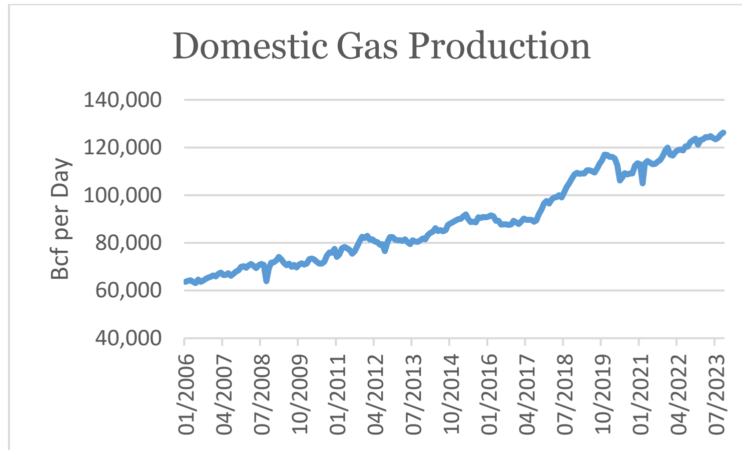
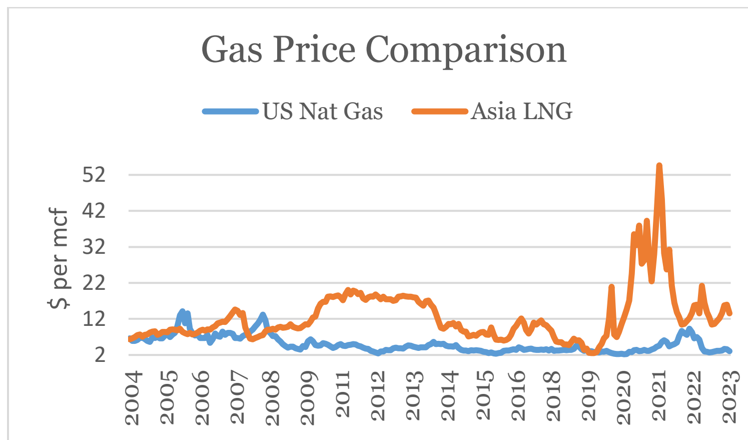
In the early 2000s, American companies expanded the use of hydraulic fracturing to extract oil and gas from shale. As fracking proliferated, American energy production soared.

Figure 1: U.S. Natural Gas Production- Billion Cubic Feet per Day (Bcf/Day)



Eventually, abundant production led to swollen inventories. Energy companies offloaded excess crude oil in overseas tanker shipments. But tankers could not take away the excess gas. A gas glut ensued, and gas prices crashed. Figure 2 compares US and Asia gas prices since the advent of shale production. Ever since 2008, U.S. gas has traded at a steep discount.

Figure 2: Price History, US Natural Gas vs. Asia LNG [1]



Source: St. Louis Federal Reserve

Low prices attracted new gas customers. Natural gas replaced coal as America's principal fuel for electricity generation. Energy-intensive industries such as plastics, chemicals, fertilizers, and metals moved production to North America. Transport companies added pipelines into Mexico. Those pipelines have fueled Mexico's rapid industrial growth of the past decade.

[1] Liquefaction adds $2 to $3 to the cost of LNG. Thus, all else equal, LNG should trade slightly higher than natural gas.

Although gas demand grew rapidly, supply grew even faster. Prices remained incredibly low.

Then along came Cheniere Energy Partners LP. The company began in 1996 as an exploration and production (E&P) company.

In the early 2000s, just before the shale revolution, the company realized it could buy gas via LNG imports cheaper than it could produce gas. At that time, Cheniere made the fateful decision to exit the E&P business. It would redeploy its capital to build LNG import/regassification facilities. Cheniere still planned to sell large volumes of natural gas to American customers. Cheniere simply replaced its domestic source of gas with imported LNG.

Cheniere opened its regassification facility in 2008, just as the shale-induced glut drove American gas to steep discounts. Cheniere could not afford to run operations. The selling price of American gas collapsed and remained far below the cost of importing LNG.

So Cheniere again transformed itself. In 2010 the company announced plans to add LNG export facilities to its Sabine Pass, Louisiana operation. In 2012, Cheniere gained federal authorization to construct the nation's first LNG export facility. In 2016, Cheniere began producing and exporting LNG.

Since then, Cheniere and other companies have added substantial LNG capacity, mostly along the Gulf Coast. LNG exports have been instrumental in rebalancing the North American gas market. American LNG exports provide reliable supplies around the world.

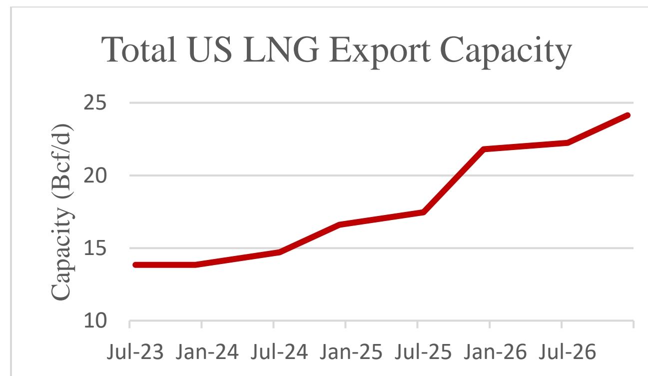
President Biden Bans New LNG Approvals

Fast forward to last week. Under pressure from climate activists, President Biden "paused" approval of pending Liquified Natural Gas (LNG) export projects. The "pause" prevents the approval of new LNG projects, at least until the next election.

Implications of the Biden-Ban

For the foreseeable future, the Biden ban changes little. Figure 3 shows how export capacity will rise over the next 3 years - according to scheduled project completions.

Figure 3: Projected LNG Export Capacity



Source: FERC

Export volumes will soar. LNG export capacity will jump from 13.8 Billion cubic feet per day (Bcf/day) to 24.1 Bcf/ day by 2027.

The Biden ban doesn't affect projects already approved for construction. It only prevents expansion of facilities that have not already been approved. On average, it takes about 4 years to construct a new LNG facility. Thus, even if the ban becomes permanent, LNG export capacity will continue to expand for about four years.

However, American officials will probably resume LNG approvals after the 2024 election. The Ukraine war and the destruction of Russia's Nord Stream Pipeline have created a long-term energy shortage for Europe. It would be unconscionable for the U.S. to withhold surplus energy supplies.

Cross-Border Pipelines Enhance Export Growth

Mexico Pacific Limited, a Houston-based company, is building the Saguaro Energia LNG export facility on Mexico's Pacific coast. The Pacific-coast location allows Asia-bound shipments to bypass the Panama Canal. This logistical innovation reduces shipping costs by 60% vs. Gulf-coast facilities.

Mexico Pacific is building the 500-mile-long Sierra Madre pipeline. It will transport 2.8 Bcf/day of natural gas from the Permian Basin to Mexico's Pacific coast.

Thus, accounting for both LNG and cross-border pipelines, America's gas export capacity will increase by about 13 Bcf/day by 2027, which amounts to 10% of domestic gas production.

Due to the low cost and reliability of deliveries, American exporters will use 100% of export capacity. American LNG trades at an average price of $7 per thousand cubic feet (mcf.). Asia LNG trades above $9, and Europe trades above $27. It is safe to assume that global buyers will scoop up all the cheap American Gas that comes onto the market.

Exports Will Drive Production Growth

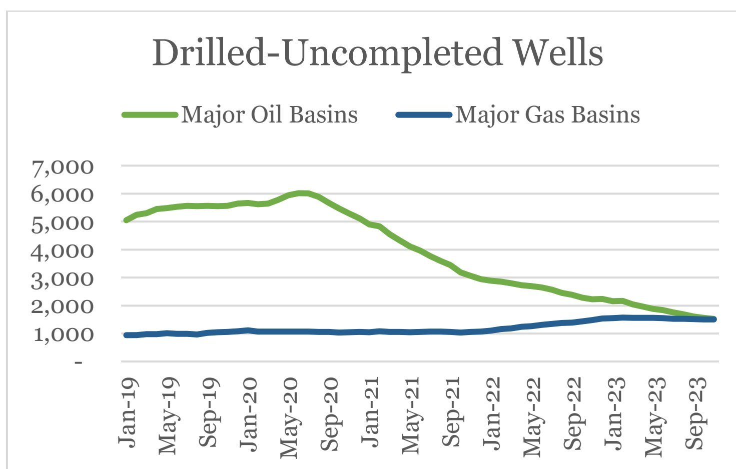
American gas producers are gearing up for substantial production growth. However, they appear to be waiting for domestic gas prices to rise before pulling the trigger.

Producers have been drilling gas wells but leaving them idle. The Energy Information Agency (EIA) categorizes these wells as "drilled-uncompleted", a.k.a., DUCs.

Figure 4 shows that energy companies have increased investment in gas-basin DUCs by 50% while using up 75% of oil basin DUCs.

Energy producers expect improving opportunities to sell gas production profitably. They are investing accordingly. On the other hand, crude oil producers are consuming prior investment in DUCs because of diminishing returns on oil drilling.

Figure 4: Inventories of Drilled-Uncompleted Wells[2]



Source: EIA

Investment Strategy: *Vigilante Investor* increased oilfield services exposure last November, when Nine Energy (NINE) fell below our target purchase price of $2 per share.

Figure 5: Nine Energy as of 1/29/2024

Source: Finviz

Vigilante Investor had previously invested in Nine Energy. We bought the stock in April 2022 at $2.72 per share, then sold the position in January of 2023 at $13.02 per share… resulting in a gain of 379%.

Below is the profile summary of Nine Energy, written for Quarterly Issue #6:

> *Nine Energy supplies oilfield services in support of land-based well-completion activities in North America. Nine Energy concentrates on hydraulic fracturing services, including cementing of laterals, wireline services that perforate laterals and set plugs,*

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[2] Oil-Basins is the sum of DUCs in the Bakken, Eagle Ford, and Permian Basins. Gas Basin DUCs represent the sum of Haynesville, Marcellus, and Utica Basins.

tools and services that isolate each stage of laterals, drilling-out of isolation plugs, and coiled tubing services.

Nine Energy has secured multiple patents for its downhole tools, products, and techniques. Nine pioneered the development of dissolvable frac plugs. These plugs isolate each stage of each lateral during hydraulic fracturing. Compared to traditional frac plugs, dissolvable plugs enable the elimination of the drill-out process, thus reducing well completion costs by about 20%. Nine has increased its market share for patented, dissolvable frac plugs, from around 10-15% in 2018 to 20-25% in 2021. The company projects 35-50% market share by the end of 2023.

Nine Energy has developed an extensive list of blue-chip customers, including Pioneer Natural Resources, Conoco Phillips, Endeavor Energy Resources, EOG Resources, XTO Energy, Southwestern Energy, Diamondback Energy, Devon, and Aethon.

Nine Energy is a risky bet on the recovery of the energy sector. Oilfield services reside at the bottom of the food chain of the oil & gas industry. In good times, producers desperately need more oilfield services, and service providers command premium prices. But during lean times, oil & gas producers can negotiate extremely low service prices. The lean 2019 to 2021 period severely damaged oilfield service companies. Those with substantial debt, such as Nine Energy, struggled to survive. Three consecutive years of weak sales, poor profit margins, restructurings, and write-offs left the company in a difficult financial position.

Since that summary was written, a few things have changed. Nine earned solid profits in 2022 and early 2023. It extended the maturity of senior debt to 2028.

With less liquidity risk, the downside risk is lower. But the upside potential is also lower. Exploration and production activity in the Permian has slowed. Nine conducts about 40% of its business in the Permian. Also, short positions have dropped by half compared to 2022. The fuel for a short squeeze has diminished.

Nine runs a solid operation. With little competitive investment in service capacity, Nine is positioned to profit handsomely over time. The key is to buy low.

Table 1: Nine Energy, Inc. as of 1/29/2024

Ticker	NINE	**EPS-TTM**	$-0.42	**Expected 5-YR Growth**	NA
Price	$2.65	**EBITDA/Share TTM**	$ 2.58	**Short Position % Float**	11.5%
Book/Share	-$0.74	**Market Cap**	$92M	**Debt/Equity**	NA
Dividend Yield	0%	**Enterprise Value**	$443M	**Debt/Ent Value**	72%

Sources: Finviz.com, Yahoo Finance

Recommended Strategy: *Vigilante Investor* took advantage of the November price drop to accumulate shares at $1.90. For those who missed that opportunity, the shares are still attractive to buy below $2.25 per share.

War Drums

Global war risks continue to escalate.

- The Ukraine war grinds on. Ukraine's offensive failed. Its army is running out of soldiers, weapons, and funding. Allies are supplying enough lethal aid to keep Russia from making significant advances. In the process, weapons stockpiles have depleted… for everyone except China.
- The middle eastern war is spinning out of control. Israel's occupation of Gaza continues with no end in sight. Attacks from Iran-sponsored Houthi rebels significantly reduced shipping through the Red Sea and Suez Canal. Counterattacks by U.S and British forces appear to intensify hostilities. As of this writing, we await the U.S. response to the deadly drone strike on U.S. forces.
- As detailed in Quarterly Issue #11, China is preparing to invade Taiwan. Chinese leader Xi Jinping's recent visit to the U.S. calmed the stock market. But war risk has worsened since Xi's visit. Taiwan elected Lai Ching-te of the ruling party as President. China cannot achieve Xi's "reunification" goal without invading Taiwan. If China invades, it will do so when the tides are favorable for an amphibious landing… perhaps April, May, or August.
- Massive numbers of migrants continue to illegally cross the U.S. border. Some migrants are connected to terrorist groups. The risk of organized violence within U.S. borders is intensifying. If significant attacks occur, the U.S. will likely retaliate.

Investment Strategy: The wars in Ukraine and the middle east are chewing up vast weapons stockpiles. The ubiquitous deployment of drones in war zones is changing battlefield strategy. Even if China doesn't invade Taiwan, militaries will boost spending to replenish supplies and update defense systems.

Lockheed Martin Corporation (LMT) designs and manufactures weapons and integrated defense systems. Lockheed's products include Javelin anti-tank missiles, LRASM long range anti-ship missiles, air-to air missiles, laser-guided training missiles, and much more. Lockheed also manufactures military aircraft such as the Blackhawk, C130, CH-53K heavy lift helicopter, F-16 Falcon, and the F-35 Lightning.

The company runs four business segments: Aeronautics, Missiles and Fire Control, Rotary and Mission Systems, and Space. Lockheed's biggest segment, Aeronautics, contributes about 40% of total revenue. The other 3 segments contribute roughly 20% each.

Table 2: Lockheed Martin Corporation as of 1/29/2024

Ticker	LMT	**EPS**	$27.55	**Forward P/E**	15.4
Price	$428	**EPS Forecast**	$27.73	**Expected 5-Yr Growth**	6.8%
Book/Share	$28.48	**Market Cap**	$103B	**Debt/Equity Ratio**	2.73
Dividend Yield	3.00%	**Enterprise Value**	$120B	**Net Debt/Ent Value**	0.13

Sources: Finviz.com, Yahoo Finance, Shareholder Report

Shareholders of LMT enjoy a low risk profile. The company uses little debt (13% of enterprise value) and delivers steady earnings growth.

Figure 6: Lockheed Martin (LMT) as of 1/29/2023

Source: Finviz

Recommended Strategy: Scale into a full position of LMT. Buy 50% at current prices and another 50% below $400.

For the ETF Portfolio: Buy a 10% position in Invesco Aerospace and Defense ETF (PPA). Top holdings include Rtx Corp, General Electric, Lockheed Martin, Northrop Grumman, General Dynamics, Boeing, and L3Harris. These 7 holdings account for 40% of ETF holdings.

The Economy

Table 3: Vigilante Investor Scorecard of Economic Conditions January 29,2024

Score	Positive	Neutral	Negative
Growth 1 Contraction 1	US Real GDP +3.1%YOY	Fed Signal +0.5% US Productivity +1.0% US Non-Manf PMI 50.6 Global Comp PMI 51.0	US 2-10 Spread -0.26%
Inflation 4 Deflation 0	CPI +3.4% YOY US Wages +4.1% YOY Gold +10.0% YOY Gold / Euro +11.5%YOY	US Dollar -0.2% YOY Crude Oil -3.6% YOY	
Positive $ 2 Negative $ 0	US-Ger2YR Spread +1.86% US-Ger10YR Spread+1.77%		

Sources: Tradingeconomics.com, St. Louis Fed, and Investing.com

To the surprise of many, the economy grew at a 3.1% pace last year. However, warning signs lurk. *Vigilante Investor*'s forward-looking indicators have slipped into the danger zone. The

most reliable forward indicator, ISM Non-Manufacturing PMI, fell to 50.6, a fraction above the contraction threshold of 50.

Another forward indicator, theFed Signal, is flashing yellow. If Nominal GDP declines more than 0.5%, the Fed Signal (Nominal GDP minus the Fed Funds Rate) will indicate a looming recession.

More than a year ago, 2-year Treasury yields rose above 10-year Treasury yields. This uncommon condition, known as an inverted yield curve, typically leads recession by about 2-years. The timing of the recession typically coincides with a normalization, or "disinversion" of the yield curve. The normalization is occurring now. The spread between 10-year treasuries to 2-year treasuries narrowed from -125 basis points to -26 basis points. If the typical pattern repeats, the economy will fall into recession soon.

Many argue that this time is different… that economy will continue to expand despite warning signs. The unprecedented shutdown of 2020 and subsequent of government spending spree may be confounding the old signals. Time will tell.

Meanwhile, inflation remains above the Fed's target. The Vigilante Inflation score, 4 to 0, indicates inflation will remain sticky. Thus, until the economy starts to contract, the Fed will probably not cut interest rates.

Stock Market Valuation

Figure 7: S&P 500 Long-Term Log Chart as of Jan 29, 2024

The S&P index is working towards the upper valuation extreme. However, the gains in the index are concentrated in the 7 biggest stocks. The vast majority of stocks are trading at reasonable values.

If the economy manages to escape recession, most of the stocks in the index will produce solid returns. Thus, at this point in time, Stock valuation is not sending signals to avoid the stock market.

Investment Strategy and Portfolio Review

In 2022, *Vigilante Investor* sat on a hoard of cash. We entirely avoided losses of the bear market. In fact, we earned solid returns due to our stock selections.

Then in 2023, we continued to hold cash. The S&P Index soared. Stock selections performed well. But we held too much cash for too long. We left too much money on the table.

Looking ahead, *Vigilante Investor* will patiently add investments with value. Because fixed income investments now earn reasonable returns, we do not feel compelled to buy expensive stocks just for the sake of being fully invested.

Liquidation Recommendation: One of our energy stocks has performed exceptionally well. We are taking advantage of the rally in uranium miner Cameco. *Vigilante Investor* recommends selling Cameco (CCJ) at current prices.

Table 4: The Vigilante Model Portfolio as of 1/29/2024

Sector	%	Selections	Symbol	Initial Price	Price Jan 29
Defense	8%	Rtx Corporation	RTX	$85.17	$90.08
		Lockheed Martin	LMT	$428.00	$428.00
Financials	16%	Chubb	CB	$165.98	$242.77
		AIG	AIG	$47.54	$69.37
		WR Berkley	WRB	$53.58	$81.20
		Bank OZK	OZK	$34.86	$49.05
Energy	26%	ProPetro	PUMP	$8.25	$8.38
		Diamondback Energy	FANG	$61.33	$154.86
		Nine Energy	NINE	$1.90	$2.65
		Coterra (Formerly Cabot)	CTRA	$18.69	$25.05
		Southwestern Energy	SWN	$4.06	$6.52
		Antero Resources Corporation	AR	$32.67	$22.57
		Cameco Corp	CCJ	$12.73	$47.10
		KLX Energy Services	KLXE	$10.21	$10.24
Agriculture	4%	Mosaic Co	MOS	$28.67	$32.12
Precious Metals	10%	Junior Gold Miners ETF	GDXJ	$46.02	$34.59
		Gold Miners Index	GDX	$29.30	$28.37
		Pan American Silver	PAAS	$21.13	$13.73
		Silver Miners ETF	SIL	$42.00	$26.19
		Newmont Mining	NEM	$53.32	$34.65
TIPS	18%	VG ST Infl Protected Sec ETF	VIPSX	$12.90	$11.69
Short Terrm Bonds	11%	VG ST Corporate Bond ETF	VCSH	$74.95	$77.47
Cash	7%	Broker Money Fund			

Table 5: The Vigilante Model ETF Portfolio as of 1/29/2024

All ETF Portfolio	%	Selections	Symbol	Initial Price	Price Jan 29
Broad Market	4%	VG Mid-Cap Value ETF	VOE	$122.88	$144.18
	4%	VG Large-Cap Value ETF	VTV	$121.81	$151.58
Financials	4%	VG Financials	VFH	$88.21	$94.56
	14%	iShares U.S. Insurance	IAK	$84.25	$106.55
Energy	24%	First Trust Revere Nat Gas	FCG	$19.01	$23.63
Defense	10%	Invesco Aerospace & Defense	PPA	$91.40	$91.40
Precious Matals	5%	VanEck Vectors Gold Miners	GDX	$32.75	$28.37
	5%	Global X Silver Miners	SIL	$39.51	$26.19
TIPS	*20%*	VG ST Infl Protected Sec ETF	VIPSX	$12.90	$11.69
Short Term Bonds	*10%*	VG ST Corporate Bond ETF	VCSH	$74.95	$77.47
Cash	0%	Broker MoneyFund			

Wishing you the best in all that you do -

Steve Koomar

January 31, 2024

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