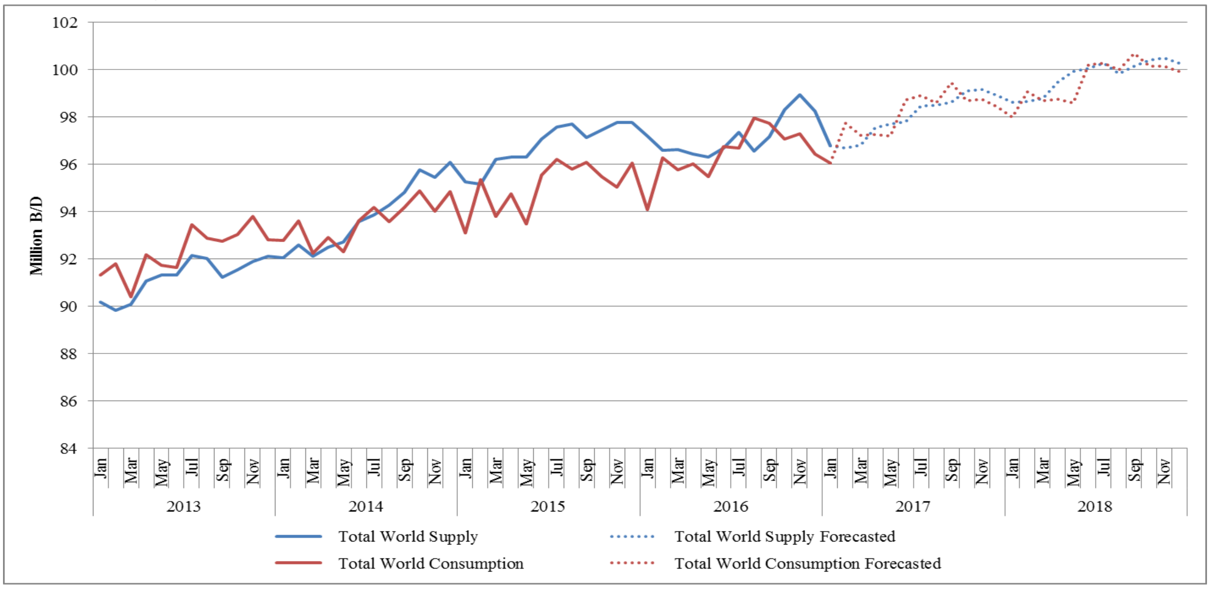
Wellesley
Investments & Pensions

Oil Update – February 2017

The joint ministerial monitoring committee (JMMC), the body tasked with monitoring the compliance of the 13 OPEC members and 11 non-OPEC oil producers with production adjustments, met on January 22nd. At the meeting, countries confirmed commitments to shoulder their share of the production cuts originally announced in November and December. The JMMC plans to provide monthly updates on the 17th of each month. Statements from countries to date indicate that production cuts are being met; current oil tanker data also indicates a reduction, according to the Energy Information Administration. In the STEO report this month, EIA made significant revisions to historical liquid fuel consumption, creating a higher baseline for which 2015-16 and subsequent years are estimated. Most notably, revisions include an upward adjustment of Chinese oil consumption and supply.

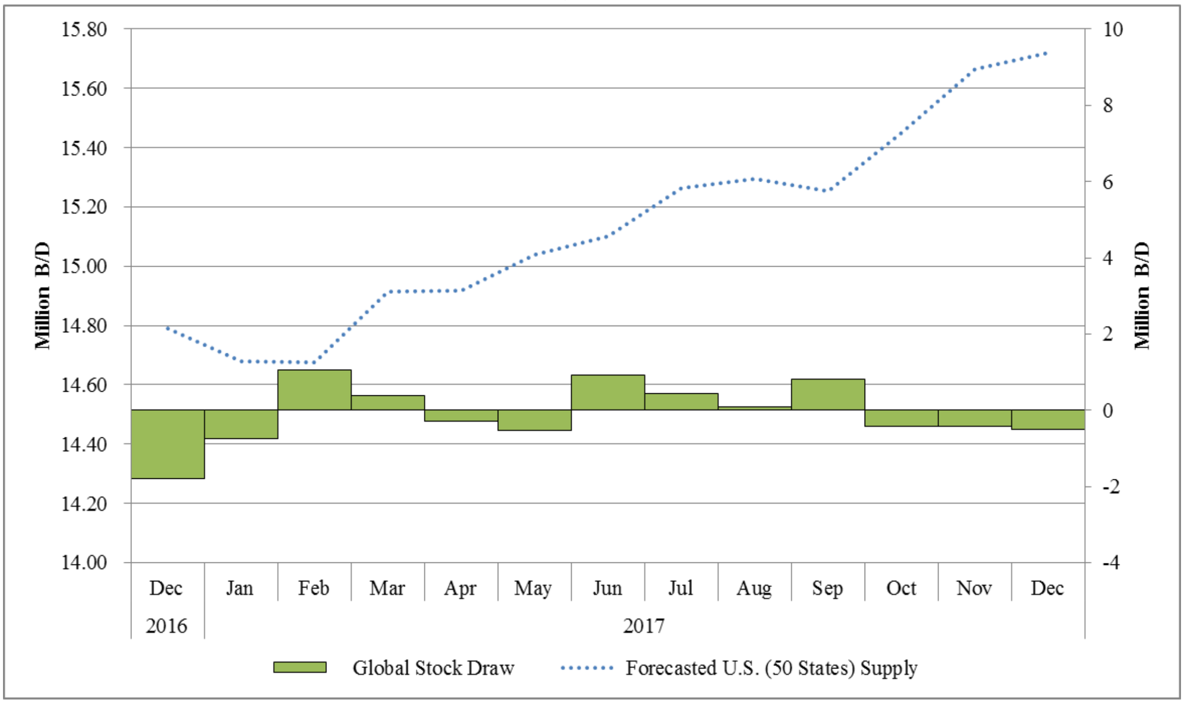
Global Supply and Consumption Levels: Historical and Forecast



Source: EIA STEO Report, Wellesley I & P

Global oil supply fell 1.47m b/d or 0.99% from December to January as the OPEC alliance production adjustment agreement takes effect. However global consumption fell marginally from 96.46m b/d to 96.06m b/d or 0.42%. EIA indicates global excess supply of 0.72m b/d in January. Global consumption is forecast to grow 1.69m b/d in February to 97.75m b/d, while global supply is expected to fall another 0.10m b/d to 96.69m b/d, indicating that global supply will be 1.06m b/d below equilibrium in February. Therefore, we should expect to see global inventory drawdowns begin in February. Overall, the EIA expects global consumption to grow 1.6m b/d in 2017. The revision of EIA global consumption numbers means that we are much more likely to see equilibrium achieved in the first quarter of 2017. Our assumption on the upper limit of price expectations for 2017 has not changed; we do not see oil prices pushing beyond $60 in 2017, given the current sizeable global inventory. However, if OPEC decides to extend the cut beyond 6 months and announces intentions to further reduce production beyond 1.8m b/d then the $60 may be reached sooner than expected.

Forecast US Supply Growth and Global Inventory Draws



Source: EIA STEO, Wellesley I&P

Although we expect to see increases in US production through 2017, we don't expect new US shale production to fully offset the OPEC cuts and the rise in global consumption levels. US production levels are forecast to increase by 0.91m b/d of which 0.6m b/d is expected to be shale. Total US capital spending for upstream, midstream, downstream and corporate activities fell approximately 24.4% in 2016, following a 36.1% decline in spending during 2015. This lower spend on exploration combined with the fact that the average WTI Crude breakeven price is $58, not including the $10-$20 transportation costs (depending on the location), means that a large surge in US shale output is unlikely in the short-term at current price levels.

We are expecting our recommended investment, the SPDR Oil and Gas Exploration and Production ETF, to outperform the WTI crude price in 2017. Increasing investment in capital intensive shale formations and reserves should benefit the underlying equities in the ETF in the short-term.

Wellesley Investments & Pensions Ltd.
15th February 2017

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