Sprott Energy Strategy

Market View: Feb 13/18

Investment Team

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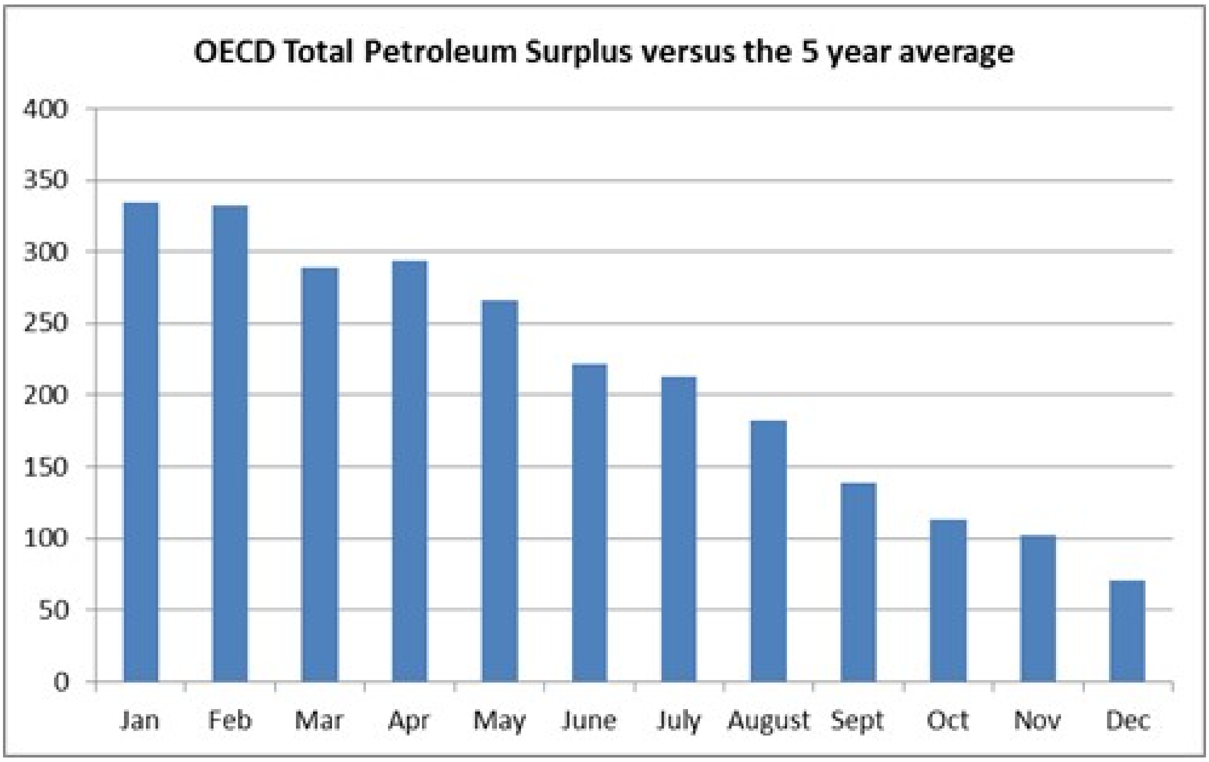
Warning: the conclusion in this commentary is way out of consensus.

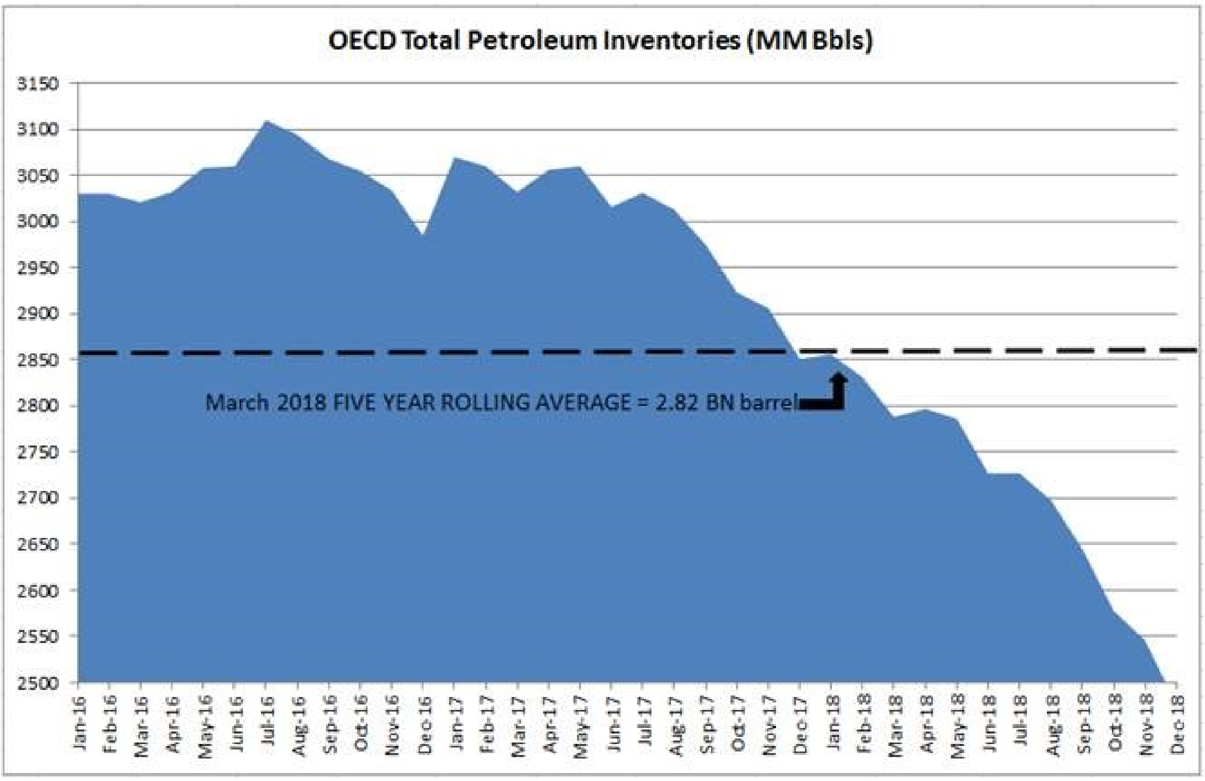
This morning the IEA provided their monthly update on global oil demand/supply/inventories. We watch the inventory balance closely as this is the intersection between supply and demand (the market mainly focuses on supply which only gives half the picture). For December OECD oil inventories fell by 55MM Bbls (this compares to the 5 year average of -29MM Bbls). This was the steepest monthly drop since February 2011. Even more importantly, their preliminary indication for January is for a build of only 5MM Bbls (inventories ALWAYS build in January due to seasonal demand trends) and this would compare to last year's build of 85MM Bbls and a 5 year average build of 36MM Bbls.

As a result of very strong demand growth, tempered US and Non-OPEC/US supply growth, and very high compliance on the part of OPEC/Russia, the surplus of oil inventories fell from a high of 334MM Bbls in January to only 70MM Bbls in December (ie. 0.7MM Bbl/d undersupplied throughout the year). This drop is the sharpest in history.



Source: Ninepoint Partners based on publicly available information

Given continued strong demand indications (China January oil demand up 10%, India up 400k bbl/d YOY, etc.), continued 100%+ compliance on the part of OPEC, and moderate non-OPEC/US supply growth we see the market remaining undersupplied throughout the year, despite an acceleration in US supply growth. We also expect OPEC/Russia to overshoot (i.e. keep the market undersupplied longer than required).

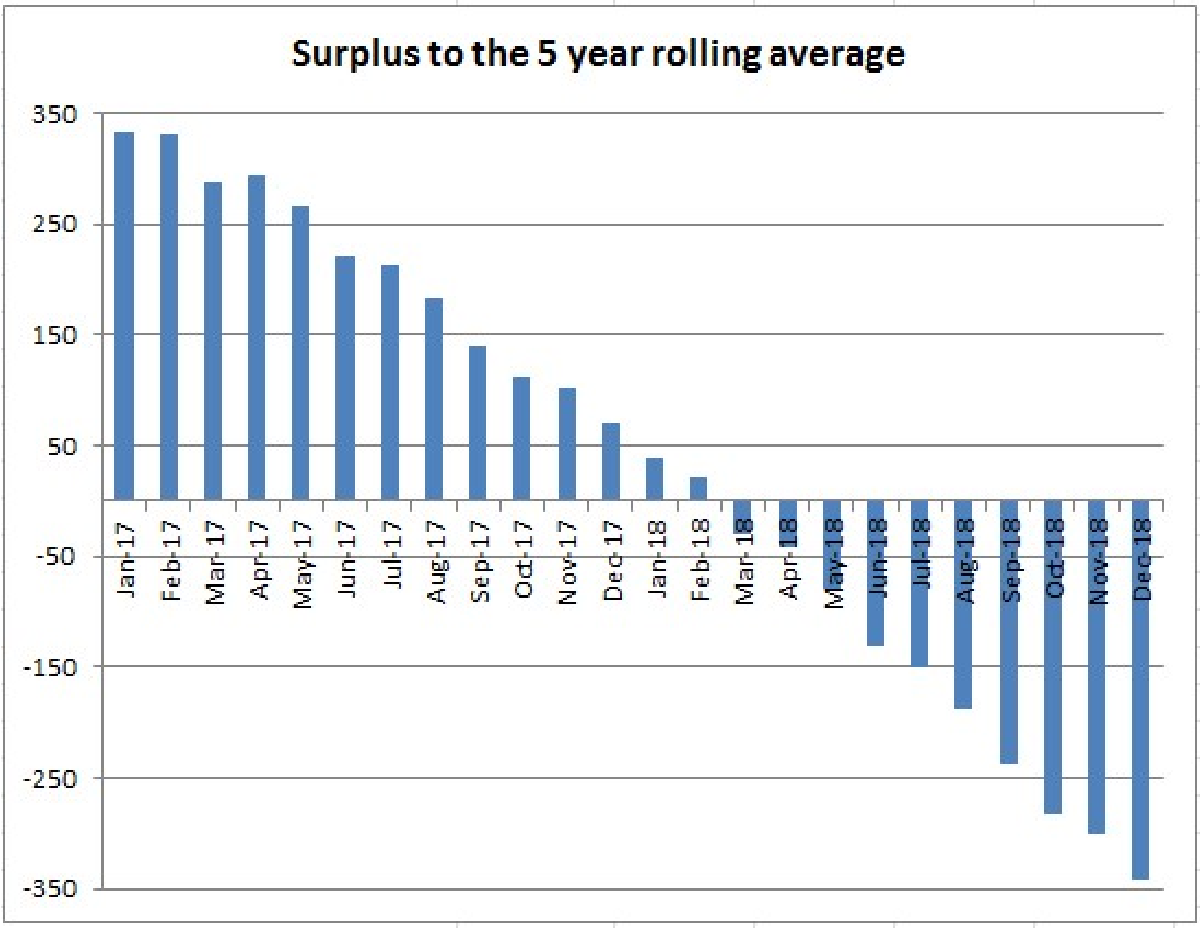


Source: Ninepoint Partners based on publicly available information

Conclusion: Even accounting for a recent uptick in the rate of US supply growth, so long as the market remains 0.5MM Bbl/d undersupplied, we believe inventories **will reach balanced levels by March**. This is well ahead of consensus (and up from our earlier estimate of May). While this forecast might sound outlandish, we were well ahead of the curve in 2017 calling for a balanced market by mid-2018 while others were saying it could take 1-2 years beyond that.

If our forecasts are remotely close to accurate (the oil market heading into deficit in Q2 2018 and potentially reaching over 200MM Bbls deficit by YE) the bias for the oil price is clearly higher. The last time oil inventories dropped below 2.6BN barrels was December 2014. We have that occurring in October 2018. The price of oil in December 2014… $70/bbl WTI. Where was the S&P Oil & Gas Index then? Around 45 versus 33 today (36% upside). Where was the Oil Service Sector Index? Around 200 versus 140 today (43% upside).

Eric



Source: Ninepoint Partners based on publicly available information

[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 January 31, 2018; e) 2004 annual returns are from 04/15/04 to 12/31/04. The index is 100% S&P/TSX Capped Energy TRI and is computed by Ninepoint Partners LP based on publicly available index information.† Since inception of fund Series F.

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