Summary & Transcript

Bernie Horn

1. Strategic Actions and Decisions

- **Capital Allocation Pivot: Shift capital allocation from overvalued U.S. mega-cap tech equities to underpriced international and value stocks benefiting from positive real interest rates.**
- **Arbitrage Strategy Execution: Capitalize on global natural gas price discrepancies by investing in U.S. LNG export capacity via total energy plays.**
- **Refining Sector Positioning: Overweight U.S. refiners like Marathon Petroleum to exploit tight global capacity and high crack spreads caused by geopolitical supply disruptions.**
- **Geopolitical Hedging: Utilize non-Middle Eastern oil producers such as Eni to build structural hedges against geopolitical risks and energy supply volatility.**
- **Option-Like Technology Asymmetry: Build exposure to clean energy transitions by holding legacy energy firms with implicit, non-priced call options on fusion technology.**

Executive Summary

Macroeconomic conditions are shifting away from a decade of ultra-low interest rates and U.S. market concentration. Positive real interest rates and high capital expenditure demands are compressing multi-year valuations, forcing capital to rotate into global value equities with high free cash flow yields. Geopolitical conflicts and refining supply constraints present compelling entry points into the energy complex, notably through U.S. refiners and geographically diversified international majors. Moreover, embedded investments in disruptive clean energy technologies like fusion offer massive upside optionality at zero incremental cost. Executives should rebalance portfolios toward international value assets to manage volatility and capture cash-generative returns.

Key Takeaways and Practical Lessons

1. **Mean Reversion in Equity Markets: Macro shifts and positive real interest rates are ending U.S. outperformance, signaling a cyclical rotation toward international equities.**
    - ***Rebalance asset allocations away from concentrated domestic growth stocks toward unloved international value equities.***
2. **Refining Industry Structural Supply Deficits: Geopolitical attacks and a lack of new global refinery builds have created structural shortages and elevated crack spreads.**

- ***Maintain long exposure to high-performing U.S. refiners to profit from persistent supply-demand imbalances.***

3. **Geographic Diversification in Energy Reserves: Reliance on Middle Eastern energy infrastructure presents acute supply-chain risks during regional escalations.**
   - ***Prioritize positions in oil producers with expansive production assets located outside volatile Mideast regions.***
4. **Exploiting Global Price Arbitrage: U.S. natural gas trades at a structural discount to international markets, creating high-margin export arbitrage.**
   - ***Invest in integrated energy players capable of liquefying domestic gas and selling it into premium European and Asian markets.***
5. **Asymmetric Optionality in Legacy Assets: Certain traditional energy firms hold undervalued, high-upside strategic investments in next-generation technologies like fusion.**
   - ***Screen for legacy companies with valuable, unpriced venture bets buried inside their balance sheets to gain free asymmetric upside.***

TRANSCRIPT

03:55:31:01 - 03:55:57:15

Bernie, how are you? Hey, George. How are you? Good. Long time, my good friend Bernie Horn brain. I go way back to the, early 80s. I don't know, there too many, my peers I've known as long as you and I. And we would always be at the same lunches together, and usually a similar opinions. And I'm down the York City area and now, see, Bernie, you and I were not meeting at the Harvard Club anymore for breakfast, but here we are.

03:55:57:17 - 03:56:20:00

Thank you for doing this, Bernie. You're busy guy brains. You don't know my first. I don't think you've been to public, head of Paris Capital Management, a firm he founded. Globetrotting global investor value orientation extraordinaire, Mr. Free cash Flow. So make sure you know that shakes me. Bernie's free cash flow. No momentum, guys. Free cash flow guy.

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So, Bernie, from where you sit, what really makes you. I think the folks really interesting for the folks today, you're a global investor. So you're not just you don't have a Nasdaq centric view of the world. You can go anywhere, do anything. So I'm kind of curious, like, not, what's the market going to do? But what really strikes you has been truly noteworthy.

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Like, you know, I can remember being with you, who at IPO roadshows in 99, 2000, we'd be like, this is insane, right?

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Or, you know, okay.

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Esther Grand, you're former mentor. You know, guy Bruce. Okay, so here we are at different time different place markets there repeat but they rhyme. So I'm going to yield the floor to you. Just give me a stream of consciousness about how do you see this and what's really sticking out to you. And in particular putting in context the US versus the rest of the world before is yours.

03:57:14:01 - 03:57:50:20
Yeah. Thanks, George. There are, a lot of kind of tectonic changes going on in the world. You know, we've come, from a period of, as everybody knows, of, you know, 10 or 15 years when interest rates were exceptionally low. They were negative in real terms. You know, that created this momentum, where anything, you know, when your discount rate is zero, it doesn't matter if you get cash flows 20 years from now or today and everything looks good.

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And, you know, that led to this period of, understandably, you know, the mag seven generated a lot of cash flow. You know, they were almost literally black holes of for a, you know, for cash flow in the world. And that, you know, obviously created a huge amount of momentum, their weights and the indexes went crazy.

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We all know this, but we think that that's changing a bit, for, for a couple of reasons. First, you know, trees don't go to this and grow to the sky. The, companies don't grow to be entirely GDP. And so there's a reversion to the mean that seems to be happening. And I know you've talked about that and you've written about it, but it is interesting that, you know, we had a period when US equities grossly outperformed international equities for a long period of time, you know, 10 to 15 years.

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Normally these cycles you know, us outperform for about ten years. And then it will revert. International will outperform for about ten years. You can look at the those periods over time. And that's been pretty true. This period was a lot longer. And after the election and after the last presidential election in the U.S, you know, international equities up to that point had performed terribly against the US market, mostly driven by the, you know, by the magic seven.

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However, you know, and a lot of, you know, a lot of investors kind of looked at that. And then after the election, it was going to be all America first. We were going to screw the rest of the world. They've already performed horribly. Let's just completely throw in the towel. And and as we all know, when you get the most disgusted about something, that's probably the time that you should really load up.

03:59:48:07 - 04:00:08:17
I have to interrupt you, Bernie. My former colleague, Nathan Weiss, I believe, you know, he used to have a saying when you want to throw up, double up. Exactly. And that and yet we, you know, we've

seen a lot of redemptions out of international equity, investments. But but by the way, are you a cousin of. Are you a cousin of Jeremy Griffith?

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I feel like I've heard this story for 25 years ago. Go on. But, you know, so, you know, it was absolutely at that moment when most people threw on the towel and redeemed all their international equity investments, that the whole thing turned around, you know, the tariff, the US tariffs, the, the, the, the narrative that the rest of the world should start, you know, taking care of their own defense budget created a lot of domestic spending in a lot of other countries, and that's stimulated a lot of equity valuations.

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Interest rates then went went up. Now we have, you know, 3 or 4 or 5% interest rates. Inflation is call it three, maybe a little bit more. So you have positive real rates. And so value stocks look a lot more appealing. When somebody used to say I can get zero or negative in my fixed income, you'll take a lot of that money and and throw it at anything, you know, and now that you actually have have something positive to compare against, right.

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You can you now I gotta interrupt you because I'm, I'm, I'm having a seizure here. We're old enough to remember when I was like, five years ago. Do you remember when they had negative mortgage rates in Denmark? They did, you know, like like like, how do we do that? That's hard to believe. It's it's unbelievable. And it's amazing that it stayed for that long.

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You know, I, you know, there are a lot of other nuances to this argument, but I'll, I'll just get to the point. So. Right. So international equities have now started outperforming US equities. The Mag seven have not quite entirely turned over. But their growth has gone a bit asymptotic. So they're not they're not growing like gangbusters. And oh by the way.

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But instead of just you know raising prices on software that they had very little investment in and making 80% margins, they're actually now putting it putting money into something called capital spending, which they so so now they actually spending money and billions and billions of it, which is, you know, now they actually look like a real company.

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You know what? They have to generate free cash flow. And that's why I think these valuations are coming in a fair amount. So so I mean, I don't want to belabor the point, but, you know, I do think that we're in a regime now where the market leadership over the last 10 or 15 years is, you know, is coming, not coming to a complete end, because these companies are still real companies that generate a lot of cash.

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But the valuation of that cash flow, you know, is coming down. And, and that allows, you know, people like us to find good value and, you know, enter into things that, you know, we think are very, very well priced. And investors are now taking note, because if you can get a 10% free cash flow yield on your equity investment, that compares pretty favorably, you know, to a ten year government.

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Well, you're getting a maybe a 1% and 1% is better than zero. So, you know, money is actually flowing to those to those capital investments where you can get the best return. So so I think we're in a good position here. You know, who knows how long it's going to last. But I think it's got legs. Awesome. So,

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This should bode well. Again, you've borne the brunt of this because people run to the shiny object of sex, drugs and rock and roll and AI and all that stuff. And now boring starts to look a little bit better. The or the sex, drugs and rock n roll is spread out more democratically so that we. So if we use it that we do think that, you know, and again, the markets are not there, they're not homogeneous.

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I mean same emerging markets. I mean you might like Brazil, you might hate China, this, that whatever. But you're finding a lot more stuff working now obviously in these markets now it means you can get excited about it. And okay, so with that as a background, what sectors, industries, countries or let's just go to the stocks. What's your weapon of choice in terms of how you want to express the view you just explained?

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Yeah. So look I think we've got an there are a couple of sectors that I thought I'd highlight. I could talk about it all day long, but I know there's been a lot of discussion on the forum about about resources and energy. And I've got a couple of things in energy that I think are quite interesting. Have a few stocks there and then sort of contre energy.

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I've got a few stocks on the, on the, kind of the hedge against energy maybe not working. Right. So that you can that in your portfolio, which I think is nice in terms we like to structure our portfolios in a way that if something doesn't work, then something else does work, and it helps mitigate the volatility of the whole portfolio.

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But so anyway, on energy, a couple of nuances and a couple of observations that I think, you know, maybe some people already know this, but we do like the energy complex. We already had a position prior to this most recent Gulf War. And and that was, you know, good. Because in some ways, in a higher interest rate environment and in a world where geopolitics can become very strange, energy actually winds up being not a bad hedge, almost in some cases better than gold.

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Gold was great when rates were low, but when when rates start going up, it loses some of its appeal. And whenever there's a crisis in the world, you know someplace, you know what it usually involves oil and it usually sends prices up. And I think that's the regime that we're in right now. So, you know, we we like the positions that we had.

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We thought, you know, after the March April War, we were going to there was going to be some period when people will, you know, will come along and say, come by saying Kumbaya, with each other. And that was going to probably create a, a view that, you know, the energy complex was going to get more benign and, and, and oil prices would come back down.

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And we felt like that would be a good opportunity to add to it, because quite frankly, we don't think this, you know, this energy issue is come to an end. So in fact, that's what that's exactly what happened. The, you know, the US and Iran. Sorry if I've got a little siren going on back here, but the, the US and Iran stopped signs, memorandum of understanding that was supposed to last for 60 days.

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We thought that, Iran would wait close to the end of that 60 day period before they, ramp things up a bit and created more volatility. And of course, that's happened already. We thought we had another month or so to go before that would happen, and then we would be able to pick up some stocks. But in the meantime, you know, I thought what I'd do is let's talk about a few things, especially globally, that maybe people you know might not be aware of.

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So there's we like a company called TotalEnergies. It's a French, you know, gas truck, gas, oil. And by Brie there is a big French oil company trade in the U.S. I'm not sure it's because of the tot, but just for the folks at home, there's an 80 or they can buy. Keep going. So you know what? What they've done very strategically is that for the last, you know, decades, U.S. natural gas has always traded at a big discount to natural gas everywhere else in the world.

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And the reason for that is because it's sort of landlocked here. It can't get out. But that has started to happen where companies have built these big LNG facilities to take low cost natural gas here, liquefy it, ship it elsewhere where they can sell it at a much higher price. So this kind of natural arbitrage is something that total has, has really taken advantage of.

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So they've got this big, position in us LNG, they ship it to Europe and, and they make a lot of money. They've also been able to, you know, increase their, their oil production. So that's good to have a little bit of electricity production where they take some of this natural gas and help, you know, help produce low, lower cost electricity.

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So we think that that's kind of a very interesting company. And obviously they've made a little bit more money. Profits are up. But here's a stock that trades at a single digit multiple to earnings. It's got a 10% what we call a maintenance cash flow yield. And it's it's kind of a really interesting longer term play. But but there's another another company that we, that I, that I would like to highlight.

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For a couple of reasons. One, this is a company called Marathon Petroleum. It's a really, really well run U.S refining company. It, has positions all around the U.S. they used to be a lot more global. They kind of divested their their ANP company and they're mostly a refining company. Now what's happened? Did you know we all know that energy certainly oil prices have gone up because the Strait of Hormuz, you know, is causing all these problems that everybody reads about every day in the newspaper.

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However, you know, there's a side, issue here. And that is, first, the reason oil prices haven't gone way up is because almost all the main buyers of oil have used up all their inventory to kind of mitigate the, the fact that they weren't getting any deliveries due to this, to the closure of the Strait of Hormuz.

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Not only that, but there's a fair amount of refining production that also, got shut down at either blown up or shut down in the Mideast. So refining has become a bit tight and but, but but the other issue here is that, as a result of kind of the, the there are some imbalances in who produces what so the US, you know, produces, you know, some refined products, but we don't have it all here.

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We don't we're not self-sufficient in it. So we actually import, you know, some refined product and, and Europe exports, let's say diesel, but they import some, some other refined products, in other words, like gasoline. And so the fact that the crude is in short supply and it's probably going to take about 6 to 12 months for the oil consuming, entities to rebuild their inventories, it means that, you know, people are going to be consuming more crude, and there may actually be less available for refiners.

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So they could wind up really buying, having to pay up for crude just to keep the refined products late, slowing to where it's needed. You know, so that already sets up for a nice, situation for marathon because they've got a really good refining, product in, refining, operation in the U.S., you know, valero's another good one.

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But the other thing that's, that's there's another side bar here that's also playing into this whole story. So the Ukraine has been, very effective in really changing the rules of war. And they've been using drones, as you may have heard, but they've almost shut down the entire refining operation in

Russia. I don't think there's a single refinery that they haven't bombed, most of which has been shut down for new product.

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Now, at first I thought, this is going to cause, you know, since they can't refine their own product, they're just going to flood the market with crude. And that could be another down leg in the price of oil. However, what's happened is that, you know, the UK, I think recently, seized a, a shadow fleet tanker that Russia was using to sort of secretly sell their oil.

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It was like a secret, but but it was avoiding sanctions, let's say. And because they couldn't they haven't been able to refine product domestically in Russia. They've been sending crude to India, have it refined there and sent back, to Russia. So it's really, really hard to buy gasoline in Russia right now. Big lines to just be able to buy, you know, maybe ten, 10 or 15l of fuel for the week, which is clearly not happening.

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And so you'd think that that would have been okay. Now, you know, so Russia is going to somehow get around this. The problem for Russia is that the Ukraine has also bombed about 150 tankers in the Sea of Azov and and the Black Sea. So Russia's ability to even export oil or import refined product is really, really compromised.

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So again, I think this really sets up the refining industry for a period of, you know, kind of interesting. So, so let me interrupt because this is fascinating. And you're not gonna have to a podcast this whole thing because we could spend we're not talking. So. Yeah. So so the other one I just going to be done.

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So as well as refining. So I thought, you know, hold on, hold on. I just let me point out as well as the refining stocks have done, you think this has got legs and you would and went for a great run. Still with the refining stocks as many people need. You know, we should buy the refiners blah blah blah.

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Go buy something else has more talk. You disagree with it. You think finance looks great? I think you know look the 321 crack spread has gone from about 20 to 60. I you know, could have come back down to 20. Yeah I suppose, but you know with all this refining capacity shut down. But I think that there's just a lack of supply.

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And of course, nobody has built a refinery anywhere in the last 20 years. Right. So, you know, the the only offset to that is that, yes, people are driving more electric cars, so there's less the need for gasoline, you know, okay. That's you know, that's a potential weakness. But I think that that's a bit of a longer term story.

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Got it. Sorry. So we got totally got marathon. Yeah. The couple minutes we got remaining. What else you want to throw? Yeah. Another, another. This is a this is the Italian energy company and I, one, you know, while most companies what most oil companies were pivoting to, you know, alternative energy, they ignored sort of those, the, those pushes and they continued to find oil in a lot of different countries that you might think were somewhat risky, but they're not in the Mideast, which is actually turning out to be a terrifically smart idea.

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And they have these production facilities all around Africa and elsewhere. And it's they're one of the few oil companies. It's actually increased production and they will continue to do so. So I think that while most companies aren't able to sell more volume and more product, they're doing so in a really nice high prices. But there's one sort of caveat.

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I'll give you, and that is that they have an investment. If you really dig through the notes to their financial statements, you'll see about 1 or 2 lines talking about their investment in a company called Commonwealth Fusion Systems. And and I and I know this is going to sound really pie in the sky, but I visited this fusion facility that they're building in Devens, Massachusetts, twice now a couple of years ago and about a month or so ago.

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And, you know, look, this may not work, but they and a lot of other people were convinced that they're going to be able to sell their building this thing called a spark. And Evans, it is a very impressive facility. You know, fusion, of course, is very different than nuclear power. And it's a very clean, very low risk, production.

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If this if this works, that that entity alone could be worth as much as any is today. I mean, I've heard some of the executives say that that's probably they have a high expectation for something like that. And they're going to be building and they're starting construction near Richmond, Virginia, of, fusion facility that they think is going to be, providing electricity to the grid in, in the 20 early 2030s, not very far off if this works, George, I'm not saying it's going to, but if it works, you do not want to be long, Henry hub gas, or you want to be long.

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Something which is going to benefit from lower natural gas prices. But it sounds like you're really not paying anything for this, right. And in its own right is interesting, right? Yeah. It's so. Oh, it's already it's already on its own. Bernie. Bernie, you are a wealth of fountain of information and ideas. We got, we got, I'll give you one more miscellaneous way to jam in here.

04:18:07:08 - 04:18:29:20
Otherwise we're doing. I know you got to keep on. I'll keep you on, Bernie. We're doing a podcast. Okay. This is great. So, in Bernie, capital management, just give me 30s. I know what you do, but tell the folks, what do you do? And where can people find you on the web? Yeah. So, you know, we

manage global equity portfolios for institutions, but we have a, you know, a good slate of mutual funds.

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The Polaris Global Value Fund is, their own fund at best, all around the world. And we have four funds at the Petrie complex, international equity strategy. That's a multi cap non-U.S.. We have an international small cap, a domestic small cap and a and an opportunity fund. So, yeah. And you can find us Polaris capital.com on the web.

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You'll see a lot of blogs and videos and things that you can, you know, follow what we do. So yeah encourage people to look at the funds and you know, that's fantastic. All right, Bernie, we're going to you and I are going to do a podcast next few weeks. It's fantastic. Bernie, thank you so much for doing this is great.

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And again, I think, you know, educating the folks about the international scene, something you don't see a lot, in social media. So I'd love to get to go down deeper in some of these, foreign economies and markets are going to be really interesting. Thank you so much, Bernie. Really appreciate it. Our honor to be with you, George.

04:19:28:04 - 04:19:30:04
It's great you're Bernie. Thank you. Cheers.