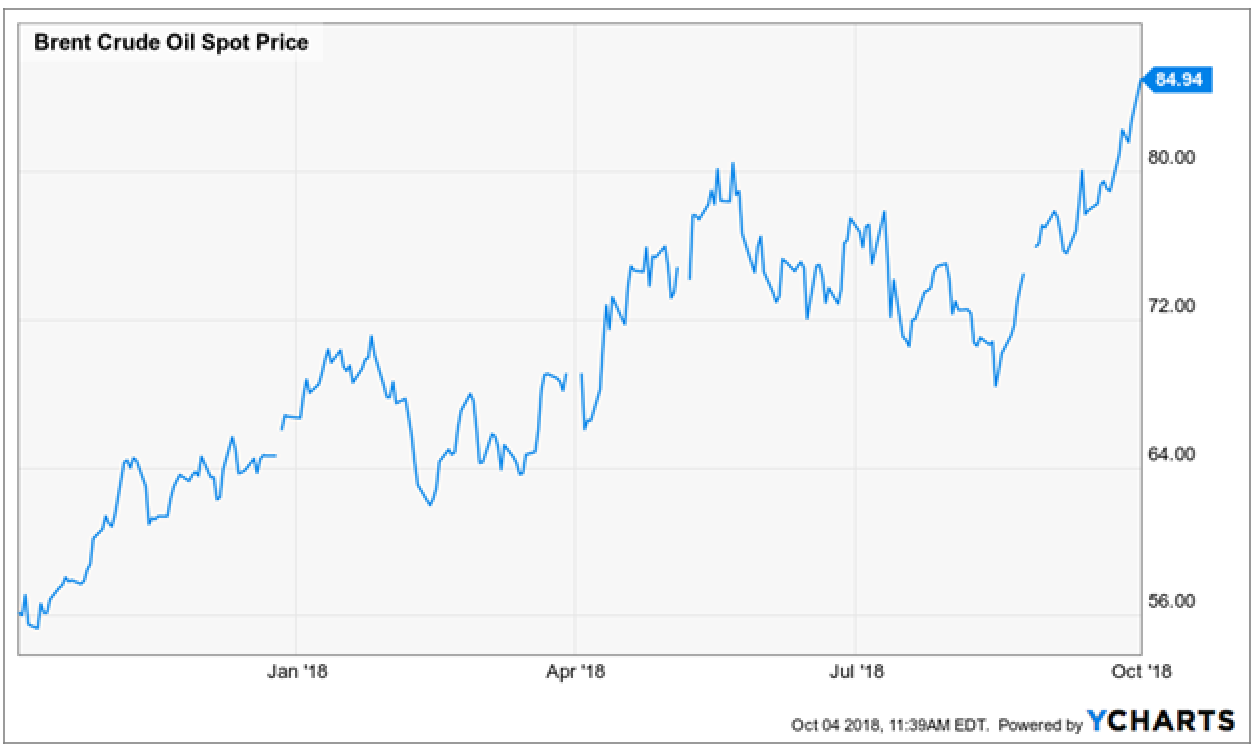
When it's mighty complicated, how shall we decide what to do?

One year ago, some smart, hardworking analysts at Goldman Sachs forecasted the price of oil for the next 4 years. They backed up their forecast with 20 pages of analysis, scrutinizing every aspect of global supply and demand. It was very deep work indeed, with an impressive command of details, including some which few other analysts had noticed, or commented upon. It was also so complicated that we mere humans found ourselves blinking and re-reading paragraph after paragraph (as if we were still puzzling over that "Economics for Physicists" textbook, back in college), hoping that comprehension might eventually seep in.

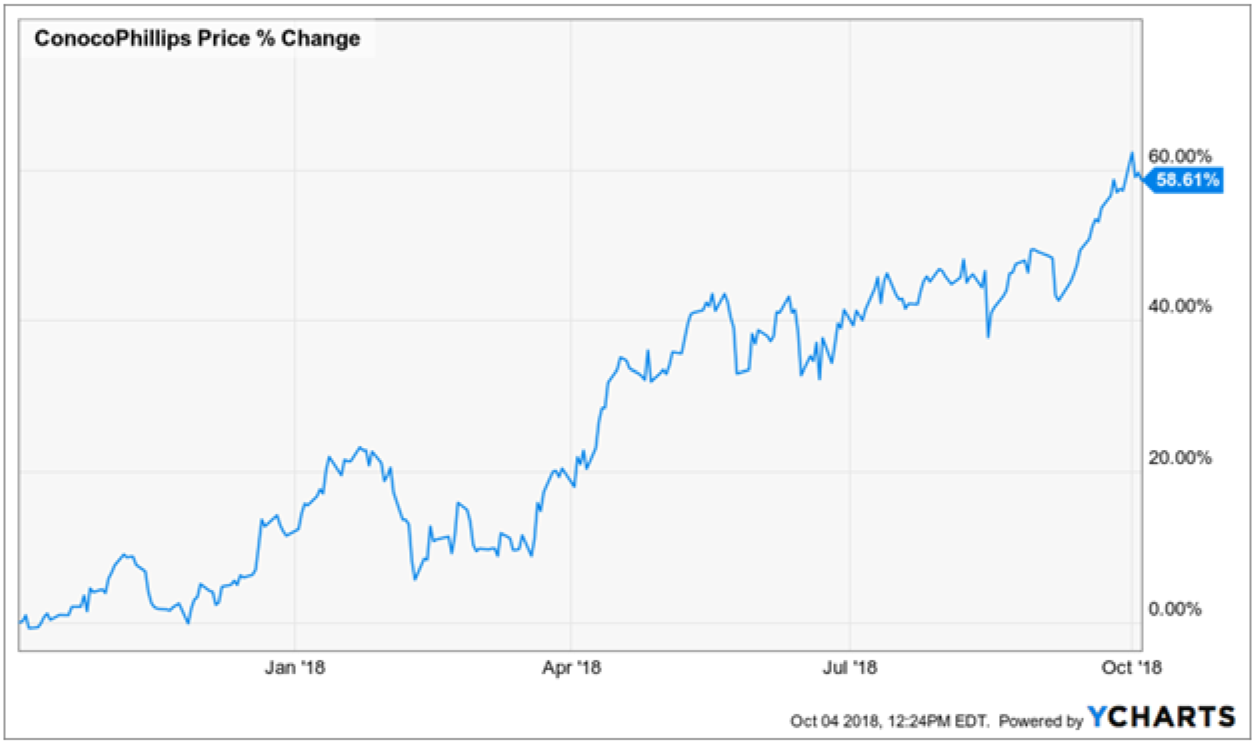
We do know what's coming next, don't we? The Goldman analysis, in addition to being infinitely detailed and highly sophisticated, was also dead wrong.

Brent crude oil was seemingly stuck in the low $50/barrel range, back then. Goldman, after those 20 pages of hard work and hard thought, concluded that $55/barrel would be exactly where Brent crude would stay . . . for roughly 4 straight years through 2021. At Outlook, when we arrived at long last at Goldman's forecast on page 20, and saw "$55/barrel" predicted quarter after quarter and year after year, the blink and double-take came on cue, but comprehension refused to seep in. "Whatever oil does," we thought, "it won't do *that*! That is not how this market behaves."

Instead of Goldman's flat line, here's what oil has actually done, so far.



And, remembering why we're interested in oil, here's what our ConocoPhillips has done: up about 60% in that year.



For Outlook's clients those charts are enjoyable—because they're "up"—but there is a deeper question behind them, and behind the Goldman story: <u>"When we must decide about something, but the analysis behind that something seems *really* complicated—so complicated that we wonder how we can figure out whether it's right or wrong—what shall we do?"</u>

We might ask ourselves this question every day, just about, in the investment business. (We might ask the same question, pretty often, about lots of tangled analyses and tough decisions outside the investment world.) Goldman's analysts literally make a career out of intense scrutiny of corners of the investment world. They—and many other clever, hardworking people on "Wall Street"—build up genuine expertise in their specialties. But with all their expertise and their intense scrutiny . . . they reach sharply different conclusions. We investors must decide for ourselves which is right, and which wrong—and we can't do it by out-scrutinizing the "experts." <u>We</u> don't have the time; and we see that all the time in the world, in the experts' hands, still leads them to conclusions which are often just wrong. And so, again, "What shall we do?"

The answer, for Outlook, is always: <u>"Make it simple."</u> We must pay attention to the intense scrutiny, to the mountain of detail . . . but we will <u>not</u> find the right answer unless we insist on reducing the mountain to simplicity, so that we can see the heart of the matter.

In the oil market—and every other free market—the heart of the matter is how normal people behave, when faced with something which makes them act. Those normal people may be the CEO of Conoco; an American family thinking about how to spend their next vacation; a Chinese office worker contemplating her first car; and everything in between. When the oil market plunged off its cliff in 2014, and didn't land with a thump until 2016, it made everyone act in their own interests. Conoco attacked its costs and debt with an ax; the family realized that driving to Yosemite would cost 60% less than before; the office worker calculated that she could afford to actually use the car, once she bought it. Conoco's actions meant that its production of oil must fall, reducing global supply—eventually; the American and Chinese personal decisions meant the consumption of oil must rise, increasing global demand—eventually.

There would be a mountain of detail in the billions of similar reactions around the world—and Goldman's 20-page forecast touched on some of them. But the details matter a great deal less than so many experts think they do. They're interesting because the speed and strength of various people's normal reactions to a drastic price change will always show plenty of differences—but they will still be "normal." They will <u>not</u> act against common sense; they'll <u>not</u> act against their own self-interest. When the price of a necessary commodity plunges, everyone will buy more . . . eventually. When it plunges, companies will produce less . . . eventually. As Outlook has noted pretty often, the single word which confounds so many experts, leading them to wrong conclusions, is that one: "eventually." Supply and demand in free markets always behave sensibly and predictably, which means a long, sharp fall in prices will always give way to a long, significant rise and vice versa. The trouble with the experts plunging into their mountains of detail is that they lose sight of those irresistible forces of supply and demand. They're fooled by the infinite peculiarities among the "suppliers" and "demanders" of oil, or copper, or whatever, which make "eventually" mean a few months in one corner of the market, and a year or two in another corner.

The market's speculators, of course, have no time whatsoever for such thinking; which means they have no interest whatsoever in waiting for all those "eventually's" to arrive at the same place. If we cornered them, they might say "Maybe you're right—but <u>we just don't care</u>. That's not our business." That is why Conoco traded at $30 in early 2016. That is why Freeport traded at $4; Micron at $10; Caterpillar at $59; and on and on. And the speculators' disinterest, plus the certain arrival of all the "eventually's," is why Conoco, Freeport, Micron and CAT have risen from 160% to 1000%--as have most other Outlook core companies.

They aren't finished. Supply and demand, in each of their respective markets, are still in the early stages of their "eventual" behavior. The speculating crowd won't believe it. Neither will much of the expert crowd, and nearly all of the media crowd. All of those crowds are very easily distracted, and frightened, by any stock whose chart has shown itself capable of pointing straight down, lately. <u>Their fear always guides their thinking</u>—when it should be the other way around. But as always, if we investors insist on thinking our way, and remembering that markets behave normally and predictably—eventually—we will make a lot of money, just as we have so far.

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