



Missive

OCTOBER 30, 2025

Oil Stocks: Another Pastel Peepers

Dear fellow investors,

One of the things we have in common with Warren Buffett is that we started our risk-taking career handicapping at racetracks. Buffett handicapped the horse races in Omaha, and I handicapped greyhound races near Portland at Multnomah Kennel Club in Gresham, Oregon. Buffett was too young to bet, so he created a tip sheet which he sold at the track. I was in college and most of the time was sending bets with my relatives while working swing shift at the Crown Zellerbach paper mill in Camas, Washington.

Many of you know that the beginning of our eight criteria for stock selection started with my five criteria for greyhound selection. My older cousins and I concluded at that time that five things really mattered in a greyhound race. First, each dog had a track record and you wanted to know who they had beaten before. The dog classes ran maiden races through class D-A. If you won a maiden race, you were promoted to the next level until you hit class A. Therefore, the first criteria for selection was class (who have you beaten before).

The second criteria was based on the shape of the racetrack and the speed which generates centrifugal force. The dogs could easily bang into each going around the first corner, ending their chances of success. The third was late speed. The dogs were bred to be quick and it was unusual for the quickest to have any late speed. The fourth criteria was post position, because the dogs had a tendency to prefer running close to the rail (very preferable) or around the outside of the track. An outside runner loved being in an outside box.

The fifth criteria was what I called the Janet Jackson rule ("What have you done for me lately?"). In other words, how the dog has been running in recent races. The fifth criteria brings us to the dog named Pastel Peepers and a summer of frustration in 1978. Pastel came to Portland, Oregon with a record of beating the best racers in Class A at a prestigious track in Palm Beach, Florida. We had studied the history of all the greyhounds entered and it was the class of the entire field.

However, some funny things can happen when you move a greyhound from a balmy, warm climate to the cool evenings in the Pacific Northwest. We began betting on Pastel Peepers in Class A and in those races, it failed miserably. Then it dropped to B class and failed to win there, and it finally dropped to C class. Unfortunately, I had to turn my attention back to heading for college. Therefore, in a season where my dad and I made very good net profits in handicapping, we lost more money on Pastel Peepers than any dog the whole season.

Once I got back to college, Pastel won a C class race, won a B race and got promoted to A. The dog won about 10 straight races and climbed back to its rightful position which we anticipated originally. All we did was lose more because we were too early.

This brings us to our oil and gas stocks. We were spot on in 2020 in the middle of the COVID-19 meltdown buying Conoco (COP) shares at around \$30 per share, Occidental Petroleum (OXY) at \$23 and reading Greg Zuckerman's book, *The Frackers*, about Harold Hamm and his company Continental Resources (CLR). We paid around \$12 per share to buy in. In 2022, Hamm bought us out in a going-private transaction at \$74.28 per share.

Our Pastel Peepers mistake came beginning in 2023 on the oil stocks. We felt that over the next ten years the Permian Basin would rollover in production and ESG initiatives would be disappointing, so we stayed with an over-weighted position in oil stocks for the last two years. These stocks have been the biggest drag on our results, just like the underperforming greyhound. When you combine this fact with not being in the futuristic/maniacal AI/Tech/Mag 7/Growth/Bitcoin securities, it is easy to see why we've underperformed our usual strong expectations.

There was a silver lining back in the late 1970s and we believe there will be one in our future as well. The five criteria for dog selection became the root cause of the development of our eight criteria for stock selection. In 1983, my firm brought a closed-end fund public called the Z-Seven Fund with financial backing from Sir John Templeton. It was called Z-Seven, because he had seven criteria for stock selection. Some of the criteria were qualitative and looked attractive, one looked like a bad idea. If the fund had a stock that hit 20 times earnings they would sell automatically.

When Z-Seven invested, it took a 6% position of the \$100 million dollar fund in Nike at 10 times earnings. If he had held Nike to today, his fund would be worth \$3.5 billion without any contribution from the other securities that fit the seven criteria. This would have been an 8.8% compounded return, even if the other \$94 million dollars disappeared.

Oil Stocks: Another Pastel Peepers

In conclusion, we went from the penthouse with our oil stocks in 2020 through 2022 and now have spent a couple of years in the doldrums. However, nothing has been done that is in conflict with the way we practice our discipline through the lens of our eight criteria. We believe that our portfolio will have the same kind of success relative to our benchmarks that we have had in the past, even though we have had numerous bumps in the road like Pastel Peepers.

Play The Long Game,



Bill Smead
Chief Investment Officer

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. Bill Smead, CIO 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.

©2025 Smead Capital Management, Inc. All rights reserved.

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

