



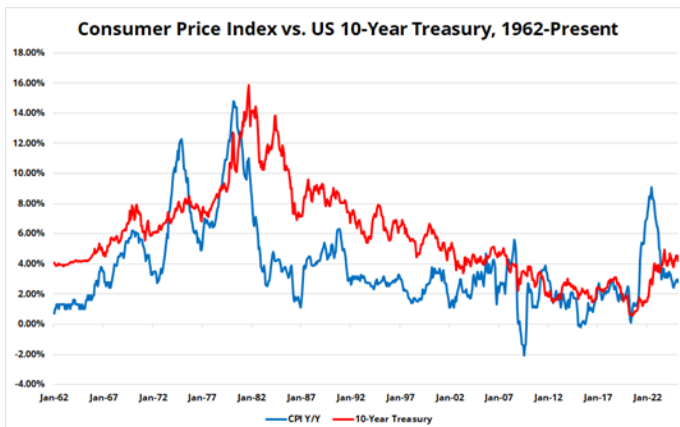
Missive

MARCH 27, 2025

O-I-L-S, Oil Stocks

When you grow up with a father who worked in the brokerage business, you hear a lot of stories. The especially interesting ones are those about the investment business in the 1980s. Many times, my dad, Bill, has told me about Jack McCarthy, who ran the Affiliated Fund at Lord Abbett & Co. in the 1980s. At that time, the podcast of the era was sending a recorded tape of your thoughts to get the word out to investors. In 1984, Jack's wisdom and recommendation were timely.

Dad has explained to me numerous times that in the tape McCarthy screamed, "B—O—N—D—S, BONDS!!!" Mr. McCarthy was grabbing investors' attention to make them aware of the rare opportunity that unfolded at 14% on long-term Treasury bonds. The chart below will also help us understand Jack's message at that time.



Source: Bloomberg

In 1981 with high inflation and high bond rates, an investor had to hope/predict that inflation would decline as a result of the work Fed Chairman Paul Volcker and President Ronald Reagan were doing to break the back of spiraling price increases. By 1984, inflation had backed off, but the fear at the time was that the economy had picked up strongly and folks thought 5-6% growth would reignite inflation.

The bond market priced long bonds at high yields assuming that inflation would come roaring back with the economy. There was a massive real interest rate available, but you had to bet against the bond market and believe you were being given something for free. You had to have less courage than in 1981, but some wisdom in 1984.

The 1984 episode in time is important because it was the second-best bond-buying year in the last 45 years.

Today, we feel like Jack McCarthy, and we are screaming at the top of our lungs, "O—I—L—S, Oil Stocks!!!"

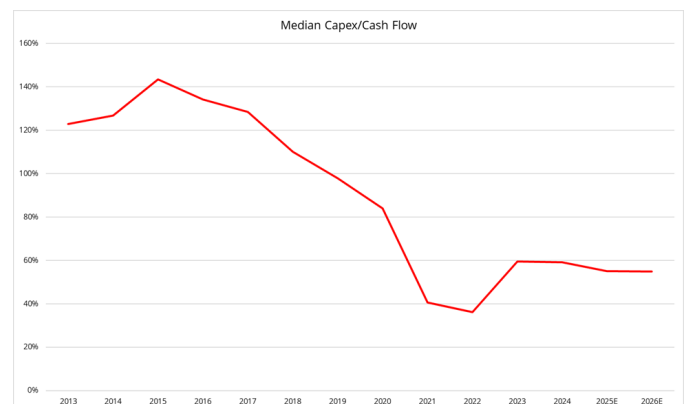
We believe this is the second-best buying opportunity of the last 20 years in the oil business and is similar to where bonds were in 1984 relative to 1981.

The best buying opportunity in the energy business for the last 20 years was in March 2020. It took immense courage to buy oil stocks. The industry had just produced a decade of dismal returns on capital during which free cash flow was often negative and balance sheets were leveraged.

You had to predict that negative oil prices would recover. You had to predict that cash flow would explode. You had to predict that returns on capital would be treated with equity investors' interest as the first priority. You had to predict that the industry wouldn't go back to its old ways.

Again, this required immense courage to bet against the "drill, baby drill" zeitgeist of the past. This is very similar to the courage needed to believe the zeitgeist in inflation in 1981 would fall away.

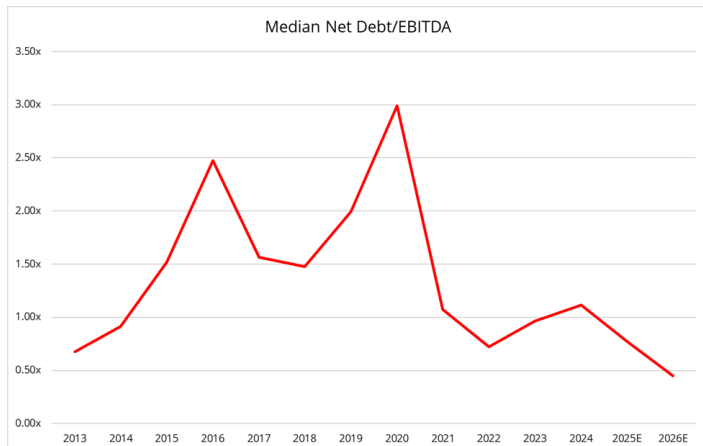
Today, in oil stocks, it is as remarkable as it was for McCarthy in bonds in 1984. Like then, it requires less courage but more wisdom. Below are three ways to understand why the investors of Smead Capital Management are so dogmatic about the opportunity right in front of us.



Source: Pickering Energy Partners.

Capex has disappeared compared to the past.

O-I-L-S, Oil Stocks



Source: Pickering Energy Partners.

Leverage has come down to low levels compared to the past.



Source: Pickering Energy Partners.

Shareholder yields, as defined by dividends and buybacks, are more attractive than in the past.

Like in 1984, when Jack McCarthy yelled, “B—O—N—D—S, BONDS!!!,” the investors of Smead Capital Management yelled, “O—I—L—S, Oil Stocks!!!” at the top of their lungs. You have to use wisdom even though the President of the USA is saying, “Drill, baby drill,” and oil executives are cringing while not following his lead.

Harold Hamm, the most successful allocator of capital in the oil business, said at the CERAWEEK conference in Houston two weeks ago that no one will be drilling below \$80. We believe investors must use the wisdom of Hamm and where we are in this industry. We must bet that we are not going to the zeitgeist of the past.

Fear stock market failure,

Cole Smead, CFA
CEO & Portfolio Manager

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