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OIL: TODAY'S UPSIDE SOWING THE SEEDS OF TOMORROW'S NEW LOWS

The 2-year old aggressive market-share price war by the Saudis led the necessity to squeeze costs for alternative energy producers around the world. Critically, US shale frackers managed to notably decrease **breakeven costs per barrel**; for some shale types **down to $29 from $59 in 2014**, according to consultancy Rystad Energy. Nietzsche said it eloquently: “That which does not kill you, makes you stronger.” Indeed.

Oil at above 50$ is set to drive a **supply response from marginal US producers**, not just the most virtuous ones. 2020 oil production can now be hedged at almost 60$ on forwards, leaving not much in the way of opening up the spigots to max production. Incidentally, US **oil and gas rig count** resumed increasing as of late, while inventories grew: next then, production may stop descending (see chart below).

Meanwhile, **technological trends** progresses unabated towards the day of inevitable breakthroughs, both on the **supply side** - in clean energy production unit costs and cheap battery storage – and on the **demand side** – energy efficiency, electric cars. Like Elon Musk says, ‘’the future is going to overwhelmingly be solar plus battery. They go together like peanut butter and jelly.’’

Notably, **Oil decoupled markedly from the US Dollar**, in spite of tight historical correlation (chart below). Will and can it last? If not, which one is to give in?

Higher rates, higher oil prices and a stronger Dollar won’t make US growth any more robust than low rates, low oil and a weak Dollar did. Expectations of Trump’s policies brought up headwinds such as Dollar/Rates/Oil, only temporarily offset by the anticipation of a miracle in productive private capital formation: absent that, the **impact on real growth** and subsequent aggregate demand won’t help much the case for significantly higher Oil prices going forward (here are our views on the global economy).

Historically, it is also worth remembering that a cut in production of 1mn barrels per day is just about as big as the **typical average over-production above quotas** for OPEC members.

› **All in all, we believe Oil oversupply to stay and be likely to meet a weaker demand in the years ahead, making the the case for new lows on Oil a genuine one. Oil is now reaching levels at which fresh new shorts are attractive from a risk-adjusted returns basis.**

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BRENT Oil vs. DOLLAR Index (inverted)

US Crude Oil PRODUCTION vs. Crude Oil Total INVENTORY Data

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CONTACT DETAILS

Fasanara Capital Limited
40 New Bond Street, W1S 2RX
www.fasanara.com
investor.relations@fasanara.com

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