Taylor Pearson:

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Jason Buck:

So I swear I'm not doing this on purpose, but I figured out, I think my last three out of four guests have been University of Colorado at Boulder Alumni.

Robert Mullin:

Oh, that's fantastic.

Jason Buck:

Got another one here. But just please tell me you didn't major in philosophy like the other two?

Robert Mullin:

I did not. I was an economics and business major, but regardless, the buffalo herd runs very strong in finance. So glad to hear that you're taking care of the buffs.

Jason Buck:

Yeah. So why did you end up going there because you grew up in the Bay Area, like the South Peninsula, is that right, of San Francisco or?

Robert Mullin:

I did. I grew up in the Bay area, but actually my parents went to and met at Boulder. And my dad had actually seen it as a young guy, his family had moved from sort of the Lake Michigan area. Took Boulder for a year because my uncle had some asthma issues and so they moved there. The whole family fell in love with it. They went back to just outside of Chicago, but all three of the brothers, including my dad, ended up going to Boulder for school. And my grandmother actually got her master's in music from Boulder back in the 1950s when they were there.

Jason Buck:

So you're a commodity of resource equity investor. So most people, if you hear Colorado, they would think Colorado School of Mines. But you went to Boulder for business. So what was your trajectory until you found your way into resource of commodity equities?

Robert Mullin:

Yeah, it was a little circuitous. We've got a bit of a family background in that my mom grew up on a cattle ranch in West Texas, just outside of the town of Marathon, hence the name of my firm. So there was always a little bit of that. We don't have a bunch of oil wells. It's not Dallas by any stretch of the imagination, so there's a little bit of resourcing ness in my family background. But I started off at the Franklin Templeton Group covering consumer products and that was back out of college. I'd always been interested in the securities' industry and buying and selling stocks. But with the sector that I started with, again, my first meeting with management was Reuben Mark, who was the CEO of Colgate-Palmolive. And so I covered consumer products and cable for a year, but then actually started gravitating towards energy then.

Robert Mullin:

So from there I found it actually worked really well with my natural inclination of analytical skill set. I'm not good at guessing what multiple goes on a consumer product stock or Gillette or something like that. But find me a process by which I can try and do a discounted present value of a decade of cash flows and try and buy a dollar's worth of assets for something less than that. That was music to my ears. So at Franklin, I helped launch the Natural Resource Fund back in the kind of late nineties and then have been doing stuff more or less on my own ever since.

Jason Buck:

I know we had discussed before privately, but you think that the seminal moment for you was 2008 and what you learned about resource and commodity equities in 2008. So can you dive into that a little bit of what your epiphany was from the 2007, 2008 great financial crisis?

Robert Mullin:

Absolutely. So it was a sort of revelation via a two by four to the head. It was a wonderful setup for resources. That was a really good decade for resource. Basically 2002 to 2007 was kind of glory days across all of energy and mining. The underlying demand poll was really great because of the Chinese industrialization and expansion of demand there. You started to see additional supply come in. But the stocks were cheap, inflation was picking up, the world looked pretty good and then all of a sudden the 2008 global financial crisis came in and swept the legs out from under it. And in fact, the resource stocks went down more than everything else despite the fact that they were the cheapest things going in. And so the epiphany there was that the environment, which is good for natural resource equities, which is rising commodity prices. Rising inflationary backdrop, is inherently really destabilizing to broader markets. And can bring about levels of volatility that leave nothing unscathed, including resource equities.

Robert Mullin:

So it was a tough lesson to learn, but it sort of shaped the way I thought about resource investing after that. So the first step beyond that was to focus my efforts within the resource sector on a more stable group of companies. If we're going to have a really super volatile sector, let's invest in companies that are more stable, free cash flow generating, good balance sheets and that sort of thing. As opposed to exploration companies or over levered companies that are going to go up huge if commodity prices go up. But probably go bankrupt if they don't. So that was really the thing that I changed in 2010 with the current strategy that we're running. And then on top of that, we started to do a lot more, and this is where you and I started talking. A lot more of the way of risk management and layering in long volatility on top of that, starting in 2019.

Jason Buck:

And we'll get into that unique hedging structure that you have within your portfolio. But I was thinking, I love your quarterly newsletters and even your monthly updates. Because I have a general romanticism I think for real assets and commodities. I don't know if it comes from reading Mark Rich's books or T. Boone Pickens. Or I just think about the swashbuckling Canadians going around the worlds to mines to check out fertilizer crops, et cetera. It's very different for you though in sense that maybe with resource equities, is it a lot of travel or is it more computerized these days where everything can be done from home?

Robert Mullin:

So I did a lot of travel earlier in my career. Visited a bunch of mines, did the helicopters out to the offshore drilling rigs. Had all the tchotchke's to show for it, boots and hard hats and all that kind of stuff. At some point you see a bunch of mines and you've seen most of what you need to see. And if you're going to do a lot of early stage investing in companies that are very much in that pre-production phase. Then you still have to do that due diligence or you have to have someone do that for you. And I've had geologists on retainer and people who spend their lives bouncing around between these different projects around the world. But I will say the focus on more mature companies, ultimately the arbiter of whether a deposit is profitable or not is the cash flow statement.

Robert Mullin:

And so it's nice to be able to not have to make sure that they're building in the right place or they've got room for a tailing dam. Or they're not going to be too close to a watershed or it seems to be too far away from a certain facet of what they need to support the mine. By the time I'm investing in companies, typically all that stuff's been sorted out. So it's less travel than it was. And certainly the post pandemic world where you can get management on a half hour, 45 minute Zoom anytime you want, has also made that to some degree easier as well.

Jason Buck:

Do you think it's a certain kind of young man that appeals to? I just think about maybe it's my love of James Bond films or I'm a sucker for any film that takes place in at least five countries. So if I was in my twenties and found resource equities or mining. I would've been one of those guys traveling to third world countries, like you said, looking at a hole in the ground. But thinking was the greatest thing ever until like you said, maybe you get a hardened grizzled veteran and then you've seen one hole, you've seen them all kind of thing. But I think it appeals to certain people or you were saying things like cash flow and real assets appeal to a very narrow segment of the populace. I feel like sometimes.

Robert Mullin:

Yeah, I mean look, there's certainly a romantic tangibility to everything that goes on here. And I was just in Morocco a couple of weeks ago. And sitting in one of their central planes where a great Roman outpost was built at the center of their olive oil industry. It was the only major Roman outpost that was away from the Mediterranean sea. And it was because of the incredible lush agriculture that was going on there. So this is the stuff that's been the building blocks of humanity for 2000 plus years. And so I think inherently it has to appeal to you from a base level. But that said, I'm not going to go out and visit the Nigerian oil fields anytime soon. I'll leave that to somebody else.

Jason Buck:

You're not going up to the heart of the Congo. But I think about when you talked about the resource equities. The first thing that always comes to my mind, and I'm sure I'm probably not unusual is this, is gold mining stocks. And people YOLOing Canadian gold miners because that's where they think they can get unbelievable leverage for a gold price play. But that's not what you're talking about. You're talking about looking for actually mature companies that have broad diversification. And I just wanted to clarify that difference a little bit.

Robert Mullin:

So gold stocks were gold stocks or internet stocks before internet stocks were internet stocks. And so the amount of ranked speculation that you see in a great resource cycle can be really intoxicating. That said, it's a really hard way to build a business over cycles because most of that stuff goes out of business in the down cycle. And so what I have found, and this was really, again, this is the outshoot of 2008. The lesson there was if you looked at a short list of resource companies that were flat or even up a little bit in 2008. They had a pretty common set of characteristics, good balance sheets, high free cash flow generation, flexibility to the point where they could actually buy back their own stock or buy back their debt opportunistically. Or even make acquisitions without the assistance of outside capital markets, without the banks and the equity markets opening up to them, they were there organically.

Robert Mullin:

And so concentrating on those types of companies gives you a lot of margin of safety in an industry that typically doesn't give you much. So it is not perfect in any way, shape or form. But to me it's really interesting in that people are like, "Oh, so those are the boring companies that you don't want to own in the up cycle." The truth is, is that these types of companies can actually build convexity through the down cycle by retiring their debt at a discount. By buying back stock, by buying out competitors who might have complimentary lands. Buying them out on the cheap because their competitors got over their skis. Flip side of that is that the companies that you think you want to own in the up cycle oftentimes have to give away a lot of that convexity with diluted financing in the down cycle. So what we've found is that we do a really good job of keeping up with the markets on the upside. We just end up protecting capital a ton better on the downside. And over the course of cycles, that really makes a difference.

Jason Buck:

Man, I'm going to steal that and use that for a pitch deck for what we do. So when you and I are so philosophically aligned, it's pretty ridiculous. And then what's even more interesting on the upside too is, if you have a highly volatile gold mine on the upside. You have to monetize perfectly and that's what people miss a lot. There's a lot of luck involved there. Where like you said, if you're riding these more large conglomerates with diversification during that up cycle. You don't have to be as perfect with your timing for rebalances or readjusting your portfolio. And I think that's what people miss a lot of time too. Is not only mitigating that downside, but people forget that the upside creates problems too. Especially you're maybe able, getting in later, it's like optionality. If you have convex put options and they're deep out of the money, you better monetize those perfectly. Or else you may have missed the whole convexity party and protecting the rest of your portfolio.

Jason Buck:

So it's an exceedingly difficult. Normally I like these conversations be evergreen, but I do want to timestamp this just because we're going to talk about different sectors and everything. So we are recording this August 23rd, 2022. And so I was going to talk about grains first, but I think to talk about grains, you have to talk about fertilizer. And part of fertilizer is obviously synthetic fertilizer and the Haber-Bosch process. But tell us what you're seeing across fertilizer markets around the world. Especially what went on in Ukraine, what was publicized in the Ukraine versus what maybe reality on the ground is maybe a bit different.

Robert Mullin:

So it's a really interesting, really multifaceted environment. I just think there's a lot of misconceptions about it and I think there's a lot of complacency about it right now. People got really concerned right after Russia invaded Ukraine and so there was a lot of tension here, but quite honestly the groundwork for the fertilizer bull market. This was ongoing for a year before Russia invaded Ukraine. And basically that was driven by longer term decline in grain inventories, it's effectively, that is driven by an acceleration of grain demand from the pre 2000 levels of 1.2 1.3% a year. To something more like 2.3, 2.4, 2.5% a year. And that's really a complexity of diets. The more animal protein you put into your diet, the more grain that requires as opposed to just eating the grain itself to be able to feed you. And so you started to see fertilizer markets tighten up post 2020, there was not a lot of incremental capacity put in. Hydrocarbons that go into the process, particularly natural gas were super cheap.

Robert Mullin:

So you had this excessive supply and all of a sudden the grain market starts to tighten up. Fertilizer starts to tighten up as well. And then you have the European gas crisis hit. And again the European gas crisis predated and in many ways, I think where the birthing parent of the Russian invasion of Ukraine. That's what gave Putin the leverage that he had. But this European gas crisis that came about in September, October, November of 2021. All of a sudden you had the entire European fertilizer complex that takes European natural gas to make nitrogen fertilizer, went uneconomic. When nitrogen or local gas prices went up by 2, 3, 4 fold, all of a sudden they had to shut down. Because it was uneconomic for them to produce fertilizer because their input costs had gone up so much. So all of a sudden the global fertilizer markets are tightened up.

Robert Mullin:

So then all of a sudden you start to have these follow on effects where farmers are going to apply a little bit less fertilizer because it's so expensive, but that's going to make yields drop. And so basically you're putting off some expenses today that likely lead to even tighter grain prices happening in six to nine months once we get through another harvest cycle. So that's the basis of what we see in the fertilizer market. We're primarily disposed towards the nitrogen fertilizers. But I think there's a reasonably good story for potash and some of the other things that are the other nutrients as well. But then you have these other things coming in which are really accelerants. You have this, I think really maybe well intentioned but utterly disastrous move towards reducing or banning synthetic fertilizers. And using organic fertilizers that has a disastrous impact on yield.

Robert Mullin:

So that's Sri Lanka, that's a number of places where you've seen it lead to actually political overthrows because it blows up the balance of payments. Because all of a sudden you don't have enough rice to support your population and all your export crops, you don't have enough of them to sell. Because all of a sudden your land isn't as productive as it used to be.

Robert Mullin:

So you've got that layering in, then you've got resource protectionism, resource nationalism, whereas grain inventory start to tighten up. The countries that have the ability to have surplus and are typically the exporters for the world are saying, "Well maybe I'll export a little less or maybe I won't export at all." So you've got this reflexis George Soros reflexive grains are tight so people get more protective so they hoard more inventory. So prices go up even more. This is the story again, I haven't mentioned Russian, Ukraine yet. This all has been going on and that's what we all of a sudden throw Russian, Ukraine into the middle of. So it's a really, I think, very complex multifaceted market. But to me it's one of the most convex opportunities in resources right now because I just think there's just an enormous amount of complacency around it.

Jason Buck:

Before we get that Russia, Ukraine, there's so many things I want to pull on that you just talked about. One is you have serendipitously, I was actually just watching a video last week on the potash pools in Southern Utah. Have you ever seen those things? From aerial view they're amazing because as the water evaporates over weeks, it creates these really vibrant colors. So if you look on it, a Google aerial map, it's just this beautiful thing in the middle of the desert in Southern Utah that I think that's 400 acres, I want to say. That some of these potash farms are basically bringing it up from underground and I think you can look at it, I think the town's actually called potash Utah or something like that. But it's trying to have some domestic sources too, because it's a very volatile compound too.

Jason Buck:

So you have to be very careful and people have died in the past trying to harvest the different combinations with potassium. But you brought up the nitrogen fertilizers, my understanding, please correct me if I'm wrong. Is part of the protests in the Netherlands coming from those farmers is the idea is that nitrogen based fertilizers create ammonia on the ground. And after, was it two to three days, that becomes a volatile carcinogen. But the way that the Dutch farmers use it, they're not using amonia in that sense. So that's what they're fighting against. But is that the thesis or process of why they're trying to restrict their abilities to use a nitrogen based fertilizers?

Robert Mullin:

Yeah, I think at the root of it, it is a global movement that is wholly political, I would argue antihuman. But it is based on both the toxicity of it when it's applied, but also the fact that it's fossil fuel based. And therefore has a carbon footprint that goes along with it. That is higher than using natural animal manure to be able to do the same thing. So that is all well and good. It is true. The fact of the matter is that the Dutch farmers with no regulation whatsoever had actually reduced the amount of nitrogen toxicity that they've been admitting by 30% over the last four or five years. Without any regulation, without any movements. So significant progress has been made and yet you have this, again, we're seeing the same thing in Canada. This desire to jump the shark and say we are going to be righteously do this and we're just going to eliminate this industry.

Robert Mullin:

The Netherlands is the second largest food exporter in the world outside of the US. So this is not taking a little player off the table. It is significant. You talk about throwing Canada into that mix, again, that's another top five food exporter. The fact of the matter is, without synthetic fertilizers that they have quantifiable detrimental impacts on the environment that have been lessening over time. And clearly you've been used in many parts of the country for 50 years or more. So they have issues associated with them that we seem to be able to manage. But the fact of the matter is you can't feed over half the people in this world without synthetic fertilizers. You just can't, the map is not there. And so trying to pretend that it's a viable solution to just go cold Turkey on this stuff is just, it doesn't work. And so I think the conversation needs to be a lot more sophisticated to be able to figure out the right balance. And that seems to be lacking from the dialogue today.

Jason Buck:

New nuance is always lacking from any dialogue understandably today. And part of that is realism is the way you're talking about it. But I wonder, almost if you take off your investor hat for a second. Both of us live in northern California, which is frequently accused of very hippie tendencies. I think that's a historical lag. It's not quite like that anymore, especially with Silicon Valley. We have some of the best produce in the world and so I always go to the farms and visit and see how the crops are grown to how the room and animals graze and all that stuff. So what do you think about, well if you take your investor hat off for a second though. The trade offs of by using synthetic fertilizers you might increase the cyclical yield of that crop. But you may be destroying the permaculture for the secular yield of that crop long term. And I think that's potentially maybe the arguments Sri Lanka is trying to make. But I'm just curious, taking off of both of our investor hats, just how do you think about that in general?

Robert Mullin:

Yeah, I've got three kids, I'm all for making sure that the world that they deal with over the next 50 or 75 years is one that's habitable one. As habitable as we have right now or better. I think the evidence of, the Central Valley of California is the most fertile productive place in the world and has people traipsing all the way through it all the time. And has been using fertilizer, one of the original places where fertilizer's been utilized extensively since, again, since the 1940s, 1950s. So I think the argument that somehow that there are long term detrimental impacts, it's 50 years later, we haven't seen them yet, maybe they will come. And so I think we have to be cognizant of that. But to me the benefits outweigh the risk, particularly when we as a wealthier society, if we want to pay $3 for a tomato as opposed to a buck or whatever. We can do that and that's a choice that we make and I'm okay with that.

Robert Mullin:

That is not something that one can impose upon 75% of the global population. They don't have that luxury. They really just want to make sure that the tomato or wherever it is, shows up. And unfortunately fertilizer, traditional synthetic fertilizer is elemental in making that actually show up. And so I think different parts of society have to make different choices and probably will make different choices. But at the end of the day, if we're going to look at this globally, holistically, world population wise, we just have to have just a much more balanced conversation about the path that we take. As opposed to saying we don't like what this might look like in 50 years, so let's cut it all out right now. And then all of a sudden the daisy chain of side effects' comes along and the next thing you know, you've got governments collapsing all around the world because they can't feed their people.

Jason Buck:

There's nuanced trade offs all the way down. I usually bring up in the early 19 hundreds a lot of farmers used to raise pigeons. So they could harvest the pigeons for their bones, crunch them up and distribute them fields. And a lot of people don't want to live like that anymore either. And they would think that's a torturous process. But then also you were referenced earlier, it was the history of natural resources is fascinating if anybody wants to study it. As I'm sure you're aware is the Guyana wars of South America between Chile and Peru is the reason why Bolivia still no longer has a port. Because we were fighting for these abilities to grow crops. It's that Malthusianism bargain from, I think it was 1799 is Malthus. And we're still always debating it to this day. And like you're saying, without Haber-Bosch and all these other synthetics, we wouldn't be able to grow the food to increase the carry capacity.

Jason Buck:

And people can argue on either side of that of whether that's good or bad. But this is the world we live in. So there's a certain amount of pragmatism to it. But I want to go back to before I get to a field in my ramblings, I want to go back to grains. Because that's why we're talking about fertilizer first and how that affects grains. But the way I want to use maybe grains in this scenario that you started to hint on already, is everything that I don't think it gets talked about enough. But everything in investing is expectations.

Jason Buck:

What are the current expectations and did the numbers come in to go above or below expectations? So it's that tertiary effect of what really moves markets. And so you were already referencing about Ukraine is all we saw across the news media was Ukraine is the bread basket of Europe. And if those grains get destroyed, everybody's screwed. So then it just because of that news cycle and expectations, it seems like grain prices skyrocketed. And then the news comes in, it's not as bad as we thought, so then they tank. So I'm just wondering, talk me through Ukraine grains and then therefore how we think about expectations within the commodity markets.

Robert Mullin:

Yeah, so I mean most grains are actually down year to date and they were up before Ukraine happened. So again, the market is more complacent today than it was in mid-February before the tank started rolling, which to me is pretty remarkable. I think the expectation set, again, there aren't a lot of folks left who play the commodity game. And so when Ukraine happened and broader market weakness was happening, all of a sudden you had to have exposure green sources, nothing else was working. So energy and grains and all that stuff was, so you had a lot of people who, I think investors bought it because they felt like they had to be there. They rolled into DBA the agriculture ETF. They rolled into nutrient and mosaic and all of these companies with the expectation that, "I have to be here."

Robert Mullin:

It's not because they had a really firm view of the long term secular bull case for grains. It was, "God I'm getting killed everywhere else if this Ukraine thing really goes sideways. I need to have exposure that's going to work." So what came out of that was, the market system, or the world, the global food system is very sophisticated. We pulled down inventories elsewhere to be able to cover the balance of what was supposed to come out of Ukraine. But really the impacts are really, you need six to nine months to really figure out the impacts because that's a typical crop season. And so we haven't seen the impact of reduced fertilizer usage. We have not seen the impact of what looks like now pretty difficult growing conditions in China, in India, in parts of the US Midwest. All of these things are coming together and when you get crop estimates for what yields are going to look like. They're pretty good at adjusting for weather.

Robert Mullin:

Although they tend to be, they're momentum chasers in some ways. They're high, high, high until the numbers get that marked down and then they rush down to meet them. What they are not very good at doing. Because it's been a long time since fertilizer prices we're really this high is adjusting for the impact of reduced fertilizer application. And I think we just need to go through a growing season to see that. So that's where I think the expectation said is missed. I think people are still looking at 170 bushes and acre corn. I think we might come in at 160, maybe even lower. And if that's the case, then all of a sudden the market goes from tight ish to really tight. And you compound that with what I foresee as the resource nationalism and the hoarding at the government level. Then all of a sudden you've got a market that goes from commodity markets are commodity markets, you got a little bit extra pricing goes along and is okay. The moment you get short things start to get a little wonky and go to the upside.

Robert Mullin:

And that's where I think grains sitting. People are also trading grains from an economic outlook. Much like they trade oil and copper where typically if you look at the correlation of grains to globe changes in global GDP. As you would expect, it's much less stable. Bull markets, people eat and bear markets, people eat. They may eat different things, they may eat a little bit less. But really this secular change of people having slightly more sophisticated diets and requiring more grain to support that. That's an ongoing steady up into the right trend. So I think you're absolutely right, people rushed in because the potential impact on agriculture was bigger than energy, which it was. All of a sudden you had a bunch of people in the market who aren't typically there and don't have long term conviction. And when the inflation expectations start to come down. All of a sudden the sell programs are like, "Sell anything economically sensitive, energy, oil, all the..." Whatever it is, all gets blown out.

Robert Mullin:

And so that's what we saw in really June, July and maybe even little bit of August. The broader market loved it because all of a sudden that's their cue that inflation is not a problem anymore. Had nothing to do with underlying supply demand. We're still liquidating global oil inventories, but oil inventories went from a hundred or oil prices went from 120 to 90 in a straight line on the concern that demand will slow. So I think a lot of it has been of positioning driven for slower economy. I think that's particularly misplaced when it comes to agriculture, which is very much less economically sensitive.

Jason Buck:

You made me think about in the last few years what I've really learned, especially with this one is that everybody's different, the definition of transitory is. And the other one is that what I think is a lot of times in the financialized markets or hedge funds et cetera. Is I don't think any of these people have really dealt with real assets or commodity resources and or ever ran a company that had physical inventory and understand lagging effects. Because that's what you're describing, even right now with CPI prints and OER being a third of that and how much that's going to lead to a 12 month lag in prints. And people are like you're saying, they just look at today and time, "Oh inflation's over, let me sell out of all my natural resources."

Jason Buck:

And so there's these really lagging effects that people don't realize when you start dealing with bull whips and supply chains and all these sorts of things. These are really slow moving cargo ships but they have volatility in between. So I can't really mix metaphors there, but that's the difficult part about it. And maybe that'll help because you started initially to talk about it, but the trial transition to energy and specifically oil. We talked a little bit about NATGAS obviously, but with oil I thought was a great quote in your latest quarterly newsletter. That previously it was a market that had a ceiling but no floor. But you feel that's changed now.

Robert Mullin:

Yeah. And that's something that is not priced into energy equities. What I think is and then the way I put it is, we've got a pivoting convexity in the oil markets for the better part of the last 40 years. You had some very firm things that put a ceiling on crude oil. Whether it was excess OPEC capacity that they were there to be able to make sure that the market was adequately supplied and didn't get out of hand on the upside. Whether it was industry who had responded to higher prices by ramping up capital investment. And therefore having the ability to add additional barrels oftentimes near the end of the cycle, which was absolutely the worst time to do so. And then you also had demand destruction. So all of those things were there to keep to some degree a lid on oil prices in the past.

Robert Mullin:

Now of those three things, two of them are gone. OPEC's got a little less capacity. You could argue, Saudi and UAE maybe a million, a million and a half barrels. But in a hundred plus million barrel a day market that's not a lot. Industry is not responding to higher prices and is in the midst of a 10 year decline in capital spending. That's effectively put us a trillion dollars plus behind the ball. The money that should have been spent to increase production in 2023 and 2024 and 2025. Needed to be spent in 2016, 2017, 2018 and it wasn't. So even if we pivoted, even if the current administration and the oil patch grabbed hands and sang kumbaya and said let's get after this. It's five to seven years until you get really incremental significant oil supply from the globe. You get some shale faster.

Robert Mullin:

But the problem is, and that's something that I've done a couple of different videos on. That's a place where we mistakenly blew through all of our good inventory really fast and really early. There is still legs to shale but it comes incrementally more expensive and it comes incrementally more difficult. We're not going to add another three to 5 million barrels a day out of shale, that doesn't exist. Can we add another million barrels? Yeah. But then just because of the decline rates, then shale goes to seven, 8 million barrels a day. All of a sudden you're losing a million or a million and a half barrels. So you've got to drill just to keep that going. So that's the nature of really high decline stuff. So that's the upside is that, so the upside is no longer capped. You still have demand destruction as a potential cap. But what we've seen in a couple of different markets is prices go up really high and stretched consumer's mindset as to how to think about it.

Robert Mullin:

Diesel prices went to six or seven bucks. European natural gas prices are going to the equivalent of $300 a barrel of WTI oil prices. A lot of those prices are more expensive in other parts of the world because the dollar's been so strong. So again, you're stretching what the consumer is good. Now that we've come back off of it the next time you go up to levels like that or even closer, you're like, "Yeah it sucks, but we've been there before." So I think consumer abilities to withstand higher energy prices, at least on an emotional basis are getting stretched. So again, most of these upside caps are now gone. Industry is not there. OPEC is not there in terms of the ability to bring on additional volumes quickly and easily. But to me it's actually the more interesting part is the floor. Is that you know often had, again, industry typically invested a ton at the peak of these cycles and they're not going to turn off stuff once they turn it on.

Robert Mullin:

So you Thelma and Louise'd your way over the end of these cycles that happened in 1998. It happened in 2008 where everyone's like, "Oh yeah, great up cycle. All of a sudden let's add a million, 2 million, 3 million barrels a day." All of a sudden they're like, "Oh no, prices are going to be crashing. And I did this at a hundred dollars a barrel and now oil prices are 30 but I still got to run it because it doesn't pay to shut it in. I at least get some cash generation to cover my debt." So that's how the typical down cycles went. The additional facet that I think people don't really understand particularly well is that OPEC was always there to help that along because it was in their interest. If you look at the big declines in oil prices over the last 25 years. They were associated with economic contractions. OPEC increased production into every one of them.

Robert Mullin:

So everything from 1998 to, that was what blew oil negative was the Saudi threat to add an additional two million barrels a day to a market that was already oversupplied. It was in their interest because what you do with that is you stunt western capital investment. And make sure that in the long term prices are higher, you have to have every once in a while, every five to seven years, you throw a big downside volatility at the market. And that stunts the capital expenditure cycle and it was successful, it really worked. But the question is, do they need that anymore? Western governments and politics and ESG and decarbonization goals are doing that for them now. They don't need to discourage western investment. We're doing it ourselves by saying, "Hey, you can't loan these companies any money. You can't get insurance for any of this stuff if you're an oil company. We're going to basically make it really hard for pensions and endowments to own you. And you're going to get no shelf space and generalist portfolios."

Robert Mullin:

So we're doing their dirty work for them. So all of a sudden this guy who used to, when we were teetering on the edge, push us over. They don't need that downside convexity anymore to achieve their goal. And in fact, the flip side of it, you just saw Saudi come out yesterday saying that, if Iran is allowed back in and volumes are, we'll make room for them. We will support oil prices in the 70, 80, $90 range. So if I'm right about all of this, which I think I am, you've gone from a market that had this firm cap and virtually no downside to a convexity profile that's totally pivoted and now has a pretty firm floor and very little in the way of a ceiling. And if that's the case, we can get a little geeky on option parlance. But you're radically changing the skew in what the underlying commodity can do.

Robert Mullin:

At the same time, your realization is that decarbonization and renewables will be more slow in the way. That people were valuing energy stocks like energy was going to be unusable. Like traditional hydrocarbons were going to be unusable after 2030 or 2035. I think people are starting to understand that's not really a feasible outcome. So if you are shifting the skew higher at the same time that all of a sudden you're going to have to give these oil companies value for a longer duration of assets. That they will actually be viable companies selling hydrocarbons at 2030 and 2035. All of a sudden your implied option value should be skyrocketing and yet all these companies are still trading at 25% free cash flow yields. And so that to me is the biggest market, the market has not shared my view as of yet. I think they might over the course of the next couple of years.

Jason Buck:

No, that's a great way of putting it. That you took an asset class probably from a negative skew to a positive skew. But said more colloquially or succinctly, like you said maybe previously the market had a ceiling and no floor and now the market has a floor but no ceiling, is a way to look at it. But then you brought up shale prices too, which made me think about the other even thing on top of that, we start lingering in more complexity is a refining capacity. And that's another Capex problem that we ran into.

Jason Buck:

And right now we're dealing with crack spreads, which is the difference between that price for barrel crude that you see and then price you pay at prompt. And depending on what region you're in, those crack spread is exploded. And that's why people are paying a lot more at the pump is a lot of that delta that expanded between there. But I think I may have stolen this from you, it's hard to remember. I've been reading your work for a while, is everybody says that the US is energy independent. But it really depends on the quality of crude and the quality of the refining facilities. So we actually have to import more of the higher grade stuff. Is that correct?

Robert Mullin:

Yeah, we have a grade mismatch. We have inherently very complex refinery, so we actually have to import the lower grade stuff. We want, excuse me, junkier crudes because we've got the biggest expensive most... Because that's the stuff that we needed to run when we were importing a lot from Mexico and South America and places like that. And all of a sudden we've got all this domestic production which is really light and sweet and shale, which has lots of high end liquids and things like that associated with them. So we need to bring in some of the heavier stuff, Canadian oil sands and things like that.

Robert Mullin:

Or other South American crudes, Maya blends and things like that to be able to make our refinery systems. So yes, we're still not there yet by the way. Technically we are getting closer to energy independence, but there is a mismatch in that which we have is not which processes well through the system that we have. So we're still reliant on, again, we got a bunch of that stuff from Russia too, heavier grades coming out of the euros, which was part of what was able to run our system well. Europe is the same thing. They've got pretty complex refineries as well.

Jason Buck:

There's two random questions I had when we were talking about agricultures and grains and fertilizer. Is one, I'm sure you followed Peter Eisenman. But one of his thesis is that when the USSR broke up, we had this unbelievable flood to the world of almost like commodities or resources and capacity. And we're seeing the tailwind of that. And when it comes to nitrogen based fertilizers, potash, that sort of thing. Do you have any pushback or do you agree with his thesis about, that we had a flood and that's what actually gave incredible tailwinds to places like Brazil. Where they could import cheap fertilizer and led to that unbelievable growth boom in Brazil and the natural resource side.

Robert Mullin:

I think you can actually make an argument that's even bigger than that. I totally agree with Peter. I think his writing is brilliant. I think it's not hard to draw a direct line between the lowest interest rates in modern history. And the excess of commodity inputs that were created not only by the breakup of the Former Soviet Union, but also by the over investment in the shale patch. And the half a trillion dollars that went in via private equity and got virtually no return on that sector.

Robert Mullin:

So what you had was a very extended period over the course of a decade and a half, two decades of really low commodity prices, which enabled growth in many ways. As you say, the development of Brazil and a lot of things, merging economies who were consumers of those commodities benefited considerably. But it fed this entire cycle of lower cost of capital because your energy and raw inputs had all fallen so much in price because of temporary periods of oversupply. Either because you unleashed the Russian beast on the world with the excess supply there. Or you just overfunded things, like you did the US shale patch.

Robert Mullin:

And I think now we're seeing the flip side of that. Is that led to a very low cost of capital, very low inflation. Inspired a lot of speculation, a lot of things that drove down the cost of many things when money was effectively free. Now we get the other side of that because we don't have another Russia, in fact, the Russia we've got may go away in terms of their ability to supply us with the commodities we want. We've run through the cheap naive capital that gave us jail and now the capital is much more skeptical and even deterred for political reasons. So all of a sudden this is fundamental not just to the commodity markets, but this drives everything. So that's the way I view it.

Jason Buck:

The second question was, do you follow any of Hackett's research about oceanic and sun cycles and different weather patterns as far as on the agricultural side at all?

Robert Mullin:

That's not something that I have used. I'm cognizant of it, but it doesn't tend to, and I see it every once in a while. But it's not part of what I think is what I use as being investible incremental information.

Jason Buck:

That'd be interesting because the one thing I think about, I don't know if it's correct or not, but I do, I find it interesting. And part of it is if we go through these 40 year slightly warming, slightly cooling cycles, it's at the flip of those where you have the highest volatility in weather patterns. That can obviously dramatically affect their cultural, which we could be going through right now. But I'll get to it later. It's that perfect storm of Capex weather, everything's converging to maybe lead us to this maybe thesis of a secular bull market in natural resources. The other one I touched on-

Robert Mullin:

Yeah, just a riff on that for just a sec. I think the guys at Goehring & Rozencwajg do really, really good research around some of this. And Lee Goehring was on a podcast recently where he was talking about that. And we really have had 10 years or more of really benevolent, very friendly harvesting weather in most of the major agricultural centers around the world. And it now looks like that may not be the case when the world becomes dependent upon a continuation of really easy growing conditions and optimal growing conditions. When systems break down are to be when they're tight and things matter. Who would've had on their bingo card that I would be checking the water levels in the Rhine and the Yangtze River every day now. To help understand my agricultural and energy outlooks. But that's where we are and that's a symptom of systems running tight so the marginal inputs around them becomes significantly more important. And things that were taken for granted are all of a sudden paramount.

Jason Buck:

And speaking the Rhine and Yangtze, how are you thinking about China's second wave of shutdowns from COVID and everything? How is that affecting your ability to allocate resource or think about what is the secondary and tertiary effects of those shutdowns?

Robert Mullin:

Yeah. I would say this is bordering on a conspiracy theory, but I think it's fundamentally sound. For whatever reason, China for the last year and a half has imposed a number of different measures that may have had a different primary driver, but their end result of them were to constrict resource consumption in every single one of them. Banning bitcoin mining, slowing down the amount of video games that you can play that impacts all the server farms that support those 3D virtual reality games. The allowance of the property sector to really radically deteriorate. So that, I think there were a lot of reasons to do that, but certainly a by project of that is you slow down resource consumption. The sort of shutdowns over very modest illness or infection levels and almost no deaths. Just shutting down of multimillion person areas. Yet all of this may be done for other reasons, but the end result of all of that is to constrict resource consumption.

Robert Mullin:

And I think in many ways China may have seen this resource scarcity issue coming a lot earlier than the rest of the world did. And so my base case is that they continue to fluctuate in and out of rolling shutdowns because that serves their purpose. Their biggest concern is people come at a lockdown and can't get their vegetables. Or all of a sudden can't fuel their cars or you can't run the factories because you don't have sufficient power. Because your hydro is down because the river levels are too low. So I think they're trying to build cushion into their system through these actions. I think they will continue to do so. That's my base case. If they come out and say, "All right, we're open for business again." I'm not sure the resource markets can handle that quite honestly.

Jason Buck:

And then I was thinking about when you're domestic hedge fund manager investor, you're not really concerned about US dollar in general. But as soon as you become global macro or you're looking at natural resources and supply chains that are around the globe. Now the dollar can dramatically effective portfolio, especially if you're investing in certain equities that are outside the US. I'm curious, do you try to isolate the dollar or you try to ride the wave of the dollar or do you think it all works out in the wash across multiple regions and sectors?

Robert Mullin:

So I will answer that a number of ways. Even when I was just running a mostly domestic resource fund. The one singular thing that I could pull up in the morning before the market opened that would tell me what direction my portfolio was trading in was the dollar. So it's always been something that you have to pay attention to. The strangest thing is that I came into this year and several of the larger macro trades that I put on to try and capture volatility in the areas where I think if they do well that resources will do poorly. Or vice versa was being long to dollar. So I was long dollar calls coming into this year. Thinking that that was good hedge for my portfolio. They both worked so that's not usual. So for the better part of this year you had dollar stronger, resources stronger, which was a very odd beast in the world of global macro correlations.

Robert Mullin:

So you saw that correlation reassert itself after the April top, where dollar continued to rally, all of a sudden economic concern took center stage and that sold off. So from a broader standpoint, I always pay attention to it. And you have to pay attention to it In terms of global affordability of commodities and things like that. In terms of trying to wean it out from my specific commodities being long and short, global resource equities. I have a tendency to leave it alone. And the reason I do so is particularly, I have a lot of exposure in Canada, a lot of exposure in Australia. For those companies, they are selling products on a global stage at dollar values typically. And their local costs are denominated in their local currencies. So all of a sudden you get this benefit of expanded margins from a strong dollar.

Robert Mullin:

So it somewhat offsets what might be the pressure on commodity prices that a stronger dollar might exert. So I tend not to mess around with too much unless I have a very specific situation where I'm very concerned about a currency for one reason. Quite honestly, I'm relatively bearish Canadian dollar right now. I think there's a perception that it is a resource economy. That's really a de minimis part of what drives Canada these days. It's really a leveraged real estate financialized economy. And that I think is going in the wrong direction. So if there was a place where I would say let's hedge out our risk, it's probably CAD today.

Jason Buck:

Yeah, you segued me perfectly, is what I love about your portfolio is not only do you have these natural resource or commodity equities. But you also hedge the portfolio too because of that volatility inherent in those markets. And so you're saying that was interesting, the US dollar is a way to hedge the portfolio, but maybe not so much now. And then I was thinking about some of your other hedges and you brought up a perfect one because when I was reading your stuff is, you're short Canadian housing. And I'm like, "How does that have anything to do with what we're talking about on the natural resource side?" But you just, I think eloquently stated your thesis on that. But is that what you have to do sometimes is maybe move farther afield from when you're looking at the hedges? Is thinking about the secondary tertiary effects of how do you hedge maybe a long play on certain Canadian minds or natural resources. You actually have to go short their housing market as a hedge?

Robert Mullin:

Yeah. Well, I think that is true, absolutely. I think it's even a little bit, if you pull it up a level in terms of macro outlook. What is right now my biggest vulnerability as a long resource manager? It's that global central banks, particularly North American central banks, are more aggressive than the market currently expects. That's where people get concerned that we don't have a dovish pivot. We don't have this decline in rates that starts next year. And so that impacts people's concerns about growth. So who would be the biggest loser from the Bank of Canada going 75 and maybe another 50 or another 75?

Robert Mullin:

By far the biggest loser there is the Canadian housing market. I think the impact there is way worse than it would be for energy or copper or anything else conception. So to me that's a much more asymmetric way to look at it. I'm short some energy, select energy stocks, short some things in the kind of lithium space I'm short. So I have some classic within the silo resource shorts. But to me to the real vulnerabilities of my portfolio from a macro basis, I think that the asymmetry on being short Canadian housing right now is just so much better.

Robert Mullin:

Wile E. Coyote has left the edge of the cliff, his legs are in mid-air and the cloud is dissipating and he's about to look down and say, "Oh, oh." That's what Canadian housing looks like to me because prices have already broken. You're already seeing the credit distress and the personal bankruptcies and the resetting, they reset their mortgages every one to five years. So no one terms out for 30 in Canada. You roll at one to five years and that stuff's all resetting a hundred, 200, 300 basis points higher. It's a huge impact on consumer spending. So the only way that I think the Canadian housing short doesn't work is if all of a sudden you see Western central banks who, particularly the Fed and the Bank of Canada. Immediately pivot and start cutting rates today, which would be hugely bullish for the rest of my portfolio as well. So from that standpoint, I just think there's more convexity in being short Canadian housing than there would be in adding more short resource exposure.

Jason Buck:

So the old trope is you can get your thesis or your timing, you never can get both. And so there's been a graveyard of people trying to short the Canadian housing market. But did you wait till the catalyst, like you said, where it's actually starting to roll over before you put those positions on?

Robert Mullin:

Yeah. It's an area that I've studied for, gosh, almost 10 years now. And I've got a couple of different consulting firms that I use up there to really give me on the ground data that I'd feel like I need. And so I looked at it, God, six or seven years ago. Back in 2014, 2015, looked at it, shorted a little bit in it, didn't do much, but really have just been patiently waiting. That's something that age gives you is the ability to say, "I don't have to be there today." So I really just started shorting the Canadian housing stuff in the last three months. And that's really when the fever started breaking where rate rises started to impact the ability of these people.

Robert Mullin:

Where you started to see people buying a new house, trying to sell their old house, and then all of a sudden not being able to sell their old house for what they needed to be able to pay up for the new house. So you had all these sales breaking down and people having to go towards alternative forms of financing that are super expensive. So that was really the catalyst to get in and I think we're there. I don't know the pace at which it will progress from here, but if I had to have a Rip Van Winkle short for the next six to nine months, Canadian housing would be it.

Jason Buck:

So we started off talking about nuances and everything's much more difficult or reality has a surprising amount of details. And then when you're talking about these hedges, I'm curious how you think about the trade offs from shorting single name equities to shorting indices to buying put options maybe on indices. Is like there's trade offs, if you're shorting single names, a lot of times you can get your face ripped off. And your borrow costs could be high if it's a low liquidity single name. So maybe then you move to index, but the index may not have quite the volatility you're looking for as a single name has. But you have a little bit better liquidity, maybe a little bit better borrow costs. And then buying the puts, then you have to get your tenure or your duration right. So tell me about how you think about the trade offs between those three ways of hedging and how you think about that across the book.

Robert Mullin:

Yeah. So I mean great, great questions and it's utterly dynamic. To me, it's how do we achieve our end goal of being able to hedge out some sector risk, some broader market risk, some country risk, et cetera via our short and hedge book at any given time. And so, you look at fourth quarter of last year, it was still really inexpensive to express that through put options. Implied VAL was cheap, so I didn't have a huge short book, but I did have rolling pretty heavy option positions over the course of that Q4. And actually quite frankly into Q1, which was part of the way that we made some pretty good money. As we've worked our way through Q1 and into Q2. And VAL picked up considerably. That's where I expanded the short book because the put options started to get so expensive.

Robert Mullin:

And when you go from using puts to put spreads, you understand your cutting off part of your convexity there. So you can offset some of the incremental spend for higher option prices. But you're losing that, there's a cost to that. So that's why the short book that we use has expanded so much. Not only because that seemed like a more efficient way to do it. But because in some of these areas there are very specific themes that we can play on. Again, Canadian housing is one of them. So to me another one has been the rise of some of the lithium companies that rely on direct lithium extraction, which is a chemical technology.

Robert Mullin:

That is I think really, really complicated and the market on the multiples that it's giving some of the companies in that space. The market is giving them credit for processes that haven't been totally vetted or commercialized yet. So again, I have a long lithium exposure that I really like that is not that technology. It's very classic spoggy re-mining. And so again, back to your question, shifting the character of the book, it's all about efficiency. It's how do I create the best profile for protecting my long book from the risks that I see evolving out there. In a way that I think the potential rewards outweigh the risks of it.

Jason Buck:

The other thing I think about, because you brought up lithium. As we run a commodity trend following portfolio. And obviously I love commodity trend followers and I love access to these real assets and a lot of them can trade 60 to 80 markets. But as a lot of them have gone for higher AUM, there's a lot of smaller, more illiquid markets that don't have the capacity for them to trade. So we don't get exposure to it. And I'll use lumber as example. Very few people trade lumber, everybody was excited about lumber a year ago. And they're talking about, "Was lock limit up?" And I'm like, "Yeah, because nobody trades it." But do you think through your single name equities, you can get broader exposure to things like lithium, rare earth, access to Canadian timber markets. Some of those things that a lot of people aren't trading, but you can get access to single names. And then once again, the nuance or the trade off, is that now you're getting access to those natural resources. But now you have a governance overlay where you have to pick the right company.

Robert Mullin:

Yep, absolutely. And so for us, that's the way that we use. And again my specialty has always been analyzing companies. So if I can get commodities generally right, what I'm really good at is finding, or at least hopefully good at, is finding ways to express that via equities. So our quintessential example of that was tin. So we were very long tin stocks for the better part of the last almost two years. Very nichey market, almost impossible to do in actual futures. But an area where there were some really inexpensive equities that if the tin price doubled, they would go up, they'd quadruple. And that happened and then all of a sudden people did, you built a little bit of excess inventory in the tin markets and both the stocks fell by 50 or 60%. So that's life in the resource sector. But I totally agree, that trying to understand the relationship between where do I find the most efficient way to express a view about commodities via equities. That's the bread and butter that I've been developing over the last 30 years.

Jason Buck:

And then to me the most important or exciting part of your book is your yield side to the book. And so over the past I've always looked at positive ways to carry, say gold with the royalty companies like the Franco-Nevada's of this world. Or lending it out to the manufacturers like Monetary Metals does. Everybody's trying to look for a positive carry convexity as you've called it. But I think that's what's most interesting about it. Is not only are you getting all these price appreciations in this expansion in the space. But the yield book keeps increasing. But once again, talking about trade offs and nuance, again, there's a trade off between Capex spending, paying down debt, doing stock buybacks versus increasing their dividend yield.

Jason Buck:

And so you constantly have to be looking at what they're doing. And it's interesting, you always talk about how they feed each other. If right now they're paying down debt, that means in the future if prices stay high sustained or increase, they might be increasing their dividend yield in the future. So how do you really think about predicting that dividend yield and then thinking that yield is covering maybe the downside of the prices that you're also hedging with your hedges part side of your book. So you're trying to get to that as close as you can to this positive carry complexity component.

Robert Mullin:

So that's the essence of what I've been trying to do with what we've done with this fund for the last 12 and a half years. Is find assets where we think they can do all of those things. That they can grow modestly over time, that they can potentially improve their balance sheet. And they can also pay out an income generation to the shareholders that can potentially go up if you have a rise in commodity prices. So that's the essence of what we've been looking at. And so it's a very unique conversation because every company has a different asset profile. Everyone has a different reinvestment intensity that they have to do to make sure that you maintain that. And you need to put different discount rates on different assets. I've got companies that are probably going to be out of inventory in 10 years, so clearly a 10% yield is not sufficient on stuff like that.

Robert Mullin:

So you got to believe that there's either more in the kitty that they can bring in or you need a 20% yield. So you get all your money back in five years and at the tail end of it you've got a little bit of a call option on that. And so it also comes down a lot to management and how they communicate their dividend policy because some have gone to very regimented ways. We will pay out 30 or 40 or 50% of free cash flow over a certain level. What we have found is that the companies that get rewarded for dividends are the ones who are clearest in the way that they articulate how that's going to be paid out and why. You have 50% of free cash flow over base capital expenditures, which is going to be this, things like that. And then all of a sudden people say, "All right, I get I the mechanics behind it." It's not a random what the board decide this quarter or this half. And then you get a little bit better feel for it.

Robert Mullin:

The beauty of it is that it shrinks the number of companies if that's your focus, which is it is ours. It shrinks the number of companies that I have to pay attention to. If they're 2000 resource companies globally, the ones who are really in a position to give significant pay back to shareholders and can do so on a sustained basis. Maybe 10% of that, maybe 200, maybe less at any given time I might own 15 or 20 and I have big positions in maybe half a dozen. So that to me is the magic of what we're trying to do. And it's just a lot of times it's a matter of understanding these businesses over the course of many years. And really understanding that the message that management is giving you is one that is actually that they can deliver on that.

Jason Buck:

Do you think that's the biggest differentiator between you and the commodity turn following space where they're obviously dealing with just raw commodities and prices. Is not only using the equities but then you're using that dividend yield. And that really separates the ability to carry this over the longer term versus the other way people try to play the commodity markets?

Robert Mullin:

Yeah. Again, you go back to a thing like 2008 where you had resource companies that were flat in a year that was disastrous for commodities. And that was because of their corporate structure, because of their free cash flow generation. Because of their ability to improve the underlying asset value of the company opportunistically in downturns. And so that I do think is a big differentiator. It's a lot harder to analyze companies than it is to, well, I won't say, nothing in any investment markets is easy. But there's a lot more work involved with really understanding the underlying assets and cash flow characteristics. And durability and sustainability of those cash flows and management's willingness to be able to share that with shareholders. It's a lot of work and quite honestly the number of people who really pay attention in the resource space has atrophied in such a way that it's de minimis these days.

Robert Mullin:

It used to be 15 or 20 years ago, every big hedge fund had three or four commodity cyclical folks. Now they have 25 people in tech and healthcare and maybe someone who covers something like cyclicals. If you think about the big funds out there, there were some really big resource managers out there in 2007, 2008. Even through the echo boom into 2010, 2011.

Robert Mullin:

But you look at the kind of atrophying of the entire sector. You got someone like Pierre Andurand who's now running, he may be running a couple billion but it's only because he's doubled every year for the last three years. That's really 500 million under management that's just doubled a couple of times. No one's allocating to this space. And so the skillset to really understand what's going on with the underlying companies is, it's just atrophy to the point where there's not a lot of competition. Just the way I like it. The good news is I was stubborn enough to stick out through a decade long downturn where it would've been a lot of more fun to do other things. Now it's a little bit more fun to do this stuff.

Jason Buck:

Exactly. And then the other place where we're two peas in a pod is with ergodicity. And the idea of especially with your yield book is by having hedges on when those equities start to crash. And you have these convex hedges that give you a lot of cash on your books. Now you're able to buy back those equities for pennies on the dollar or lower NAT point, let's call it. But even more importantly with your book, that is actually increasing the yield. And I don't think people are thinking about that a lot. So do you almost get excited about these pullbacks because you know your end client investor done well. It doesn't matter about the time, the actual ensemble average is when they're rebalancing due to your hedges. They're going to increase their yield book over time. And there's got to be a point almost where the yield book subsumes the actual other side of the book in a way.

Robert Mullin:

Yeah. So to me, defending against downturns well is the most gratifying part of what I do because it gives you that opportunity set. I don't want to make that call that's like, "Yeah look, markets fell apart. They're down 30, we're only down 20 be a great time to invest more money." What I really want to do is, "Look, we've increased the organic yield of the fund from 8% to 13% because stuff went on sale and we defended capital relatively well." That to me is enormously gratifying. I wrote in my original big macro piece, I wrote about Frank Lloyd Wright and the Tokyo Imperial Hotel. And the feeling that, again, I won't go through the whole story.

Robert Mullin:

But he effectively built something in a way that no one thought he should in an earthquake prone area that survived an earthquake that many modern structures did not. And it was because of the thoughtfulness of design. It was designed for where it was and the natural environment that it was sitting in. Getting that telegram that said, "Hey, your hotel survived an earthquake that leveled two thirds of Tokyo. Thank you. It sheltered many of the people in the surrounding areas cetera." That moment was very visceral to me as a fund manager because that's the role that I want to play for my investors. To be able to preserve capital in a hospitable environment. That's where we should earn our chops.

Jason Buck:

That's perfect. Actually, I should end there if I was a good podcast host. But I just had one other question for you because your newsletter highlighted to me this idea I think about all the time. In that if we get much more philosophical about the mind body problem. What people are really saying, not the actual mechanics of it, but the idea is, we have a human animal nature to ourselves that's obvious that people tend to run away from. But then we have the societal nature and that's to me, the mind body problem.

Jason Buck:

Is those are always in conflicts with themselves and related to almost, you have this bifurcation in investing where you have these long risk on cycles. Where us living here in the Bay Area, is tech does incredibly well. So I think about during those times those bull markets are risk on, we can get much more digital and ephemeral in the way we invest. But then nature always kicks back in and takes us back to real assets and being able to eat at the end of the day. And that's when the commodities jump out from behind the curtain.

Jason Buck:

So I'm curious about how you think about that trade off is we lived in this fictitious world during risk on. And then almost during risk off we go back to Maslow's hierarchy of needs. And so building maybe an investment portfolio that has a little bit of both. This emerging Metaverse combined with real assets is maybe the way to think about your portfolio moving forward.

Robert Mullin:

So one of the earliest things that I remember writing when I started my hedge fund back in the late nineties was I wrote something in 99 or 2000. That said, "I think we are evolving from a decade of fluff to a decade of stuff." And that is actually, you can chart that where you have physical assets and financial assets doing this periodic dance. And financial assets, the trend is up to the right. So over long periods of time, financial assets will outperform physical assets and that's just the way that the world is. But you get these 12 to 14 year out performance of financial assets. And then you get these stretches of six to eight years where physical assets are where you want to be. It's a byproduct of where does capital flow when risk premiums are really low and you are being encouraged to really get over your skis and take a lot of risk. That's when capacity in those areas gets overbuilt and the stuff that you need suffers. Atrophies, that's the money is not spent on the boring stuff.

Robert Mullin:

It's spent on the exciting stuff. And that natural has a natural cycle to it. I put out a chart a few months ago that showed the percent of S&P Capex done by metals and mining versus the tech sector. And it's this beautiful inverse correlation of tops and bottoms and tech earning, tech Capex gets to 30 or 5% of the S&P or whatever it is. And resource Capex gets to 4%, it's time to go the other way. And I think what people are missing here is that this is the most extreme example of that cycle. Because it's been augmented by ESG and decarbonization concerns and other things were the movements on that physical versus financial has been so three or four standard deviations.

Robert Mullin:

That we are very early in the reversion of that process. And I just don't think many people are positioned for it. I think people want it very much. You can see it in the flows this year, people are still wanting to buy the dip in ARC. I put out something a little while ago that ARC took in more money a couple of months ago. ARC took more in more money in a week than all of the resource ETFs had taken in all year. So clearly people are not buying that this is a reversion. I think time will probably tell us something different,

Jason Buck:

Man. Unfortunately we both have a hard time to stop because there's so many other things I want to talk to you about. With your secular bull thesis, whether it's that perfect storm of Capex and supply chains, everything we've been talking about. But we didn't even get to touch on is these negative feedback loops between rates, releasing reserves, helping people out on their gas pump prices. And how that almost bolsters even more inflation and it has the negative effects that people wouldn't even think about in the feedback loop. But that just means I'm going to have to have you on again in the near term future. So I always enjoy our conversations and I want to thank you for coming on the podcast. I really appreciate it.

Robert Mullin:

Hey Jason, anytime. Love your stuff. And the work you do out here is great for us as investors. I always learned something new about expressing volatility or what's going on in various asset markets. So again, I'm at your disposal and let's do it again soon.

Taylor Pearson:

Thanks for listening. If you enjoyed today's show, we'd appreciate it if you would share this show with friends and leave us your view on iTunes. As it helps more listeners find the show and join our amazing community. To those of you who already shared or left your view, thank you very sincerely. It does mean a lot to us. If you'd like more information about Mutiny Fund, you can go to mutinyfund.com. For any thoughts on how we can improve this show or questions about anything we've talked about here on the podcast today. Drop us a message via email. I'm taylor@mutinyfund.com. And Jason is jason@mutinyfund.com. Or you can reach us on Twitter, I'm @TaylorPearsonMe and Jason is @JasonMutiny. To hear about new episodes or get our monthly newsletter with reading recommendations, sign up at mutinyfund.com/newsletter.