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OIL: A WEAK PRESENT AND NO FUTURE

Oil correction (~10% from peak) is not necessarily the foretell of an imminent debacle. Oil corrected by approx. 20% twice in the past months (June-July 2016 and October-November 2016), without derailing the bull trend. Important supports were breached in both instances, and yet Oil managed to resurrect, powerfully.

However, this latest development with Oil offers the opportunity to update views, and record relevant incoming data in either confirmation or denial of our bearish thesis on Oil: so far, we seem to have confirmation.

1. The most interesting element / 'new news' is that **the forward oil curve is no longer exhibiting a marked 'contango' shape, meaning that long-dated forwards are no longer well above spot.** In contrast, it is almost becoming 'backwardation'. As the contracts are often used by real producers to hedge future output, this may happen in reflection of a market peak.

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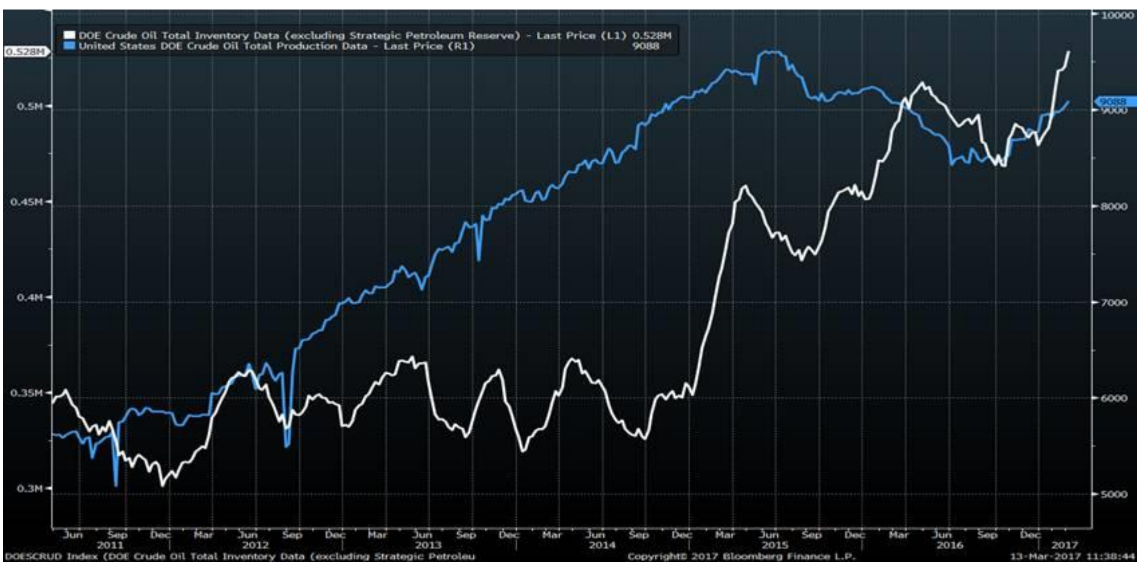
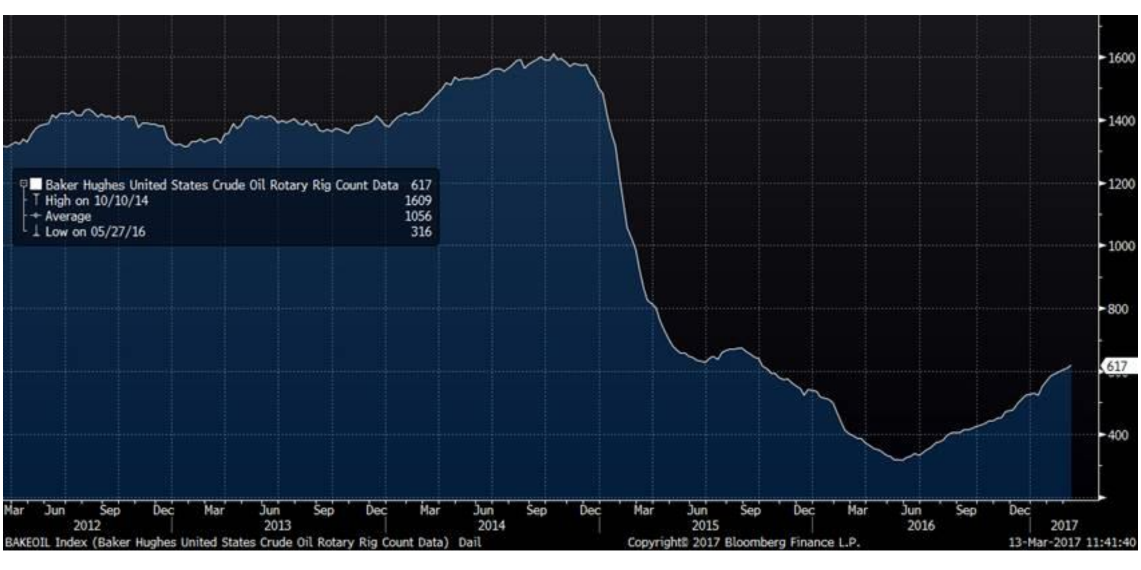
2. As a recent GaveKal research notes, **OPEC is less relevant today than it has ever been.** Russia, Saudi Arabia and Iran have today no more grip on oil prices (controlling 50% of oil global supply) than Rio Tinto, BHP Billiton and Vale demonstrably have on the price iron ore (of which they hold a 70% market share).

3. As expected, **higher levels for Oil have indeed led to a resumption of production and oil rigs formation in the US,** over the past several months. **Shale's reaction function to levels of Oil above 50$ was entirely predictable**. So it is predictable for the recent rebound in production to persist: as we noted in December, critically, US shale frackers had managed to notably decrease breakeven costs per barrel; for some shale types down to $29 from $59 in 2014, according to consultancy Rystad Energy.





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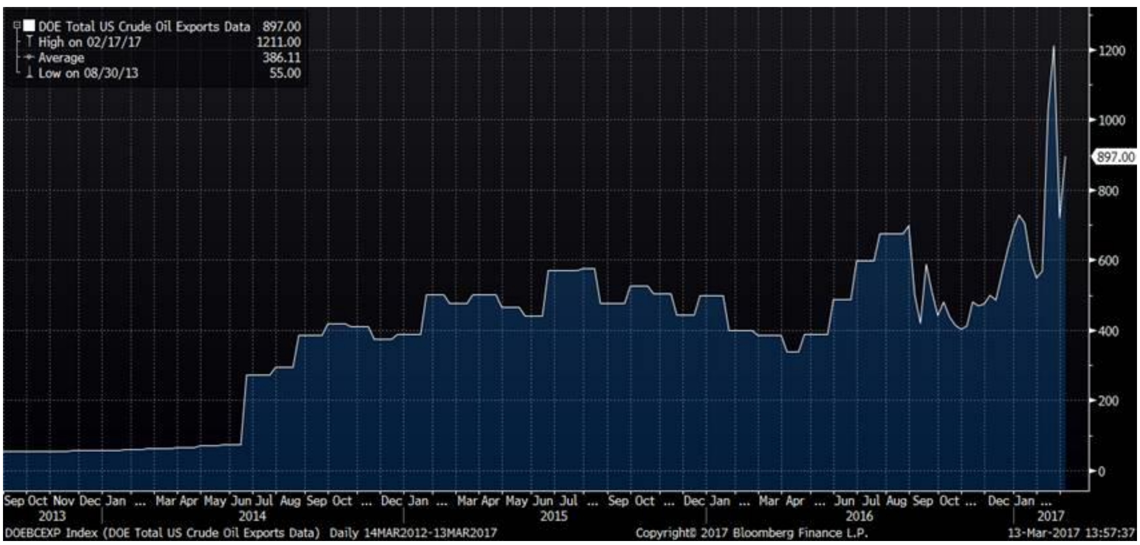
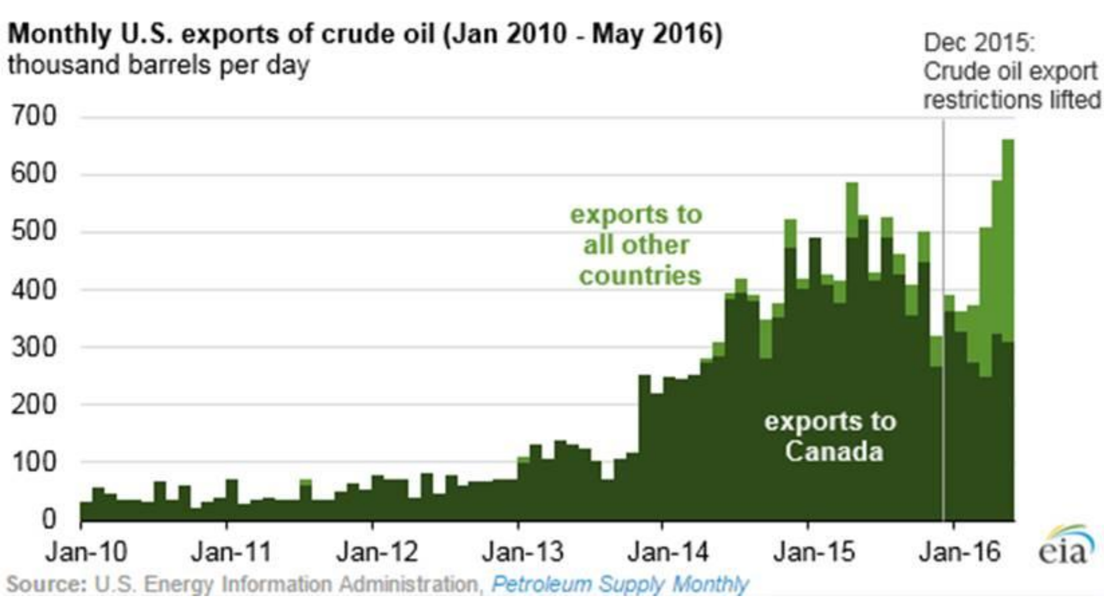
4. **Promised deregulation of the oil market by Trump**, and his friendly views on coal, may further exacerbate structural oversupply issues in the Oil market. This comes at a perilous time, as **US crude oil exports are increasing at an alarming pace** (see Chart below), and reaching more destinations, after the **removal of restrictions on exporting US crude oil in December 2015**. (EIA data and US crude Oil exports). **The US is expected to export at least 0.8mn barrels per day in 2017** (according to analysts polled by Bloomberg), which would exceed that of OPEC members such as Lybia and Qatar. This is not far off from the 1.2m bpd of OPEC's budgeted cuts, further eating into OPEC's market share and therefore possibly undermining the stability of the agreement itself.





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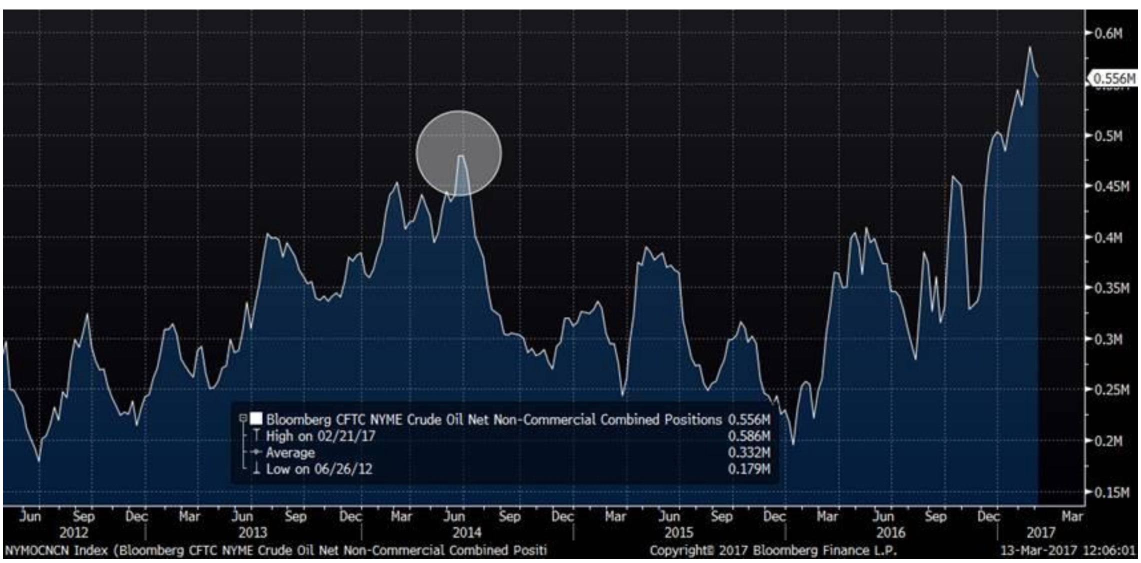
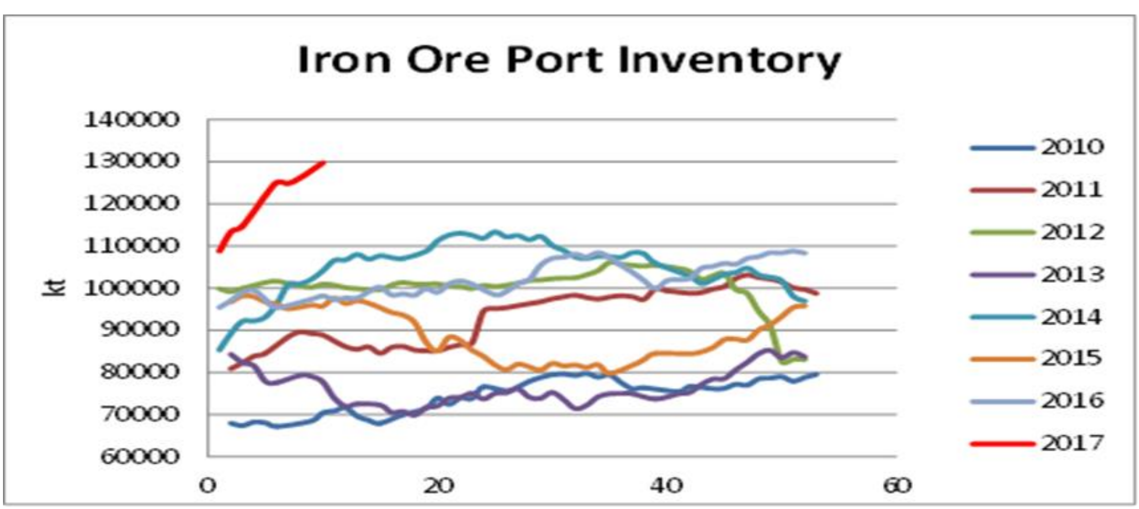
5. **Speculative positions on Oil are at historical highs, well above where they stood in the summer of 2014 (just before Oil started its 76% descent).** They may be peaking now that China has partially put on hold its steroids-rich fiscal stimulus program, as of last summer, and started some tightening of its monetary policy. **The speculation in Oil is reminiscent of the leverage built up for Iron Ore** in the Dalian Commodity Exchange in China, reflected in record inventories at Chinese ports (see Chart below from GS Bulks Trading). Now that China slows the rate of credit growth to stem financial speculation, and the property cycle softens, we may see some of the leverage working in reverse.





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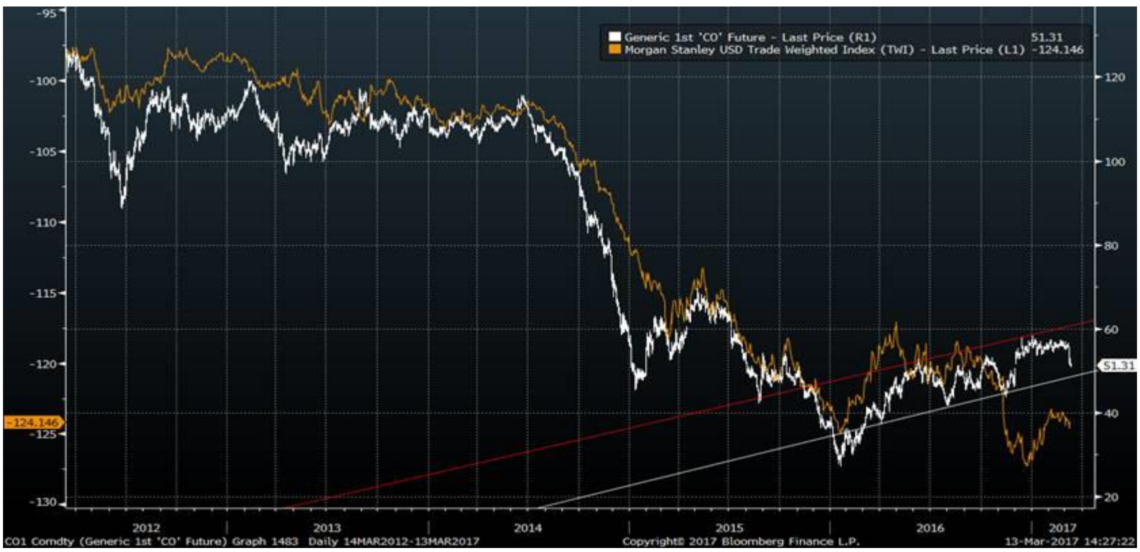
6. For what is worth, the fundamentally-proven and historically-strong correlation with the Dollar Trade Weighted Index would project a price for Oil sub-40$. We are now nearing a trend-line level, the test/break of which may determine an acceleration of the re-coupling.



In conclusion, not so much in denial of our long-term outlook for Oil, so far: therefore, **we reiterate our view that Oil is defying gravity at current levels and is set to revisit lows in the not so distant future, due to overwhelming structural factors such as exponential technologies, shale oil/shale gas/nat gas, substitution effects. Long-term prospects have little bearing in the short-term for price-discovery, but do provide a magnet for prices over time, as cyclical factors like OPEC and speculation fade.** Here below we attach our previous note. We will update our views on incoming data if relevant.

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CONTACT DETAILS

Fasanara Capital Limited

40 New Bond Street, W1S 2RX

www.fasanara.com

investor.relations@fasanara.com