

The Outlook: March 5, 2018

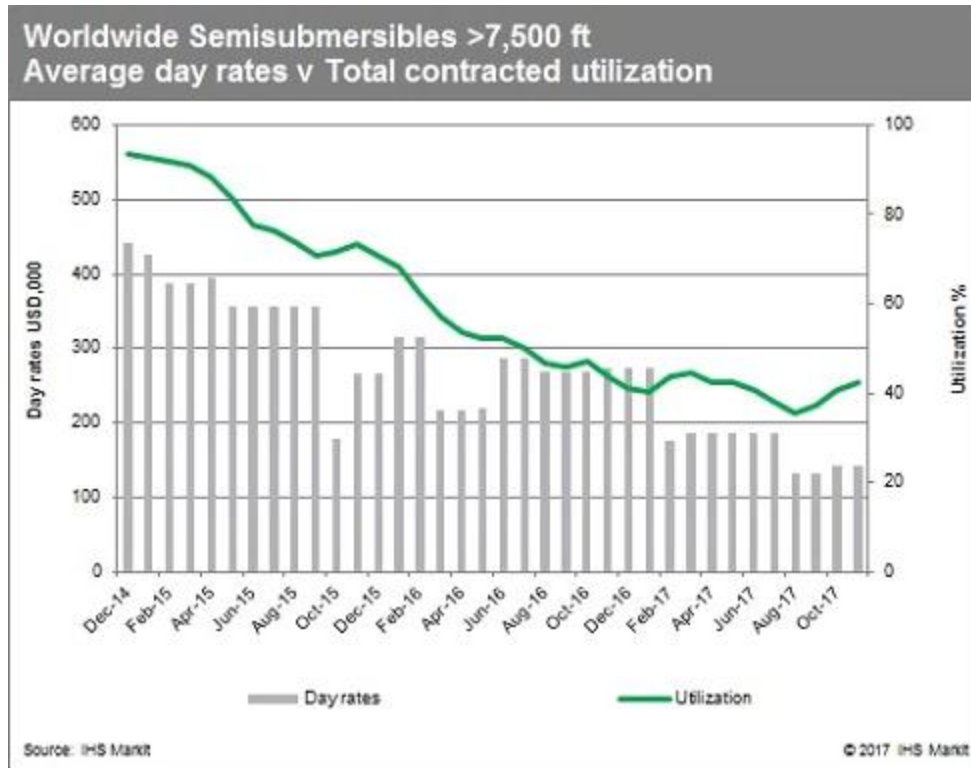
Transocean's Mr. Thigpen comments upon "rampant" bandwagons of opinion.

The year was 1977. An investment manager with 40 years of experience was talking to a just-hired investment analyst with zero years of experience, but a Master's Degree in Economics from a prestigious university (which turned out to be mostly a handicap to figuring out how the investment world worked.) The question, from young to old, had been: "But what part of all this daily reading material should I focus on?" The answer, from old to young: "All of it. It all matters. Last year the anchovy harvest failed, off the coast of Peru, and that turned out to matter a lot to a bunch of our companies, even though they never see anchovies unless they're on top of pizza, for lunch."

40 years later, the challenge of handling the daily mass of material is harder than ever, but also as enjoyable as ever. But we would give a different answer to that young analyst's question. We'd say, "You must read a lot, and think deeply about what matters to your investment positions. But eventually you will develop a certain "feeling" about the mass of expert opinions out there. You will see that experts jump on popular bandwagons just as fast as ordinary people, and you'll sense when a lot of expert analysis is really being shaped by the age-old human tendency to believe what the biggest crowd seems to believe, at the moment."

Outlook clients have very recently seen the chart below, which shows the tremendous drop in rental rates for ocean oil-drilling platforms and ships, since the oil market peaked in 2014. (That is Transocean's business—an Outlook core company.) The "Valley of Despair," through which Transocean is trudging right now, features a worldwide glut of platforms and ships, hence those plummeting rental rates paid by oil-exploration companies to use Transocean's equipment. And the "bandwagon" of opinion about it—from experts to amateurs—amounts to: "Ocean drilling companies are in a world of hurt today, and no end's in sight."

2014 – 2017: Deepwater Oil Drilling's Valley of Despair



So a recent, seemingly-trivial exchange between a Wall Street analyst and the CEO of Transocean, Jeremy Thigpen, caught our attention:

Wall Street Analyst:

Okay, thanks, and then a similar question. Obviously, industry-wide, (companies aren't disclosing their rental rates, probably because they're so bad.) And I'm wondering in Transocean's assessment, how rampant has it been, if at all, that you've seen rates that are below cash operating costs for the driller? And do you think that's something that continues for a meaningful period time in 2018, or what's your view on that?

Mr. Thigpen:

I think you used the term "rampant." It's certainly not rampant. We've seen one-offs here and there where we suspect or have been informed that some of our competitors have gone below cash breakeven (renting out ships below operating costs.) But it's not – it's certainly not rampant.

Let us go right ahead, ourselves, and make a big deal out of that one word: "rampant." The Wall Street analyst had a picture in his mind, of the state of the oil drillship industry, which might best be described as "too awful for words . . . except maybe words like "rampant" to describe drillship companies seemingly cutting their own throats from sheer desperation to put idle equipment to work." Mr. Thigpen, on the other hand, knows about Transocean's market . . . or at least we might suspect he knows a little more than an outside observer, on Wall Street or anywhere else. And his reaction amounted to an eye-rolling, "For heaven's sake! Where do you people get these notions?"

They get them, of course, from human nature, which always tries to persuade us that merely bad news is actually terrible news, and terrible news is probably end-of-the-world news. And so our young analyst, 40 years later, having seen a great many examples of such misjudgment, has indeed developed a certain "feeling" about such opinions: that you can count on them to exaggerate the problems, and flatly

disbelieve the problems can be fixed . . . until facts come along which make it perfectly clear they are being fixed. Not long ago we commented on just this phenomenon with Caterpillar, whose monthly reports of 3-month rolling equipment sales had “suddenly” turned from “in the morgue” to “in the Olympic 100 meters” over the course of about half of one year. Transocean and its industry are back where Caterpillar was a year or two ago—in a cold, dark place. They will not stay there. Nor will the stock price.

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