OIL LORDS BATTLE IT OUT

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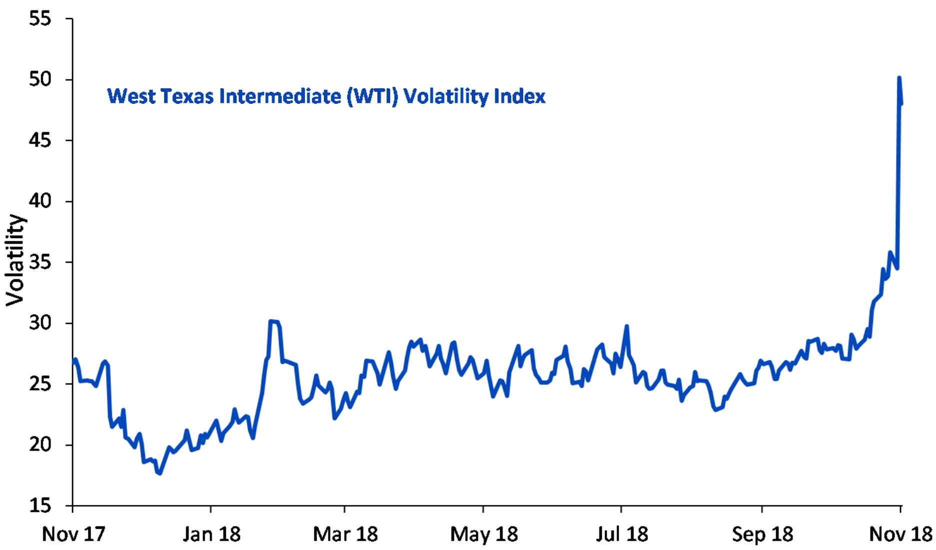
Oil prices experienced one of the most volatile weeks[1] in recent history.

They got off to a strong start at the beginning of the week in response to the supply cuts discussed at the Organization of the Petroleum Exporting Countries (OPEC)-Non-OPEC Joint Ministerial Monitoring Committee (JMMC) meeting in Abu Dhabi over the weekend, but prices swiftly nosedived sending oil price volatility to its highest level in a year. The release of the key oil reports in the week by OPEC and the International Energy Agency (IEA) stoked volatility higher. As both agencies lowered their forecasts for the growth in oil demand next year. While a weaker demand story by OPEC & IEA certainly played its part in lowering oil prices, we believe the change in rhetoric on the supply situation took precedence over the sudden shift in sentiment.

Figure 1: Oil volatility spikes to highest level in a year



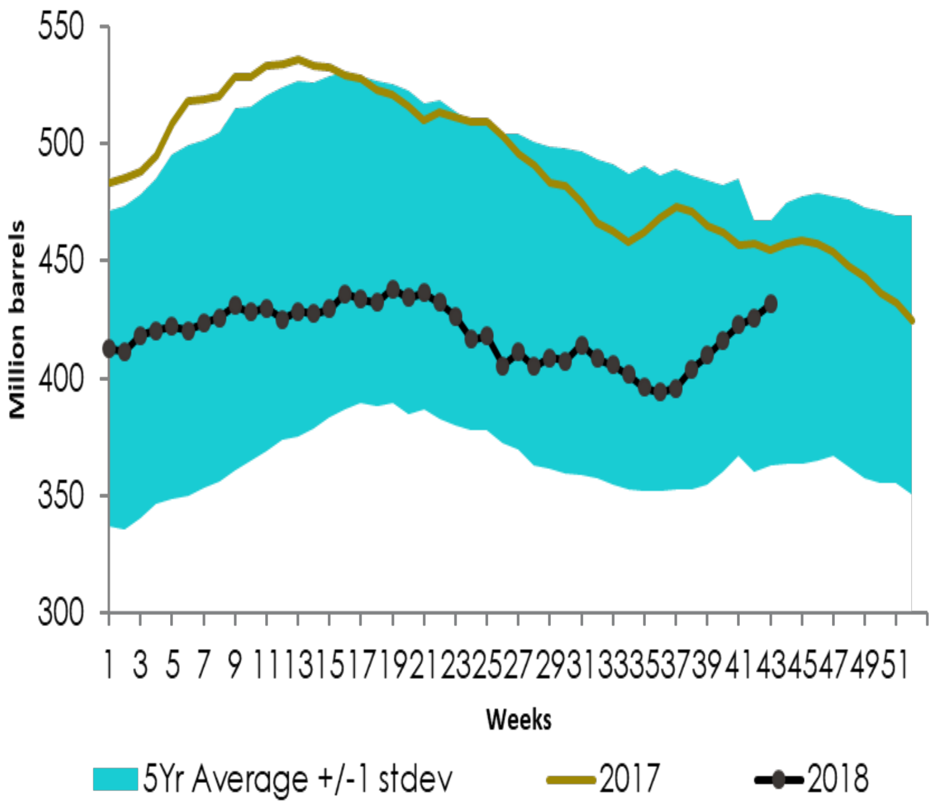
Source: Bloomberg, WisdomTree, daily data available from 14 November 2017 to 14 November 2018

What really caused the turnaround in sentiment?

We think that oil prices have been caught off-guard by the swift turn of events. A month back, the markets expected the US sanctions on Iranian oil exports in November to reduce oil supply significantly. However, the unanticipated US waivers to 8 key importers of Iranian oil for the next 180 days coupled with sharply rising US oil production is increasing the likelihood of the oil market being oversupplied in the current quarter. *These temporary concessions by the US for countries that take the lion's share of Iranian oil exports has led to a mismanagement of expectations.*

Although temporary, the nature of these concessions is quite generous as it allows South Korea to import two thirds of its normal amount and India as much as three quarters. Iranian oil exports could actually rise in the near future. Added to that, US oil production is rising faster than anticipated. The US Energy Information Administration (EIA) announced that US shale oil production is set to rise by 113,000 to a record 7.94mn barrels per day (bpd) in December. The ill-timing of the easing of the supply situation on the global oil market alongside reduced expectations for global energy demand underpinned the weakness in oil prices this week.

Figure 2: US Oil Inventory: Weekly data in millions of barrels, from November 2013 to Nov 2018

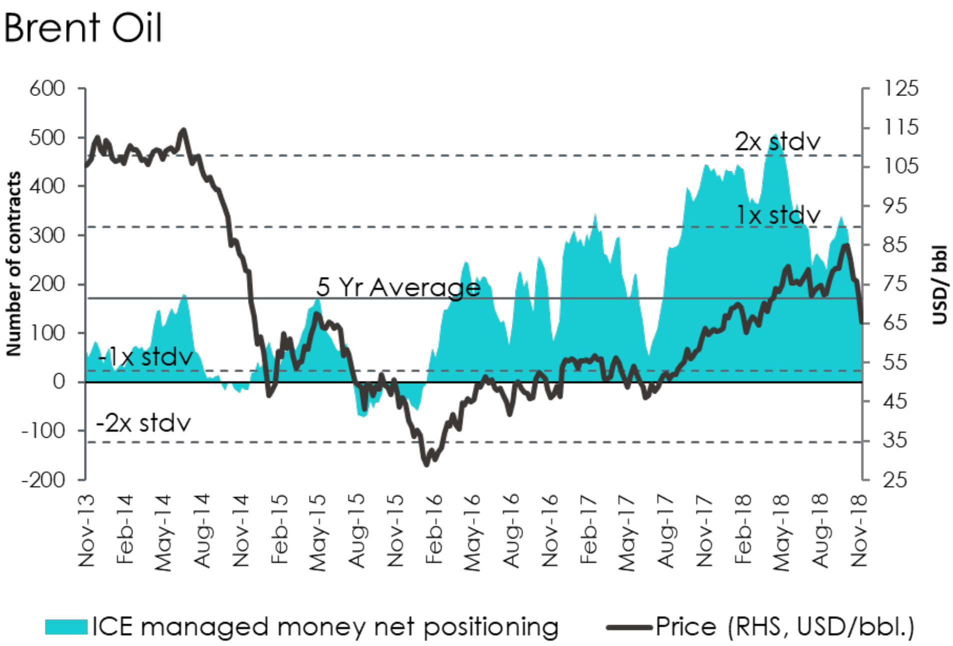


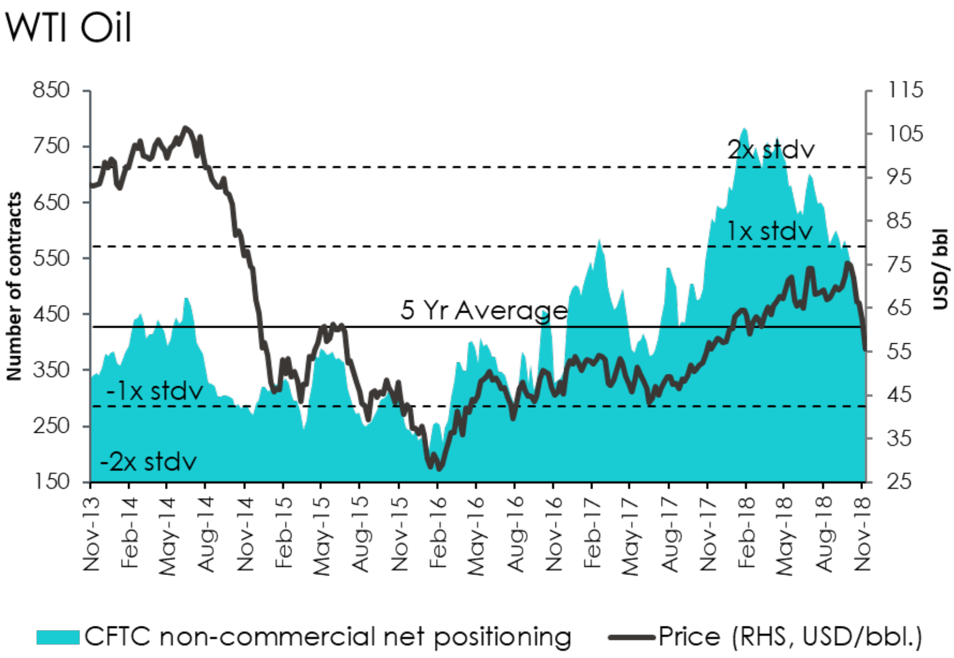
Source: US Department of Energy. While only the 2017 and 2018 weekly data is shown, the blue area which refers to an average, +/- 1 standard deviation, was calculated using 5 years of data, back to November 2013.

OPEC vs Trump

In response to the ongoing supply glut, OPEC led by Saudi Arabia intends to lower oil exports by 0.5mn bpd. At the JMMC meeting in Abu Dhabi over the weekend Saudi Energy minister Khalid Al-Falih set the tone for a need by OPEC+[2] to cut oil production by 1mn bpd from October levels. Reuters reported on 14 November 2018 that OPEC is considering reducing output by as much as 1.4mn bpd. This is likely to put OPEC on a collision course with the US, evident from the recent tweet by US president Trump that OPEC should not cut oil production. According to Commodity Futures Trading Commission (CFTC), net speculative positioning for both Brent and West Texas Intermediate (WTI) crude oil futures have declined below their long term 5-year average underscoring the bearishness among investors.

Figures 3a and 3b: Net positioning for Brent and (WTI)





Source: Bloomberg, WisdomTree, data as of 13 November 2018. **Historical performance is not an indication of future performance and any investments may go down in value.**

Evidently sentiment has changed on the oil market. The sharp oil price correction signals that sentiment is overriding fundamentals. Sentiment is being dictated by the political confrontation between Trump and OPEC. We believe OPEC are justified in cutting oil production as the market had pre-empted a shortage in oil supply in November owing to the sanctions on Iran. The front end of the oil futures curve has moved into mild contango while the back end of the curve remains in backwardation[3]. OPEC's main objective is to restore stability on the oil market. It's hard to decipher if US sanctions on Iranian oil exports will resume in 6 months, for now the oil market appears to be oversupplied and OPEC is acting responsibly by cutting production in an effort to restore prices after the excessive price fall. Investors will be looking ahead for OPEC's next meeting in Vienna on 6 December 2018.

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[1] Week to the week starting on 12 November 2018

[2] 24-member group comprised of the 14 OPEC members and 10 Non-OPEC nations, notable among them Russia, Mexico and Kazakhstan.

[3] *For a full description of backwardation and contango please see pages 48-52 of the ETPedia (Chapter on Understanding Commodity Indices).*

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