Ninepoint Energy Fund Market View

December 03, 2020

Investment Team

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OPEC meeting behind us + a post-COVID world ahead. What does it mean for oil and energy stocks?

The OPEC+ drama resolved itself today with members agreeing to add only 0.5MM Bbl/d of curtailed production (in actuality less than the headline as cheaters still have to make up for their shortfalls) in January (vs. the worst case 1.7MM Bbl/d) with the potential for monthly incremental 0.5MM Bbl/d additions depending on market conditions. While slightly bearish to what consensus was a month ago, given increased tensions recently I view this as an amicable resolution and not impairing the short/medium term trajectory for the oil price. The market is currently looking through short-term demand weakness from regional lockdowns (US, Europe) anyways towards a post-COVID world in 2H'21 with the successful deployment of at least 3 vaccines. What will a post-COVID world look like for energy investors?

While the majority of the market's focus has been on the temporary impact on demand (no need to rehash that…we know it was REALLY bad back in March/April) I have been vocal that what the market should be focussing on is the structural impact to supply as this will be much longer lasting. Though the trends of US shale growth deceleration, the lack of meaningful OPEC spare capacity, and the peaking of global offshore production due to 5+ years of insufficient investment in new projects were all ready in place prior to COVID they have been accelerated by the pandemic: US shale production is now down 1.2MM Bbl/d YTD and global integrateds have pledged to invest more in renewables and less in hydrocarbons (BP allowing oil/gas production to fall by 40%, Royal Dutch Shell saying 2019 will be their high water mark for oil production, etc.) further exacerbating offshore declines. In short future supply growth is highly challenged in the years ahead! While it is true that OPEC technically sits on 7.2MM Bbl/d of "spare capacity" due to still weak demand this will be returned to the market over the course of 2021 as demand normalizes due to successful vaccine deployment and people largely returning to their old way of life (countries like Japan and China that are not under lockdown are already back to 96%/102% of pre-COVID levels). At that point the remaining spare capacity will be in Saudi Arabia (~1.5MM Bbl/d) and Iran (~1MM Bbl/d) versus a likely 100MM Bbl/d market. Given the world population is set to grow by 26% over the next 30 years while the largest energy companies endeavour to become emissions neutral and wokely purge themselves of their legacy hydrocarbon production it is not much of a leap to see that we are headed towards a supply crisis in 2022 and beyond.

The price of oil was at $62WTI before COVID hit…given all of the above why would we not get back to that price level (and higher)? What is incredibly frustrating is that 2020 was set to be an excellent year for energy investors: US shale growth was slowing, demand was growing, and OPEC spare capacity was limited yet COVID deferred our bullish call by a year. Our earlier (and VERY non-consensus) repeated calls that oil could reach $50WTI by year-end 2020 are no longer looking quite so extreme! What do we see going forward? Continued inventory draws (aided by today's announcement) in Q1'21 despite Q1 being the seasonally weakest period of demand allowing oil to reach $50WTI in early 2021 while demand normalization + falling US/non-OPEC production should allow for inventories to reach normalized levels by the 2H'21 leading to an oil rally to $60WTI (or higher). Looking to 2022 we see challenged supply growth + continued demand growth with the backdrop of below normal inventory levels and exhausted spare capacity manifesting in much higher oil prices than strip.

In this context, energy stocks that are still down 50%+ YTD represent tremendous value (ie. they need to double to get back to their January levels). The significance of a truce being found by OPEC today means we have passed the final hurdle that was preventing generalist money from returning to the sector. I've been routinely told by energy desks these past days that "no one is positioned for a higher oil price" other than ourself and our Fund's performance helps to support that view. This means that the market is still very much underweight and it is inevitable that the "fear of missing out" given very strong sector performance (November = ~35%) will pressure institutional fund managers to start to increase their sector weighting. The energy sector has been the largest casualty of COVI19 and as we head towards a post-COVID world in 2021…why would the energy sector not be one of the biggest beneficiaries? Our Fund is positioned to maximally benefit from this bullish outlook for oil.

Let me be clear: the oil market is heading into a multi-year bull market beginning in 2021. All of the potential roadblocks have now been surpassed (OPEC+ dissolvement, perpetual demand hit from COVID-19 due to unsuccessful vaccines, US shale growth satisfying 100% of global demand growth, etc.). While a now significant percentage of our client base are relatively new and have experienced strong returns our goal remains to make our long-standing clients who have suffered through the worst bear market in the history of the sector whole. I firmly believe that we are heading into a multi-year bull market for energy and am excited about the upside in many smaller energy stocks in which we have amassed meaningful and strategic ownership positions. Years of patience look to finally pay off next year.

In the shorter term given the potential for a continued growth vs. value unwind and the overall sector underweight on the part of generalist institutional investors we see a likelihood of a strong December rally (just like last year). Don't be fooled by the spectre of tax loss selling…now is the time to get fully weighted.

For a more detailed discussion of my views for 2021 I would encourage you to watch a few recent presentations:

1. The Road Ahead – November 26th, 2020

https://ninepoint.com/commentary/commentaries/2020/102020/eric-nuttall-audio-commentary-nov-2620/

2. BNN Market Call – November 20th, 2020

https://www.bnnbloomberg.ca/video/eric-nuttall-s-market-outlook~2081585

3. Presentation at the CAODC Virtual State of the Industry along with the Ministers of Energy of Alberta and Saskatchewan – November 19th, 2020 (starts at 20:50 mark)

https://www.youtube.com/watch?v=DsdADtC7YqU&feature=youtu.be

4. Twitter for daily observations on the energy sector

https://twitter.com/ericnuttall

As always, reach out with questions on my outlook/strategy/positioning.

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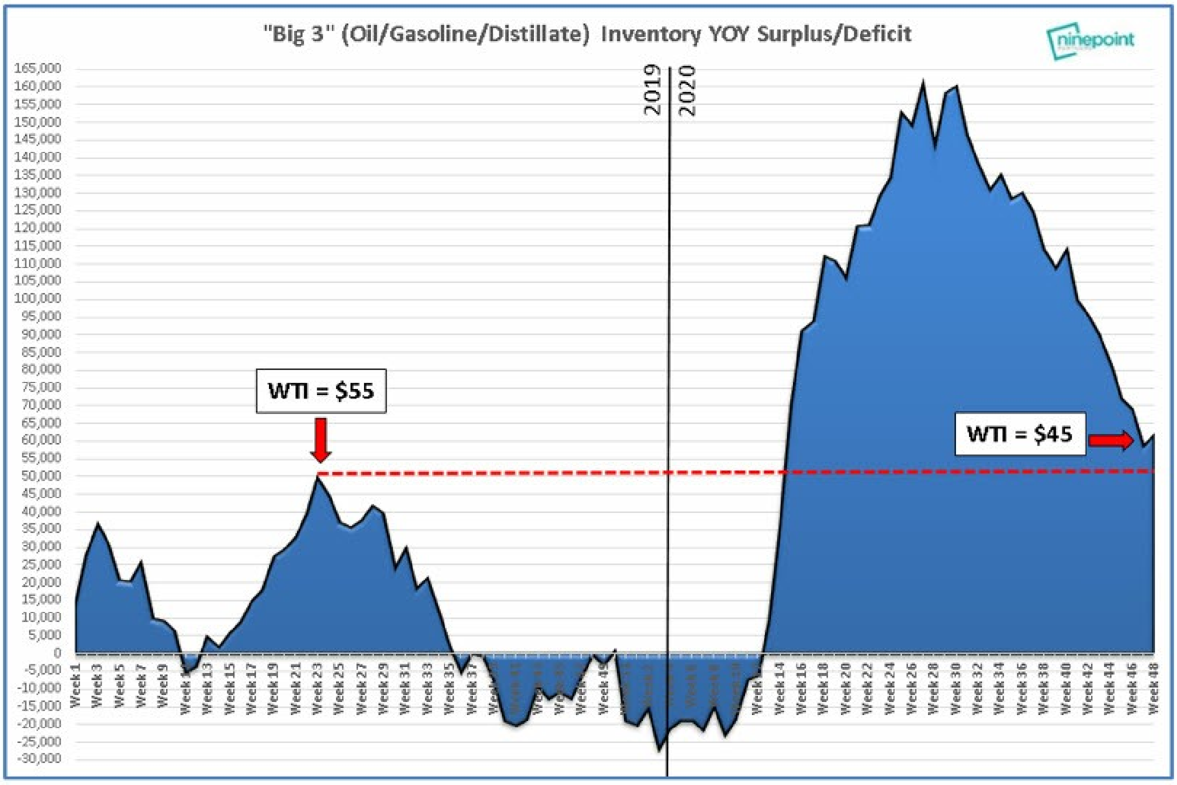
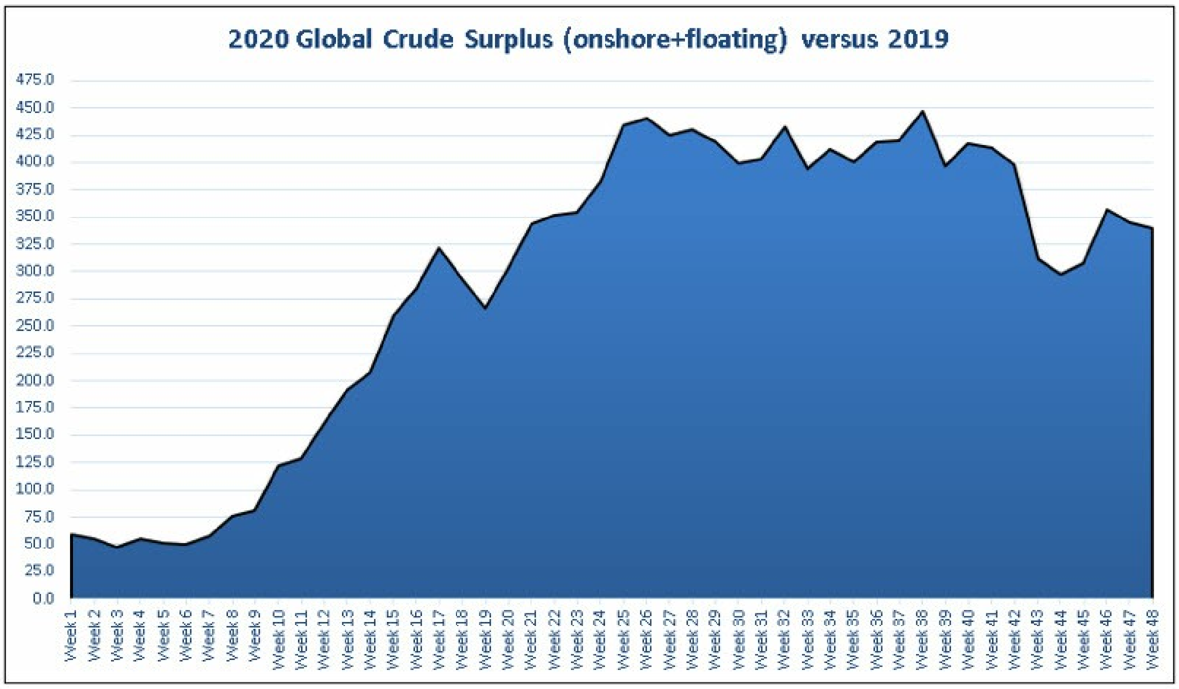
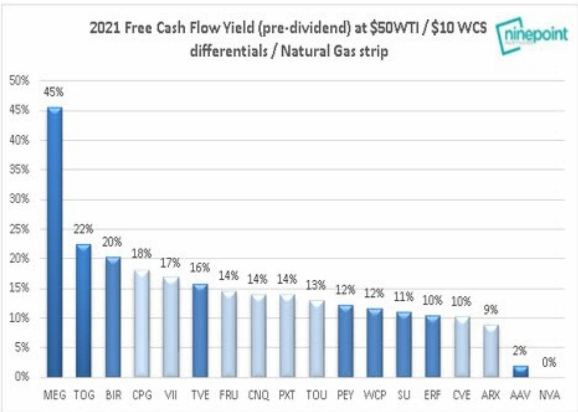
Portfolio Snapshot			
Number of names:	12		
% Oil	77%		
% Gas	20%	Average Holding	
% Services	0%	FCF Yield at $50	21%
% Cash	3%	FCF Yield at $60	45%
Portfolio Beta	163%	EV/CF at $50	3.9
Average Market Cap (MM)	$7,113	EV/CF at $60	2.9



Source: US Energy Information Administration

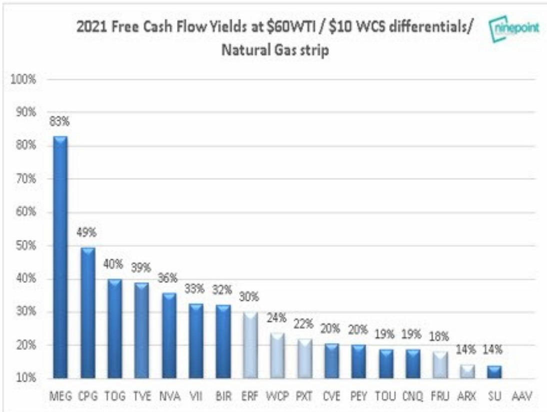


Source: Kpler



Free cash flow = operating cash flow (pre-hedging) minus capex required to keep production flat

Source: Bloomberg, Ninepoint Partners
For illustrative purposes only



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NINEPOINT ENERGY FUND - COMPOUNDED RETURNS[1] AS OF NOVEMBER 30, 2020 (SERIES F NPP008)

	1MTH	YTD	3MTH	6MTH	1YR	3YR	5YR	10YR	15YR	INCEPTION
FUND	33.4	-32.3	20.6	60.1	-18.3	-20.5	-14.5	-9.6	-6.0	-1.4
INDEX	33.6	-39.0	8.6	11.7	-31.8	-20.6	-10.9	-9.0	-5.1	-1.3

[1] All returns and fund details are a) based on Series F units; b) net of fees; c) annualized if period is greater than one year; d) as at November 30, 2020. The index is 100% S&P/TSX Capped Energy TRI and is computed by Ninepoint Partners LP based on publicly available index information.

The Fund is generally exposed to the following risks. See the prospectus of the Fund for a description of these risks: concentration risk; credit risk; currency risk; cybersecurity risk; derivatives risk; exchange traded funds risk; foreign investment risk; inflation risk; interest rate risk; liquidity risk; market risk; regulatory risk; securities lending, repurchase and reverse repurchase transactions risk; series risk; short selling risk; small capitalization natural resource company risk; specific issuer risk; tax risk.

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