



Missive

JUNE 7, 2023

Buy Energy. I am.

In October 2008, Warren Buffett penned an op-ed in *The New York Times* titled, “Buy American. I am.” Warren argued that though things looked terrible, he was buying stocks personally. He was selling government bonds he held to buy these securities. He argued how poorly cash would do at that time and in the foreseeable future.

Fast forward to today when Berkshire Hathaway (BRK) sits on \$130.62 billion in cash. It’s not deploying capital very quickly via Warren, Charlie Munger, Todd Combs and Ted Weschler to investments, let alone stocks. There is one thing that has burned a hole in Warren’s pocket though: OXY.

Beginning in early 2022, Buffett began gobbling up stock in the company at \$60 or below per share like he’s playing the classic video game Pac-Man. Why hasn’t Buffett penned an op-ed advocating for energy stocks at a time he doesn’t find stocks attractive?

What Berkshire is not!

Over the last 10 years, we and other shareholders have asked Buffett to allow Combs and Weschler to explain their investments. Warren and Charlie have rebuffed these attempts. They reply by saying they are not investment advisors and have no interest in explaining what they do to make investments. His latest line was, “How would you like to manage my money for nothing?” Buffett only hands out advice when he has no conflict with sharing his thoughts on stocks and investments. His [Freddie Mac recommendation in 1988](#), his [Sun Valley talk in 1999](#) and his [op-ed in 2008](#) all fit that bill.

Lastly, Berkshire Hathaway is no longer an opportunistic stock picker/arbitrageur. It’s not because they don’t want to maximize the compounding of capital. They do. It’s because they need to be able to sink a minimum of \$1 billion into an investment, and more typically up to \$10 billion, which greatly limits their options. Buffett’s complaints over the limits brought on them by the Bank Holding Act of 1969 at the 2023 Berkshire Meeting should be read correctly. He wishes he was in banking, rather than insurance. He whispered it and you had to pay attention. He’s not whispering on oil.

Lower oil, more energy shares

Despite his conflicts with advice and size, he buys and files week after week in an oil company that three years ago was left for dead by investors. In 2020, OXY was a highly levered oil company from its purchase of Anadarko which included \$10 billion of preferred stock that Warren received warrants in.

Warren’s purchases in early 2022 should explain how he viewed the company’s capital structure and return on equity relative to where the stock price was. Oil has been falling since his purchases began. While investors began to give up on the hope that this was the greatest bull market in oil equities ever, he continued to buy the stock as oil dropped to \$70 per barrel on WTI. This leaves you with two assumptions. He likes what OXY does, and he sees bright prospects on the horizon for oil.

Berkshire’s case for oil

At the 2022 Berkshire Hathaway Meeting, Charles T. Munger advocated that we shouldn’t be pulling America’s oil reserves out of the ground. He argued that we should use other countries’ oil as it is too important of a resource. Munger argues this while the world believes it is far less needed than ten years ago. According to Buffett in the 2023 Berkshire Hathaway Meeting, if you stopped shale, it would reduce oil production by five million barrels per day. He also talked about the strategic oil reserve as the ultimate oil field. He said it was supposed to be “strategic” and now it “gets involved in politics.” It’s interesting to think about this as the Saudis also agree with Munger. They cut their production on Sunday as they feel they aren’t getting the appropriate price.

Buffett went on to say, “If oil sells at X, you do very well. If it sells at half of X, your costs are the same and it doesn’t change the production and it doesn’t work as well, but it also brings down the oil production of the United States very fast.” As he continues to buy OXY at lower oil prices, he is letting everyone know that he believes Mr. Market is wrong on the OXY share price at a minimum, and more than likely on oil price, as that drives the overall economics of OXY.

Mr. Market isn’t just wrong about oil

At the 2023 meeting, Mr. Munger said, “Admitting you’re buying coal would be like going out and seeking to acquire a cancer of something. You can’t even borrow to expand a coal mine now. It’s really, it got very unfashionable.” It has become unfashionable and un-bankable, so these coal companies adapted. They have no debt, thus needing very little banking. They continue to produce the energy needs of the non-western world “unfashionably” but highly profitably.

¹ https://www.basketball-reference.com/leagues/NBA_stats_per_game.html

Buy Energy. I am.

In the 2023 meeting, Buffett continued on Charlie's coal rant by saying:

We think frankly some of the things said are ridiculous on both sides in both extremes. I mean your dealing with physics. The politicization of positions on something that's enormously important in term of energy, it just lends itself to demagogues and fundraisers and advisory organizations and everyone in sight. We will make rational decisions and we do not think it is un-American to own oil.

We agree with Warren and Charlie but go further to say that it is not un-American to grow the total energy supply from many resources, whether we are talking carbon-based (oil, gas, coal), nuclear or the government-subsidized ones (wind and solar). We see the energy complex at large to be a great place to grow our capital, while others don't care.

Why do we own so much energy in our portfolios today? The answer is simple: it's one of our best ideas. Mr. Munger, in the 2023 meeting, said:

I think one of the inane things that's taught in modern university education is that a vast diversification is absolutely mandatory in investing in common stocks. That is an insane idea. It's not that easy to have a vast plethora of good opportunities that are easily identified. And if you only got three, I'd rather have it in my best ideas than my worst.

The insane thing for us would be to not have a lot of our capital in these wonderful energy ideas, much like Berkshire has in OXY. We can play in companies that Berkshire struggles in (<\$50 billion), hand out investment advice (like we are now) and lastly, believe that the scarcity of these energy sources based on the stock prices of the companies that produce them could cause our investors to build wealth while other people avoid rational thought. That's why I'll end back we began with Warren. At what seems like a dark time now for energy companies of many forms, we'd advocated for a policy of selling your cash investments that will be hurt by the current inflation that will eat away at their investments.

Without knowing the timeline of when we will feel blessed for doing so, we believe you should go buy well-priced energy assets to grow your capital. This is while Buffett provides no recommendation for the broad stock market and isn't deploying cash rapidly. To put it simply: Buy Energy. I am.

Fear stock market failure,



Cole Smead, CFA
CEO & Portfolio Manager

The information contained in this missive represents Smead Capital Management's opinions and should not be construed as personalized or individualized investment advice and are subject to change. Past performance is no guarantee of future results. Cole Smead, CFA, CEO and Portfolio Manager, wrote this article. It should not be assumed that investing in any securities mentioned above will or will not be profitable. Portfolio composition is subject to change at any time and references to specific securities, industries and sectors in this letter are not recommendations to purchase or sell any particular security. Current and future portfolio holdings are subject to risk. In preparing this document, SCM has relied upon and assumed, without independent verification, the accuracy and completeness of all information available from public sources. A list of all recommendations made by Smead Capital Management within the past twelve-month period is available upon request.

©2023 Smead Capital Management, Inc. All rights reserved.

This missive and others are available at www.smeadcap.com.



smeadcap.com

2777 East Camelback Road
Suite 375
Phoenix, AZ 85016

Sales Desk US 877.701.2883
Sales Desk UK +44 (0)20.8819.6490
info@smeadcap.com