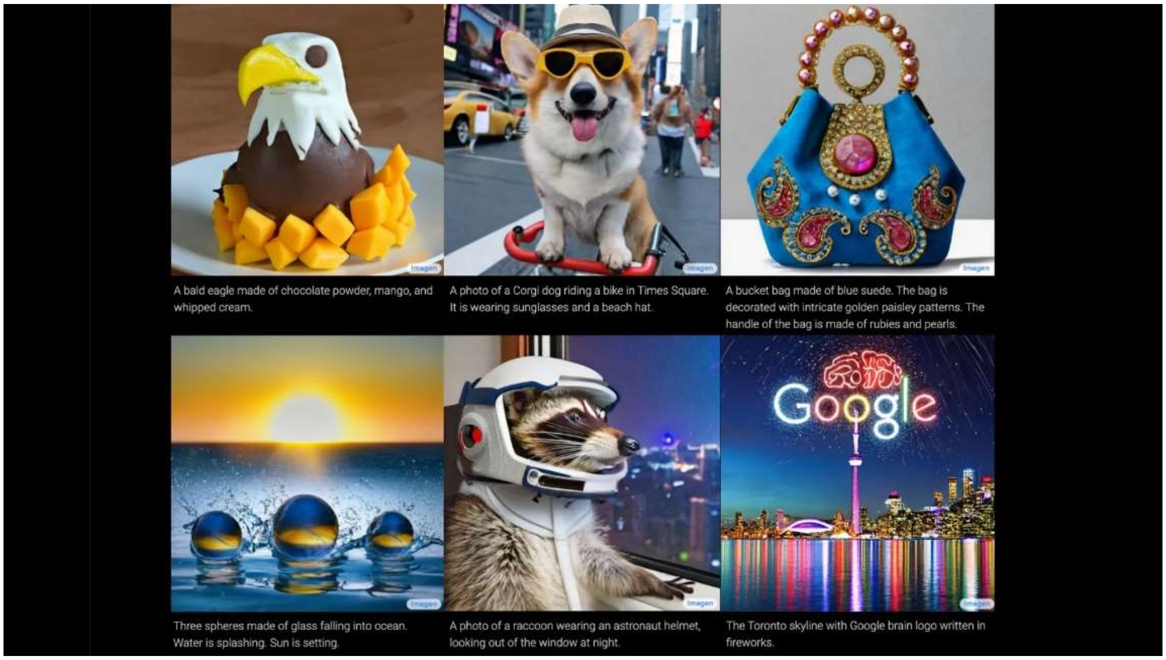
Keep your eye on the prize

'ALL THESE IMAGES WERE GENERATED BY GOOGLE'S LATEST TEXT-TO-IMAGE AI'

This first story clarifies why we must be cautious of what we see and read on social-media.



https://www.theverge.com/2022/5/24/23139297/google-imagen-text-to-image-ai-system-examples-paper

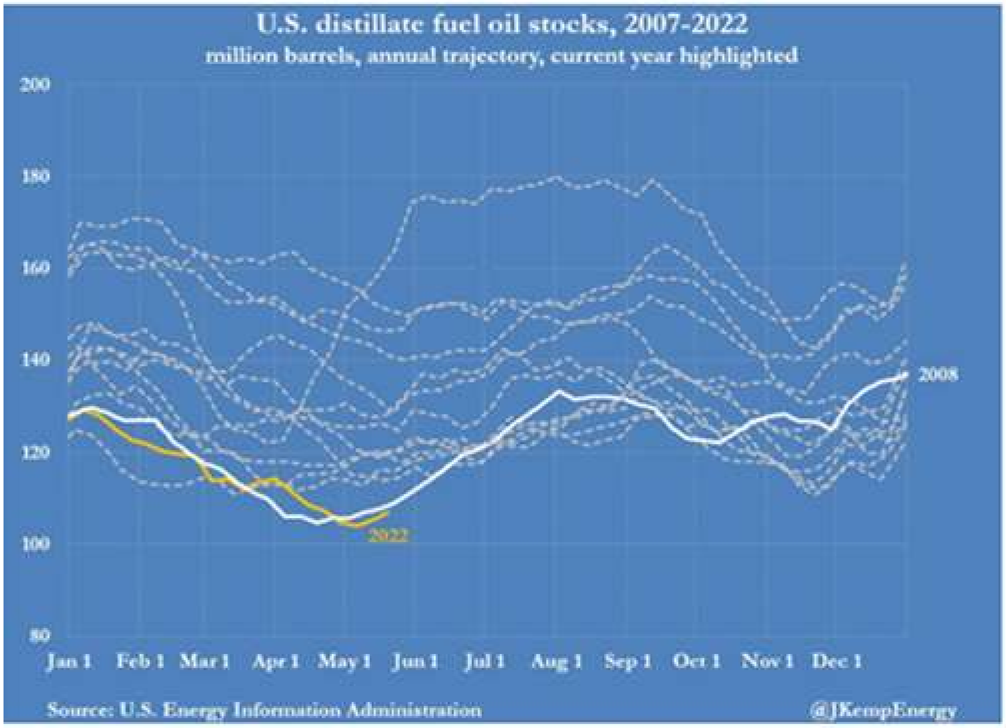
Why are gasoline and diesel prices high?

From NBF's Energy Desk Daily Notes May 26, 2022: *"The UK hitting O&G companies with a 25% windfall tax (expected to raise US$6.3bln) will no doubt produce some unintended consequences (avoidance, future underinvestment, etc). As we saw here in Alberta when the province jacked up royalty rates, the pie shrinks and so does the expected take along with more longer-term damage."*

These types of taxes often reflect sloppy, revenge thinking as in *'Fat Cat Big Oil is ripping us off taking advantage of high oil prices'*. The result is NOT lower prices and more supply from a chastened industry. Driving up taxes A) drives up the cost to the buyers relatively inelastic demand and B) drives down the incentive of the seller (supply). Costs rise further. The 'wind fall tax' increases. Rinse and repeat. The assumed revenue rarely arrives.

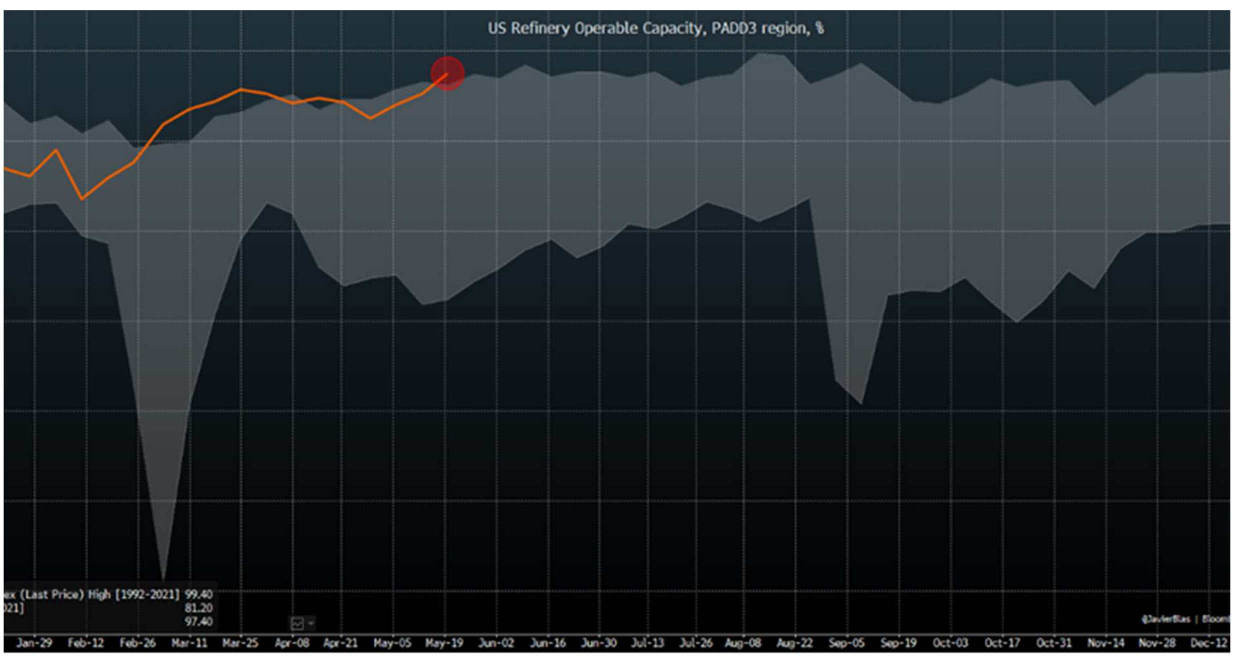
So why are fuel prices higher?

This isn't complicated. Politicians, policy makers, 'divest' activists, and influencers have been telling the oil and gas industry their days are numbered, enacting regulations, policies, review boards, taxes etc. determined to make it so. The industry has responded with *'Okay. We Get it. You don't want us around'*. Exploration and development contracted. Prices rose. The typical oil & gas industry response of selling more supply into higher and higher price hasn't happened. Despite sharply higher prices supply is down. Less fuel is available for sale.

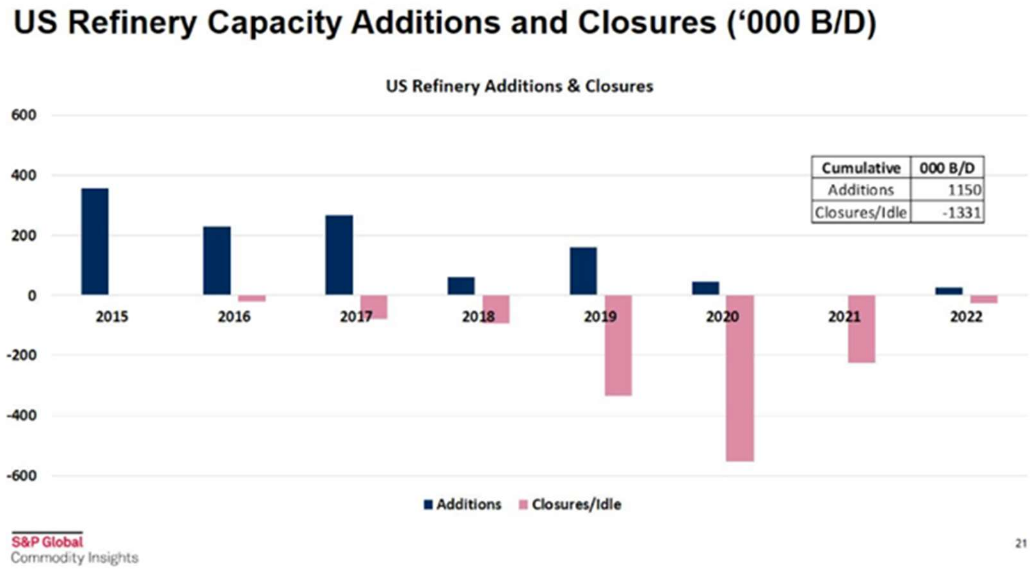


Recent fuel inventory supplies have been at record lows. Two points. 1) The 2nd chart above plots 15 yrs. of monthly actual inventory. It doesn't adjust for a growing economy and population demand growth. 2) The above data is <u>for the US</u>, one of best supplied G-7 petroleum markets.

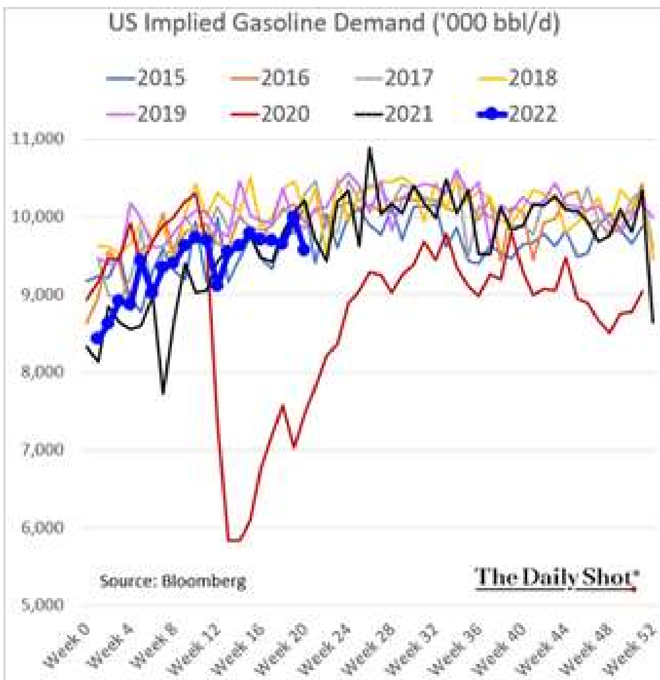
Are Refineries to blame? Are they just sitting on their hands raking in the cash?



The above chart plots the average refinery rate runs from 1992 to 2022 (grey cloud area) and this year's run (orange line). The refineries are running full tilt. To no surprise they'll move heaven and earth to produce every drop they can at the current ultra profitable spreads. Recall the US isn't at full demand yet. Meanwhile…



It's demand – stupid.

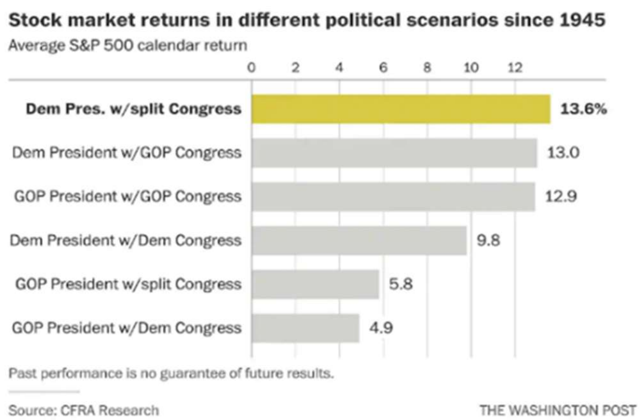


The next chart's red line plots 2020 demand. The US 2022 demand (blue line) has yet to completely recover from the 2020 COVID-19 lockdowns. Neither has the global economy. The reverberations are still being felt. Wars, inflation etc. alter supply/demand. Our longer-term premise has liquid petroleum fuel demand exceeding the previous cycle highs. The bond, stock and commodity markets are all pricing that future demand in. The markets have more money than we do. We're not going to argue with them.

Little wonder raw commodity and fuel prices are up. Policy makers may wish to revisit their assumptions. Is that likely? As US politics around fire-arms prove, despite all evidence to the contrary, elected officials cannot/will not alter their political agenda against what their base believes. The November 2022 US mid-term elections will be…interesting. The betting is that the mid-terms will – per usual – see a President facing a Congress dominated by the opposing party. The next chart plots US stock market 12-month returns under various Administration/Congress election results The best returns have come from a Democratic President facing a split congress (13.6%). The second best have been Dem President/GOP Congress (13%). The markets are okay with 'dysfunctional' governments.

Best of the David L. Fingold Blog (#463): May 18, 2022 – May 24, 2022

Blog Entry Date May 23, 2022:



Source: CFRA Research

We note that at this year's Exxon shareholder's meeting held a first-time ever vote on an 'Emissions Target Resolution'. The vote garnered 28% support (fail). Over at Chevron a similar resolution received 33% (fail). Last year it got 61%. Is shareholder voting a precursor to wider voting trends? Watch for changes in the narrative coming from elected leaders.

Which brings us to the wider political debate over energy that has dominated much of Canada's politics over the past decade. The Hilberry Group understands our environment matters. Protecting our environment and the world we've been intrusted with for future generations is one of our greatest responsibilities. We simply can't pollute at abandon. We believe most Canadians agree. Canadian politicians who've made a career solely focused on the issue are now in leading positions government. They got elected.

Confronting these challenges are complex, boring and tiresome. It's a marathon spanning multiple political careers not a one-and-done 100-yard dash. Studies prove the average North American adult's attention span lasts 20 mins. The social media/cell phone age has reduced this mental endurance. Our seminars are restricted to 50 minutes (proving how patient and enduring our clients are to our on-stage ramblings). A 20-minute attention span is not a good recipe for addressing climate change.

There's a saying in politics. *"When you're explaining, you're losing".* Focus on sound bites and easily understood concepts. It helps to find an 'other' to blame, and it really helps if 'someone else' can be made to appear to pay for it all. Facts, details, efficiency, likely costs, and outcomes are rarely considered. This is not a good recipe for addressing the climate change issue.

We believe the solutions to pollution are unlikely to come from government. One simply cannot legislate or tax an economy into a new direction. The only way to achieve our climate goals is for someone to invent a new way of using energy that is more efficient, with less pollution than the current options. Reminder: Pollution is excess wasted concentrated material. Truly efficient process don't pollute. More efficiency = more productivity. If history is any guide, that increased productivity will lead to a wealthier, healthier, happier, cleaner and greener future. Increased productivity is the ONLY way we'll achieve our goals. It is this productivity question we've repeatedly raised. Most of the current climate change solutions are couched in 'climate emergency' language. Under this view ANY solution is acceptable. We disagree. A solution that is less productive, trading a future we can't see for a present we don't like is a very tough sell. Those who find a new productive solution will understandably be enriched more than the rest of us. That's the contract. We want in! But…Governments cannot force these ideas upon inventors or consumers. Like Ring Starr advised: All we have to do is act naturally.

Just as we must all protect our environment from pollution, the Hilberry Group must protect our client's life savings. Its not 'someone else's' money. We must carefully manage their wealth not only for pure returns but for durability of purchasing power. We must be in front of 'the market' and the broader scope of living costs. This explains our constant harping on energy policies leading to rising costs and inflation. It also explains our intense focus on politics. If elected leaders get this wrong, and lately they clearly have, their well intended efforts result in an angry, frustrated, fearful electorate, desperately seeking a solution. The world's worst dictators all came to power during trying economic times. This stuff matters.

Some have argued Vladimir Putin pondered Russia's long-term future dominated by fossil fuel sales. Western determination to end consumption was alarming. On the other hand he may have looked at Russia's declining population, the declining state of it's military and decided if he wanted Ukraine now was the time to act. Rather than opening up the economy, canceling corruption and improving the rule of law, he decided to steal from his neighbor's through violence. It isn't going well. To be clear, the Ukraine war is not the West's fault. On the other hand, many have not understood the importance of energy NOW.

RBN Energy Daily Blog for May 25 comments on this reality. We urge clients to make the 10-minute read. It's available as an audio podcast for our commuter clients.

'Tell Me Why' Markets React As The Energy Transition Slams Into Energy Reality

https://rbnenergy.com/tell-me-why-markets-react-as-the-energy-transition-slams-into-energy-reality

Speaking of rising costs…

The end of fish and chips? Rising prices threaten a British tradition

https://www.reuters.com/world/uk/end-fish-chips-rising-prices-threaten-british-tradition-2022-05-26/

'How Goodhart's Law Can Help Us Understand How We Got Here' – The Felder Report May 25, 2022

This week's blog from Jesse Felder talks about measuring sticks becoming targets. His commentary on passive index investing is required reading. It will be on the test!

Excerpt (one of the more polite passages):

"When investors invest in an index fund, they bypass this investment process instead using the S&P 500 Index a shorthand symbol for the economic value of American business. The more investors make the same decision, the more their blind buying begins to outweigh the investors making rational decisions, undermining the efficiency of the market. Because passive investing has become the single most popular strategy in use, markets have become less and less efficient, undermining its most basic assumption."

https://thefelderreport.com/2022/05/25/how-goodharts-law-can-help-us-understand-how-we-got-here/

We focus our clients' risk assets on holding individual, dividend paying, large-cap stocks. We think there's plenty enough risk and reward in that approach, shunning the high-flier market darlings. We're not averse to using various funds for dedicated purposes. We believe individual security ownership is the purest form of risk taking with the lowest cost to our clients. (For a recent accounting of our approach vs. the broader indices, see last week's note). If we can anchor our client's living costs within a band close to their cash dividend income, the market doesn't matter to them. They can use the market for it's intended purpose. Liquidity. If they don't want or need to sell, they don't have to. While we think we're competent in addressing financial markets, we don't plan our clients' retirement income streams around projected market price returns. The result is our clients often experience close to bench-mark index returns with meaningfully lower risk. We might not squeeze every last dollar on the way up, but we'll keep a lot more of our winnings on the way down, and our clients lifestyle isn't impacted by price moves. We strive to deliver superior risk-adjusted returns. Historically we've succeeded.

Examples of our approach are the Canadian banks. The Canadian media (looking at you CBC) and elected officials make great sport of targeting the Big Banks as bad actors that need management. The Fed Govt's 2022 **Canada Recovery Dividend (CRD**) 'one-time' 15% tax on Canadian financial firm profits exceeding $1 billion in 2022 is a good (bad) example.

https://www.fitchratings.com/research/corporate-finance/canadian-banks-earnings-not-materially-impacted-from-government-recovery-dividend-12-04-2022

All the banks reported this week. The CRD didn't do much denting. They all reported higher earnings. Excepting TD Bank, they all hiked their dividends. The hikes were modest versus the earnings. Are Canadian Banker's holding their breath?

Description	Symbol	Q1/2012 Dividend	Q1/2017 Dividend	Q1/2019 Dividend	Q1/2022 Dividend	Q2 2022 Dividend	2022 % Change	2019-2022 % Change	2017-22 % Change	2012-21 % Change
Bank of Montreal	BMO-T	$0.70	$0.88	$1.00	$1.33	$1.39	4.5%	39.0%	58.0%	90.0%
Bank of Nova Scotia	BNS-T	$0.55	$0.76	$0.87	$1.00	$1.03	3.0%	18.4%	35.5%	81.8%
Cdn Imperial Bank of Commmerce	CM-T	$0.45	$0.64	$0.70	$0.805	$0.83	3.1%	18.6%	30.7%	78.9%
National Bank of Canada	NA-T	$0.38	$0.56	$0.65	$0.87	$0.92	5.7%	41.5%	64.3%	132.0%
Royal Bank of Canada	RY-T	$0.54	$0.83	$0.98	$1.20	$1.28	6.7%	30.6%	54.2%	122.2%
TD Bank	TD-T	$0.34	$0.55	$0.67	$0.89	$0.89	0.0%	32.8%	61.8%	161.8%
									Avg %	111.1%

Source: Hilberry/NBF/Refinitiv - an expanded version of the above table is available

Over the past 10 years, on average Canadian bank dividends have increased 111%, an average annual compound growth rate of 7.75%. Dividend re-investment would have increased this annual growth rate in cash income to a shareholder.

Over the past 10 years the average price gain for the Canadian Banks is 131%, an average annual compound growth rate of 8.73%. There's something going on here. Note we're making this comparison from set dates (May 28, 2021 to May 27, 2022). Changes in the starting/ending dates will alter the price return. The point is the dividends reflect earnings. They are cash payments so are hard to argue with. The 10-year price history – spanning the COVID-19 induced sharpest market crash since 1929 – proves market prices are slaves to earnings and dividends, explaining our calm surrounding market events.

DISCLAIMER: Anna and I own all of the above names personally and for family accounts. We own all of them in client accounts over which we have trading authority. We have traded in all of them within the past 60 days.

We believe the market is our friend, not our enemy. If investors want to sell at below average prices, we will be buyers. If they want to buy at above average prices, we'll gladly sell a bit. Don't get lost in that process. Keep your eye on the prize.

Minor Mistakes = Big Lessons | Important Career Lessons for Young Professionals in Finance

Watch Anna's latest video here

https://www.youtube.com/watch?v=KD1SnsoGlCQ

Have a Great Weekend

Steve & Anna Hilberry

FOR THE RECORD May 27, 2022

DOW INDUSTRIALS:	32,974
S&P 500:	4,126
S&P/TSX COMP:	20707
WTI:	$114.74
LOONIE IN $USD:	$0.7845 $US

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