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Energy Investing in 2023

Arjun Murti, Former Head of Energy Equity Research at Goldman Sachs and Publisher of “Super-Spiked” on Substack

We kick off the new year with Arjun Murti, the Former Head of Energy Equity Research at Goldman Sachs and the Publisher of “Super-Spiked” on Substack. SmarterMarkets™ host David Greely sits down with Arjun to discuss some of the big issues facing energy investors in 2023.

Arjun Murti (00s):

My basic tagline is the virtue signaling part of ESG. There's, you know, good and bad energy or clean and dirt energy... we could do without all of that. All energy is good. There are different levels of carbon intensity, there's different levels of cost, there's different levels of timeframes and CapEx involved, but all energy is good. We just need to figure out how to motivate less carbon intensive, less environmentally damaging forms of energy over time while we're trying to be affordable, reliable, and secure.

Announcer (30s):

Welcome to SmarterMarkets, a weekly podcast featuring the icons and entrepreneurs of technology, commodities, and finance ranting on the inadequacies of our systems and riffing on ideas for how to solve them. Together we examine the questions are we facing a crisis of information or a crisis of trust and will building smarter markets be the antidote?

David Greely (56s):

Welcome back to a New Year on Smarter Markets. I'm Dave Greely, Chief Economist at Abaxx Technologies. Our guest today is Arjun Murti, the Former Head of Equity Research on the Energy Sector at Goldman Sachs and the publisher of Super-Spiked on Substack. We'll be discussing some of the big issues facing energy investors in 2023. Hello Arjun, welcome back to Smarter Markets.

Arjun Murti (01m 20s):

Dave, it's great to be here. Thank you for having me again.

David Greely (01m 23s):

Absolutely. So glad to start the New Year 2023 with you and I really enjoyed reading your first Super-Spiked article of the year this week and you caught my attention with your statement that we are entering what you said is unfortunately what you will expect to be year three of the messy energy transition quagmire and I wanted to start off today by asking you, you know, what do you mean by that?

Arjun Murti (01m 48s):

You know, Dave, it's been quite a period here for energy markets and I think why year three and why do we, so we're in an environment where you look at traditional energy, which is still the overwhelming energy of the world, at least 80% of our primary energy and we're out of essentially everything, spare capacity and OPEC inventories, natural gas deliverable capacity, what have you, despite what are now two years of better returns on capital and much higher prices. You still have this confluence of everybody, traditional investors, new investors, climate oriented people, the executive sell saying we don't want to spend on the old stuff, but it's 80% of our energy mix. There seems to be a notion that either because profitability was poor, so we don't trust the companies or we're concerned or think that various climate solutions are gonna result in a big shift in a short period of time of how we demand energy.

Arjun Murti (02m 42s):

You're just not seeing the spending and so long as that is the case, I think we're gonna be in a, a pretty challenged environment. It's, it's not a knock necessarily on the new stuff. I think it's more recognizing the stuff doesn't happen quickly. If you wanna switch to more fuel efficient vehicles, if you can switch to EVs, if you wanna have different forms of power generation or what have you, all these things take time measured in multiple, multiple, multiple decades and you need spending on all of it. You need spending on traditional energy, you need spending on new energy and you need a whole host of policies that recognize those realities and in the absence of that, I'll say it's perhaps fortunate if you're an investor in these things and you feel it's a environment, but it is unfortunate for the

world, make no mistake to not have abundant energy and I think that's why we use the term the unfortunately, I think we're gonna be in year three of this energy quagmire that we're in.

David Greely (03m 35s):

Yeah, and I wanted to dig into this reluctance to invest that you brought up cause it seems to be so central and of course oil companies had a very profitable year last year and that's caught a lot of investors' attention who may not have been paying much attention to the sector for a little while. But of course, you know, we've had the fed continuing to tighten the economy slowing and what's turned out to be an extremely warm winter period in Europe, which has really helped out the energy situation there but it has put downward pressure on oil and natural gas prices and I'm curious, you know, investors may be asking if this energy cycle is over already and you've been doing this a long time, a where do you think we are in this energy cycle?

Arjun Murti (04m 20s):

I mean Dave, my reflection on this is in my 30 year career, every time energy rallies, no matter what the backdrop, it could be structurally bullish, structurally bearish, a seasonal rally, a cyclical rally. That is always the question is, isn't that like tech where people like love the product, get excited about it and can see 15 or 20 years of perpetual growth and returns. There's always a worry with energy. I still think you have to take a step back and say, well where are we in the broader cycle and so after what was a 15 year profitability downturn 2006 was the peak profitability for the sector, which I would note two years before the oh eight price peak, maybe a full seven or eight years before the cycle kind of notionally ended, as most people would say in 2014. But it's been 15 years of down profitability one or two years at better times is I clearly not enough for either companies or investors to say, let's turn on the spigots again, I think you then add in this notion of hey, there is uncertainty about the long-term demand.

Arjun Murti (05m 15s):

What is the pace of electric vehicles or fuel economy or sustainable fuels or whatever alternate forms of energy you want to mix in there. We don't know how quickly that we can all debate that these things might be slower or faster, but that long-term demand uncertainty, the reality of 15 years of pretty down cycle profits, one year of better profitability has not been enough. I will say one more thing Dave, I get the frustration people sometimes have with political rhetoric, especially say here in the US or this notion of ESG investors and it's out there. I'm not saying it doesn't make a difference, but when I think of why hasn't CapEx risen more, I'd say it's in my opinion, overwhelmingly driven by this really challenging extended period of poor profitability we've had and simply having one year of better returns is not enough now is it two years, three years or four years. Somewhere in there I think would be the debate and you then mix in the points you mentioned, which is what if we have, if not a recession, but a weaker period in 2023 or a war winter, what have you, all these kind of things, the inherent volatility is gonna cause a delay in the CapEx response.

David Greely (06m 20s):

Yeah, I wanted to ask you that point cause I really like the way that you've been characterizing the recent cycle of being a, I think you call a super vol cycle as opposed to a Super-Spiked cycle. Because I think it's important in that, you know, you kind of see this underinvestment lack of capacity, low inventory and demand can fluctuate. You can have a warm winter, you can have a cold winter, you can have demand get destroyed and that being prices down, but until you get that investment you don't keep prices lower and more stable over the long term. So I'm curious, when you think about being in a super vol environment where prices are gonna be moving around a lot more, does that discourage the investment we need or encourage it? What's the investor attitude towards that type of volatility?

Arjun Murti (07m 07s):

I think it unquestionably discourages it. So I'd say the couple, I also just say differences with the 2002 to 2014, what I've called the super spike era is in, in that environment there is not really uncertainty on the long-term demand trajectory. People might have debated in any given year have prices risen too much or could we have a short-term recession or what the FED is doing. But that basic relationship, a population growth, economic growth leads to oil and gas demand growth. There is no questioning of that. And while I think the extreme question we're having right now is overdone, I for one think natural gas grows as long as one can see 20, you know, at least the next three decades and that's maybe as far out as anyone can go but even oil demand I think is gonna be very hard to kill oil demand.

Arjun Murti (07m 52s):

But while saying that, there's no question, there is more of an uncertainty this go round than there was last time we had China joined the WTO and while no one knew exactly at the moment they joined that it would lead to such an emerging market boom. As that boom progressed, you know, Goldman came out with the bricks call our friend Jim O'Neil and you had a host of people say, this is a really

good economic event. No one is saying that now, right. So we're in this kind of really unique environment where you don't have spending for all the reasons we've articulated, but we also don't have that booming economic growth environment. So I think you'll keep budding up against demand destruction, pricing, quote unquote, it's not a specific number. It can be different products to different times. So it was as you know, Dave last summer, five to \$600 per barrel equivalent natural gas prices in Europe.

Arjun Murti (08m 38s):

It might be diesel prices, it might be gasoline prices another time. We sometimes simplify that total oil price, but it's not a hundred dollars a barrel or 200 or any specific number. It's going to vary. But when you hit that price, whatever it is in whatever commodity it is, it then causes a period of economic weakness. You know, and without that sort of underlying, again in the past booming emerging market growth that drove us 20 years ago, with that type of backdrop, I think you're gonna whip around from these much more bullish environments to also an environment where you back off none of which is going to motivate new supply growth, which is what is needed both traditional supply and new supply to get out of this quagmire as I'm calling it.

David Greely (09m 19s):

Yeah, that's a really interesting distinction between back when you had a secular support for demand in China and the bricks versus now where we have this messy energy transition where it's more of like a secular move away from fossil fuels and oil and gas but as you said, that move isn't gonna be quick and it's not gonna be easy and I think there's a wider and wider recognition that energy transition's gonna take some time before we can move to widespread electrification powered by low carbon renewables and I wanted to get your thoughts on how should investors be thinking about that secular impact of the energy transition on the traditional energy industry, the oil and gas industry.

Arjun Murti (10m 01s):

Dave, I think you've hit the nail on the head in terms of the crux of the issue. I think it's coming to terms with first and foremost we have to have abundant, available, affordable, reliable, secure energy for all. But we need to do that with as small of a climate environmental footprint as possible and I think people struggle with, if I am particularly focused say on the climate or environmental side, how do I get comfortable with the fact that we're probably gonna need 20 to 30 years at least of oil and gas investments to continue, we're going to need new pipelines, we're going to need new LNG facilities and how do you do that in a way where you're still lowering the carbon intensity. In the case of natural gas, I would say de facto eliminating or at least near zero method I think is the right phrasing type of emissions.

Arjun Murti (10m 44s):

How do you do that in as responsible a manner as possible and you're gonna have to wrap your arms around the idea that these things are not quick and easy. I think one of the big things we're gonna learn in 2023 is the hockey stick EV growth forecasts are going to prove challenging. I am personally an EV bull, meaning I think EV sales are going to grow every year. I've driven happily an electric vehicle for the last seven years and will personally have no intention of ever buying an ice vehicle again. But as I've said before, I'm also very fortunate to have had a career on Wall Street. I live in a suburban single family home with a heated garage that makes only that Tesla both affordable for me and manageable in terms of being able to charge at home and these kind of things.

Arjun Murti (11m 25s):

And so the, you get into things like cobalt, you get into things like lithium, you get into all the sort of metals and mining that Robert Friedland and you and Josh have talked about in prior podcasts. These are all huge issues and they're, they're solvable but they're not solvable in five years or 10 years. They're solvable in multiple decades, you know, so the idea that we're gonna have these hockey stick EV growth forecasts, I pushed back hard, I think some of the correction we're seeing in Tesla stock as an example, some of the short term kind of thing with higher fed rates. But I think a larger part of it is going to be the idea that yes, their sales may still grow, but the idea that it's gonna lead to some major displacement of all demand within 10 or 15 years. I think that's the part we're gonna get some pragmatism on. And pragmatism would be the, the word of the year. I would hope that from both investors, from policymakers and from just general people, we'll see more of that in 2023.

David Greely (12m 12s):

Yeah and I wanted to talk to you a bit about that pragmatism on the government side cuz we really can't talk about the energy transition without talking about the influence of government policy and you know, we've seen a lot of new policy coming out of Europe coming out of the US and I was curious, where do you think we are currently in terms of the government's attitude and policy towards the energy industry?

Arjun Murti (12m 34s):

Well, I'll caveat this by saying we're starting from a really low bar in terms of basic understanding of energy and frankly any sense of pragmatism from anybody. So someone like myself might find it easy to pick on what we would call progressive democrats in here, but the sort of the opposite side where we're getting from Republicans, we actually need ideas. We don't just need, let's mock solar and wind and make fun of it. Let's actually, what are the ideas that if you wanna have say call it conservative climate principles, what are they who articulates these? Why don't we hear anything about it? So let's say all sides, or at least in this case, both sides in the US context are kind of to blame for what I think is really poor narrative in and around energy. I mean, so again, the goals are simple. We need affordable, reliable, secure energy with the small of an environmental and climate footprint is possible.

Arjun Murti (13m 21s):

And where I gained some optimism, I'll just have to be conscious of Chaturmas rules from some of the meetings I've been in, is I've seen a shift from folks either in or we're recently in or associated with, let's just call it the left side of the aisle in the United States where behind closed doors you will hear phrases like, well of course everyone knows you can't do a hundred percent renewables and you're gonna need nuclear power and we're gonna need natural gas. I say time out, hey if that's so obvious, how about articulating that. Can I vote for you if, if it's such an obvious statement. But of course the politics keep them from say that. And in the same time I have been in meetings with folks, well let's just say it's rite of center affiliated with either congress or, or maybe folks in and around prior or perhaps future administrations with also what, what are kind of interesting ideas, again maybe from more a markets or a conservative oriented side, but you don't hear those expressed as much publicly.

Arjun Murti (14m 14s):

So there's a reticence to speak publicly about this, but I do take some comfort that have been in enough meetings and it's really been, I'd say over the last three months or so, that there's just been a noticeable change. I hate to say it's towards the middle cuz that always sounds like compromise. What I'd say is it's away from the extremes towards what I'm gonna call what I think our healthier and more realistic solutions with realistic timeframes attached to them as well. But it's, that's off a really low bar. I don't wanna create a sense of over optimism here. Any signs of progress are good signs.

David Greely (14m 46s):

Yeah and I'd love to follow up with that because you know, on Smarter Markets we're always trying to, to look at ways to carve out that pragmatic middle ground and find people that are interested in focusing on the problems. So when I hear you mention that there seems to be this shift, however subtle towards a more reasonable or at least being able to have a conversation with one another. I'm curious, like do you have a sense of what has triggered that. What's led to that movement towards being a little bit more pragmatic.

Arjun Murti (15m 14s):

I mean I think we've come out of our dream world of 14 years of four free money, right and we're seeing kind of the, the downsides of that and the debate on what is correct fed policies for I'm sure a different group of podcast participants than you and I, but that notion of sort of free money growth to the moon irrespective of profits if we're looking at some of the unprofitable tech companies as they've called, I think the reality of the Russia Ukraine conflict and what that means for energy security, I think the mistakes Europe has made in terms of being overly reliant on Russian in particular prematurely retiring nukes, again the, the place where I'm least optimistic there's been some policy progress is actually Europe, I'm Dave American as you are and so clearly have sort of an American's perspective on this, but I still find it shocking that Europe's going through what it's going through.

Arjun Murti (16m 03s):

And while I know Germany has talked about delaying the shutdown of some nukes and so forth, there still seems to be a lot of lack of pragmatism there. So I'll say in my political commentary, at least based on meetings I have directly attended, I feel more optimistic that again, relative to a low bar there's a little bit more progress in the US I think Europe's gonna have to get their arms around where they are today and some of the things that they're talking about and counting on and it's great to talk about hydrogen, it's great to talk about a whole sorts of things, but I think you have to be realistic. Are we talking 50 years here. Are you sure you wanna count on this for the next five or 10 years, whatever these various options are, we're gonna need a whole bunch of traditional stuff hopefully done in a more efficient manner, hopefully done with less methane emissions, what have you. I think while we're waiting for the new stuff to start to come and we're gonna also need nuclear to be part of this conversation.

David Greely (16m 50s):

Yeah. And when you look at things like say US policy in particular where you see it get, you know, moving from a low bar towards more reasonable and we've had of course the, you know, the inflation reduction act went through lots of supports for newer forms of energy. If you think about the energy industry broadly, do you see the government at this point in the US as potentially positive for investing in that sector or more of a risk?

Arjun Murti (17m 15s):

You know, Dave, this is where I think folks that are writer center are gonna have to figure out what is the role for government. So one can be for limited government, limited government does not mean no government and on anarchy and things like negative externalities related to the environment. These are the things classically that markets quote unquote don't solve. So I am someone who is more sympathetic towards let's try and figure out ways for private capital and private enterprise and markets to solve this stuff, but they cannot solve everything and I think what are the rules that should be in place. What is the areas that we do need government help and support things like fuel economy rules, if it is a goal to decrease our dependent on gasoline, it's unclear to me why both Republicans and Democrats in the US context are willing to exempt a whole bunch of heavier, less fuel efficient cars with things like fuel economy.

Arjun Murti (18m 06s):

And that again, that's a way to take a chunk out of oil demand. If you really wanted to, rather than miss our fuel economy targets by 95%, as has generally been the case over the last 25 years, you get a stricter rules and that that's gonna require governments to step up there. Things like a price on carbon as an example, it's either gonna be labeled as a tax and therefore the right center doesn't like it or an excuse to allow fossil fuel production quote unquote, which is why the left doesn't like, oh we got bipartisan support to not do anything. That's great, right So I think both sides are gonna have to figure out what is the role and so the role might be that if you write a center, we're going to need some amount of rules and regulation on some of this stuff.

Arjun Murti (18m 44s):

Methane is a clear and obvious place where if the companies are not going to voluntarily, and I'm talking about all the companies, not just the large ones that I think have made good faith promises, but all the mid and smaller size companies, if they're not going to proactively deal with their methane emissions, then that is someplace where you'd say some sort of rule is required and I think what are the examples of that? I think when you go to the left, the idea that they should just be against every oil and gas pipeline because it's yesterday's issue and we need a future, it's not realistic. You can hate oil companies and gas companies all you want. You can hate fossil fuels all you want, but it must be better that it comes from the US and Canada than from, and again, apologies Dave. I'll say this, as an American from Russia or Iran if these are our choices or at least some of the choices, so I, no matter how anti fossil fuel you are as environmentalists, I would still think it should be stopped elsewhere before it's stopped here and that these are just two examples or a few examples of where I think both sides need to adjust how they think about things.

David Greely (19m 42s):

Yeah and in addition to, you know, those sorts of conversations within government circles of course, you know, I also wanna talk a bit about the influence of investor behavior, notably through ESG investing, looking outside pure financial returns. You know, we've seen a lot of pullback in investing in the energy sector for ESG concerns. In particular a big move by European financial companies to pull back from financing in the oil and gas sector and where do you think we are at in terms of ESG investing's influence on the energy industry and is what we mean by ESG investing evolving?

Arjun Murti (20:22):

It's a great and actually very broad question and topic. So I would say my basic tagline is the virtue signaling part of ESG there is, you know, good and bad energy or clean and dirt energy we could do without all of that. All energy is good. There are different levels of carbon intensity, there's different levels of cost, there's different levels of timeframes and CapEx involved, but all energy is good. We just need to figure out how to motivate less carbon intensive less environmentally damaging forms of energy over time while we're trying to be affordable, reliable, and secure. Let me get to the European financial. So we've had Munich re, the reinsurance company, HSBC, the bank both announced to be consistent with climate objectives. The Ill's net zero report, they're going to stop quote unquote financing oil and gas starting in 2023.

Arjun Murti (21m 11s):

And I believe it's related to new CapEx in in both their cases. You know, I find these announcements to be really deeply disturbing. Completely unhelpful. They're private companies, they're certainly entitled to do what they think is best and I think if they were doing it because they weren't making money in these areas, I could say as an investor that might make sense, but when they're specifically citing climate, who is Munich Re and HSBC financing. Are they financing Preveza, the Venezuelan oil company, are they financing Russian oil or Iranian oil or are they most likely financing western companies. The war on fossil fuel supply, someone else's made the comment analogous to the war on drugs. I don't understand the relationship between singly killing fossil fuel supply, which is what these types of things do and how that's going to impact demand.

Arjun Murti (21m 58s):

So are they still doing auto loans or, or other loans that de facto use energy that is of course 80% fossil. So I could go on a long time about this. I would just say that to me it is not climate friendly. It is not going to lower emissions. It is not helpful to citizens of the world to have major financial institutions stop financing the energy that the world heavily depends on. I think when you get to the investor base, there it is, it is a really complex and diverse issue and the same way, I don't think anyone could generically say hedge funds, all hedge funds are good or bad or all pension funds are good or bad or, or all anything is good or bad. I think that's true for the ESG topic. So no one could dispute that these companies need governance and that maybe if every company had a well i r drill, baby drill model in the 2015 time period and it didn't work, maybe some diversity of at least thought process might've helped come up with at least one or two different strategies amongst that group of companies.

Arjun Murti (22m 55s):

And I think the idea that companies should not adhere to health safety and the like, so like the core concepts of ESG, of course it's needed in I think every company and I think as an investor you can make an effort to discern that. Do I have conferences management or not. I think where I push back on energies when it starts getting into the moral argument of this is good or this is bad and I wanna be on the side of good and I wanna be against the side of bad and somehow quote, clean energy is good, not that there's any such thing and that fossil fuels are quote unquote dirty and therefore bad and so I'm calling it ESG 2.0 again, the fundamental factors of ESG I think are critical to the success of any company, but I think what we'd like to get away from is these sort of moralistic labels.

Arjun Murti (23m 38s):

There is no such thing as green and clean there. It's bad words, words matter. All energy has elements of clean and dirty. All energy has positive and negative externalities. There's no forced labor. I'll try and be somewhat constrained here going on with a lot of traditional like you see for example in cobalt in other areas. So forced labor for the solar panels with the, like these are the, some of the examples all energy has its positives and negative externalities and I think I'd rather switch the, the semantics if we could to that type of language.

David Greely (24m 13s):

Yeah and as you talk about, you know, ESG 2.0 and evolving beyond virtue signaling, one thing that I've been waiting to see maybe you can tell me if, if we're getting down that path, is when do the energy companies be seen and become more allies in the effort instead of being seen as adversaries because when I look at the commodity sector, the energy industry, one thing that hits you right in the face is just the sheer scale of it. The millions and millions of barrels of oil consumed every day, the immense quantities of gas, the megawatts of power and I don't see how we do something as big as transition off of fossil fuels and into new energy forms without the skills, the talents, the engineering know-how, the infrastructure that only exist inside the big energy and mining companies. So I'm curious like when do they become seen as a resource and an ally in this transition as opposed to the adversary?

Arjun Murti (25m 15s):

I think there's a whole host of things that need to happen. I mean first and foremost it's just a fundamental understanding of how basic energy is to everything. You know, I think when people talk about, for example in tech the cloud if you don't really think about it, it's really just energy powering data servers around the world and your data is not stored on your local computer, it's stored in these various physical locations, right. The whole world is physical. I labeled it metaverse meets universe. It was a play on a Babylon joke of a similar title. But the idea that everything in the world is ultimately physical and it ultimately all requires energy and so that that just sort of basic understanding that energy is absolutely critical and that's first stop the entire point of it. No one at the end of the day actually cares where their energy comes from.

Arjun Murti (26m 03s):

They simply care that is available when they need it. I think the idea then of why do we use energy, why do we use crude oil. We don't use it because we love crude oil and most people will say they don't love crude oil based oil and gas companies. It's because it is there, it is available, it is affordable, it is scalable and again, I think there's a little bit of an idea that somehow it is big oil or someone else holding back a transition. Look, companies are always gonna fight for their turf. That's true in every single sector. But I, I think the idea of how much different metals do you need to really ramp up battery capacity, are those gonna be affordable for the mass population, like there's just so many questions on all these, these different areas of new energy technologies. I think we need to become a lot more realistic about what these timeframes are.

Arjun Murti (26m 49s):

When people talk about, as an example, solar being the cheapest form of energy, well for only counting the variable cost when the sun is shining, which is a zero cost kind of variable cost, then yes it's the cheapest, but if it's not shining all the time and you need backup or you need storage or you've got other grid investments that you need or that the capacity utilizations are low. So I think folks on that side of the aisle or that side of the argument, they need to understand nothing is inherently the cheapest, right and so this, all of this conversation that just gets muddled into ideology, well solar and wind are cheaper so we should only do that, which is absolutely not true. On the flip side, if you're an oil and gas person say, well all the solar and wind is just a bunch of nonsense, that's also not true and it doesn't mean there's nothing that should be done on, on the traditional side as well and so whether it starts with semantics, whether it starts with a basic understanding of energy, you know, I think these are all the steps that are gonna have to be taken to get to a healthier conversation going forward.

David Greely (27:44):

Yeah, and you have lots of great conversations with all sorts of investors in the energy industry and oil and gas and I was curious, you know, what do you think that investors are looking for when evaluating investing in the energy industry today and maybe are there different groups of investors that are looking for different things?

Arjun Murti (28m 03s):

I mean I've always thought it all boils down to profits. So if you make money, people will, will come back to your sector and if you lose money they're gonna avoid you and I've always thought from an investor standpoint, that is the be all and end all yes is gonna be a small group of people on an ideological spectrum will say I will not invest in this on some moral grounds if that's their review and that that's fine. But I've always thought the thing plaguing traditional energy investing most has been what again was a 15 year profitability downturn and what is now two years of better returns of which the first year simply kind of got us back to even and so we've now had one good year of let's just call it above historic normal type profitability levels and so that has sparked interest in the sector.

Arjun Murti (28m 45s):

The traditional energy sector in the US has gone from 2% of the SMP at its October 2020 lows to a little over 5% today it's, it's been a good period at a time that the rest of the market has, has faced some challenges, but that's still much a much lower weighting than historically has been. 10% to 15% has been more than traditional energy waiting. So it's still a sign that while investors have come back, they still don't quite trust the companies yet to spend the money wisely. They still don't quite trust what the long-term demand outlook may or may not be and all the volatility points we started with. And so again, what do investors want. I think they want profits first and foremost, but I think it's reasonable to say if you're an investor in traditional energy, what is my outlook for Royal demand?

Arjun Murti (29m 26s):

Like Arjun, you might have the view that fuel economy's disappointing and that EVs are gonna take longer because you know it's gonna, we're gonna have to mine all these different metals and so forth and it's not gonna be as quick and easy as just expanding in the luxury vehicle market as Tesla's done. That might be my view and someone else might have a different view, say no, those battery costs are going to continue to come down. We're gonna crack the code on cobalt mining and lithium mining and we're gonna have the IRA and permitting reform and all these things and it's a reasonable thing to debate. So I think investors will debate and discuss all these things, but it is still gonna boil down to do I believe this group of companies or this specific company is going to be profitable going forward and I think that is always and should always be the driving metric for investors as part of that. Does the company have good governance? You know, as part of that, do they treat their employees well. If they don't treat their employees well then do I have to worry that at some point they could have an exodus of high quality employees and so like I think you factor in those ESG factors as you're considering the long-term profitability of the company. But I've never thought of it as a separate scorecard or a separate metric. It is ultimately going to be the profits and the sustainability of those profits that matter most.

David Greely (30m 36s):

And what are the some of the things you look for as like you know, when you're thinking about is this gonna be profitable, is this company gonna be profitable or not. Are there certain things you, you look for your, your first pass?

Arjun Murti (30m 47s):

I mean I think it's always trying to understand and have a view on what are going to be the future low cost resources. It's, it's Lee Raymond's methodology from when his time as Exxon, which was his line, was always, I have no idea, we have no idea where all prices are gonna go. We're always gonna try and invest in the future low cost projects and that is the trick. You know, I can't say that I personally recognize because I didn't that the Permian basin which would be such a sizable resource. So it's not always a question of trying to perfectly guess these things in advance, but as it becomes evidence that the Permian Basin is starting to expand, that then may cause you to call into question a deep water explorer as an example. And, and the similar analysis applies to incorporating new energy.

Arjun Murti (31m 31s):

Do I think hydrogen or electric vehicles or solar or wind or whatever the various competing things may be, how do I think they're gonna stack up, do I run the risk of all these oil fields getting displaced by future opportunities to provide an equivalent energy resource to people and again, I come out and decide that I think oil and natural gas overall, not in every location but overall is going to still be quite competitive and therefore that plus what I think will be not as low a cost technology progress in some of the newer areas as I think some people may be forecast or at least it's not a straight line down. So yes, we've made a lot of progress in lowering the cost of batteries that go into electric vehicles, but maybe those costs are starting to level out. Maybe we need next generation battery technology, what's the timing of that. What's the timing of solid state batteries as an example. Can you really replace cobalt with some other product that then eliminates that cobalt mining issue. These are all huge questions that will play into do I wanna invest in oil and gas, do I wanna invest in new stuff or some mixture of, of all of the above. But these are all gonna be commodities. It will always, I think, boil down to the future sizable low cost resources is what you're trying to go after.

David Greely (32 m 38s):

That's great. Now I wanna pick your mind a little bit more because when we talk about these cycles, you know, cycles can be 10, 15 years and you put that in the perspective of a person's career in the finance industry, you start to realize that when you get these upcycles again often, you know, there aren't people around who have been used to looking at these sectors that have fallen out of favor. So, you know, might be a lot of people who know how to evaluate tech companies right now, because that's been a pretty profitable thing to do over the past decade, but maybe not so much, you know, evaluating energy companies and so as people get interested in the space again you know, if you have someone who's new to investing in energy companies, what would your advice be for how to begin thinking about investing in this space?

Arjun Murti (33m 22s):

David, it's really been a sea change shift in terms of who has been looking at the traditional energy sector and even at the start of my career in the early nineties, that was a period where the sector was generally out of favor and there was the boom in the seventies, the bust in 1986 and I started in '92, that energy, at least at that point in time was still in the eight, 9% of the SMP type range and so you still had a robust and grouping of senior and newer analysts covering the sector. I was a newer analyst at the time, that's not the case today, again, after a 15 year downturn, which coincided with a 15 year period of free money and growth is all that matters and tech is all that matters and you're down to 2% of the SMP instead of 8% of the SMP.

Arjun Murti (34m 04s):

There's been a real elimination of I think people who understand energy, especially traditional energy and for that matter, even newer energies. I think all these areas are lacking in just people who know about these things. You know, one of the reasons I've been able to have any sort of growth in my which you mentioned I think has been people are looking for people who've been around the block a few times. And so, you know, Dave used to be one of my favorite analysts to follow and I do hope as part of your Abaxx roles, you'll start writing again publicly. Cause the world does need people like you to be sharing their views publicly. I took it upon myself. I do this for fun, I do it for networking, but I do it also in part for educational purposes as well, you know, and so I think there's a dearth of people looking at the sector right now and, and you can start by reading books like the Great Dan Yergin and the Prize and so forth to understand the history.

Arjun Murti (34m 52s):

I recommend reading Vaclav Smil, the Canadian professor who has had a number of great books in energy numbers Don't Lie, Energy and Civilization and there's a newer book that he is got out as well. There's those types of resources, I think some of the social media, the Twitter, the Substack, there's a lot of great people on these platforms. So while it gets a negative connotation social media for some of the downsides, I think if you learn to harness it and to eliminate the kind of the negative voices and the people who are just out there to cause trouble and curate who you follow, try not to make it an echo chamber. There's just a ton of great content today. So I don't think you have to cover the sector for 30 years, but I do recommend going through the history. It is an older industry.

Arjun Murti (35m 33s):

It all of energy is, it's been around for 150 years and I think people do need to understand these historical lessons and I always say start with an understanding of the profitability cycles and how they change and what causes them to change and how which resources are in favor and out of favor, how that changes because it gets to that notion of what is going to be at the low end of the cost curve and how that shifts over time and you can look at traditional energy, newer energy is absolutely part of that mix. I should absolutely be concerned when I look at the outlook for oil demand or, or let's just take natural gas demand. There are plenty of ways to do power generation. So if that is going to be a future growth area in my opinion, then I should be concerned or not concerned, but at least understanding how can solar wind undercut that or not.

Arjun Murti (36m 14s):

Will we have a nuclear marshal plan, if not in the United States, at least in other parts of the world that could eliminate natural gas demand growth down the road or not, how do the geopolitics play into supply. It's not always that the lowest cost form of supply gets developed. If they're in a geopolitically challenged place, Venezuela comes to mind that could be a really sizable low-cost oil resource, but very sadly, due to self-inflicted, in my opinion, government wounds that oil has been staying in the ground and so it's what makes this sector interesting to cover as an analysts. There's just so many cross currents, geopolitics, but there's, there is no sector more important to the world than energy. Without energy you don't have anything. Yes, you need to drink water and eat or you're not alive, but right after that, right after drinking water and eating comes energy because without energy you don't have tech, you don't have cars, you don't have an economy, you don't have anything. Which is why, to get back to where we started this idea that we should label some of it good and some of it bad and some of it clean and some of it dirty and all these sort of moralistic labels, it's all good, but it can all also be improved. All energy is good, but all of it can be improved and let's try and get to focus on the types of energy that are lower cost and affordable, but then also can help us decarbonize and have a smaller environmental footprint.

David Greely (37m 33s):

Thanks again to Arjun Murti, the Former Head of Equity Research on the Energy Sector at Goldman Sachs and the Publisher of Super-Spiked on Substack. We hope you enjoyed the episode. Join us next week for our new series of Smarter Way where we'll be discussing smarter ways to address some of the ongoing problems in policy media investing in markets. Our first guest will be Craig Pirrong, Professor of Finance and Energy Markets, Director of the Global Energy Management Institute at the Bauer College of Business at the University of Houston. We'll be discussing the new European cap on natural gas prices and smarter ways to deal with energy shortages and high energy prices. We hope you'll join us.

Announcer (38m 14s):

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