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MARKET INSIGHTS

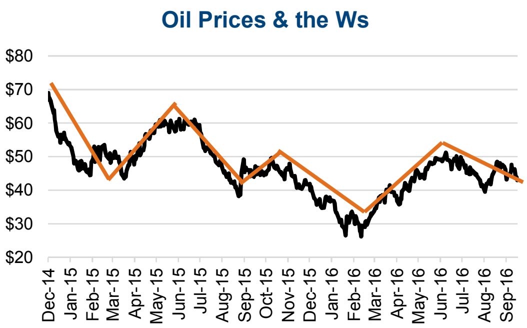
The latest Market Insights
from the Connected Wealth team

Beware the Shoulder Season

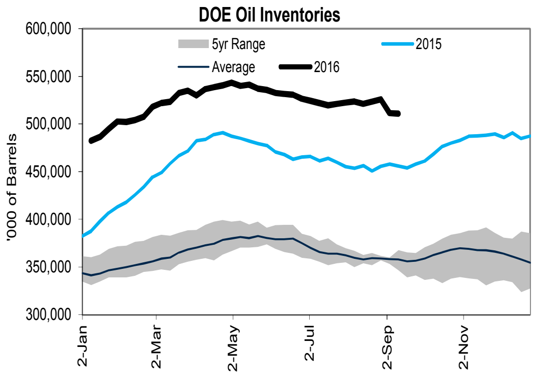
Chris Kerlow, CFA

Summary

- We have taken our underweight energy view to an even more material underweight in the past couple weeks.
- Production disruptions appear on the decline as we head into the seasonally soft shoulder season.
- With a world awash in liquidity, capital flowing back into energy appears unphased by the fundamentals.
- With the U.S. dollar on the rise again, this could weigh more on oil prices.



Oil prices have continued their volatile ways over the past couple years falling from over $100/bbl to a low of $26 early this year, and then staging an impressive recovery to $50. Recently, West Texas Intermediate (WTI) crude prices have fallen over 10% in the past six trading sessions (top chart). The recent weakness is lining up with the shoulder season in the oil market, a time period from Labour Day to the end of October where refiners ramp up maintenance preparing for the winter heating season. With inventory builds likely on the horizon in the coming weeks (2nd chart) it appears ill-timed as production expectations have risen from Nigeria, Libya and the Canadian oil sands.



It appears that this latest move could be the start of another leg down in the Ws pattern we have written about over the past two+ years. Early last week, we expressed our bearish energy view by lowering the energy weight in the majority of our investment mandates. We are now materially underweight energy in both Canada and the U.S. as we think this weakness will persist over the coming weeks while the secular headwinds in the market intensify.

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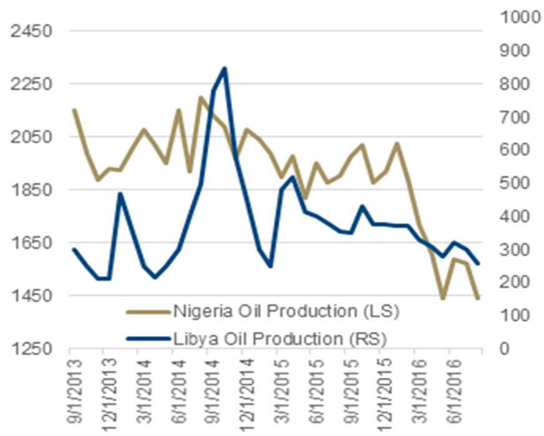
Demand & Supply

The market remains awash in supply and with shoulder season just beginning we foresee this supply and demand imbalance to be deepening. As the season trend in the coming weeks typically sees inventories build, the market appears at risk of reacting poorly.

Adding to the supply woes, a force majeure appears to be coming to an end in both Libya and Nigeria with both ramping production over the coming weeks. A conflict laden terminal in Libya which hasn't exported crude in two years because of conflicts in the region was preparing to begin loading tankers this weekend before rebels put a damper on those plans. This most recent conflict seems to be giving a boost to prices this morning. However, this is hoped to be short lived and Libyan officials said they think they can increase production by 300,000 barrels a day in just a few weeks.

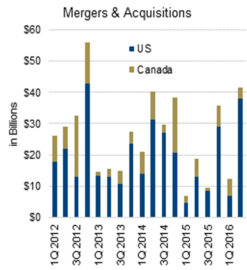
Exxon Mobil and Shell are seeing improvements in Nigeria where they are preparing for resumption of production now that conflicts surrounding their operations have subsided. This could add another 200,000 b/d of supply to the market.

Lastly, oil sands production appears to be back to normal following the disruptions caused by the fires earlier this year. And three new projects were approved by the Albertan government just last week.



Access to Capital and Complacency in the Debt Market

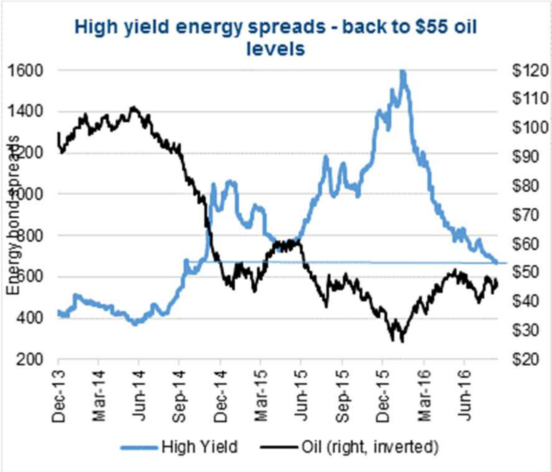
Despite the market being a wash in supply, inventories set to rise and prices falling, oil and gas companies are not finding it challenging to access capital (bottom chart). IPO and Secondary offerings are still prominent and M&A activity in the U.S. ran at the highest level last quarter since 2012. Capital markets are demonstrating a level of complacency amidst the new era of lower for longer oil prices. There are still many North American operations that are unsustainable under $50WTI prices. However, credit spreads have been consistently trending lower since prices bottomed in mid-February. The complacent aspect has been the disregard for the cash burn that high cost producers have been undergoing for the past two quarters, something that is unsustainable and a going concern for many. A slew of



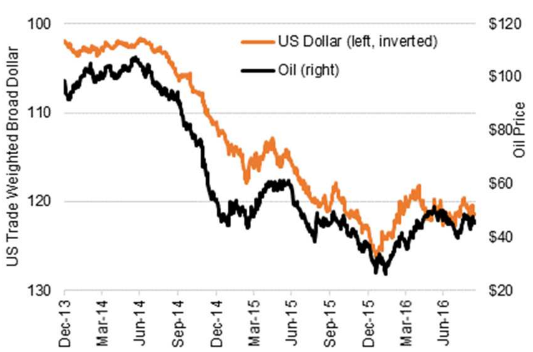
bankruptcies or further fall in prices could be a catalysts and spike credit spreads which would likely have similar roll on effects of the last time they flared up and we saw a downturn in anything within two degrees of separation to the oil patch (top chart).

A Strengthening Dollar

Another major headwind oil pricing and all commodities, for that matter, are facing is a strengthening dollar. The dollar has caught a bid lately and is gaining against most major pair trading partners, the loonie included. Expectations for a December rate hike in the U.S. have been rising since the summer. The market is pricing in a 54% chance of a hike by the end of the year. It was below 10% at the start of July. This is a dislocation from most other economies that could cut rates in the near term. Next week is going to be impactful with the Bank of Japan and the FED both having monetary policy meetings. The UK decided to hold rates steady this week, as their economy deals with the ramifications of the Brexit vote. The correlation of the dollar and oil prices isn't perfect but they do move quite closely together.



Not perfect, but a very strong relationship



Charts are sourced to Bloomberg unless otherwise noted.