OGIB INTERIM BULLETIN #435 - November 19th, 2015

WTI PRICES COULD HAVE A TOUGH WEEK--
HERE'S HOW TO PROFIT FROM IT

CONFERENCE CALL MONDAY NOVEMBER 30TH
1:15PM PACIFIC
PINECLIFF ENERGY
PNE-TSX; PIFYF-PINK

On Nov 17, **Enterprise (EPD-NYSE)** reported their 450,000 bpd Seaway Twin pipeline (Enbridge also a partner) was essentially shut, without citing a reason for the stopage. (http://bit.ly/seaway-shut-glut) The roughly 500 mile pipeline flows crude from Cushing, Oklahoma to the Gulf Coast--see graph below:

There is a strong possibility this is the canary in the coal mine that US oil storage is getting VERY full--and could lead to a temporary sharp decline in WTI prices. I'll explain this potential (but likely) problem, and how investors can profit from it in a short term trade.

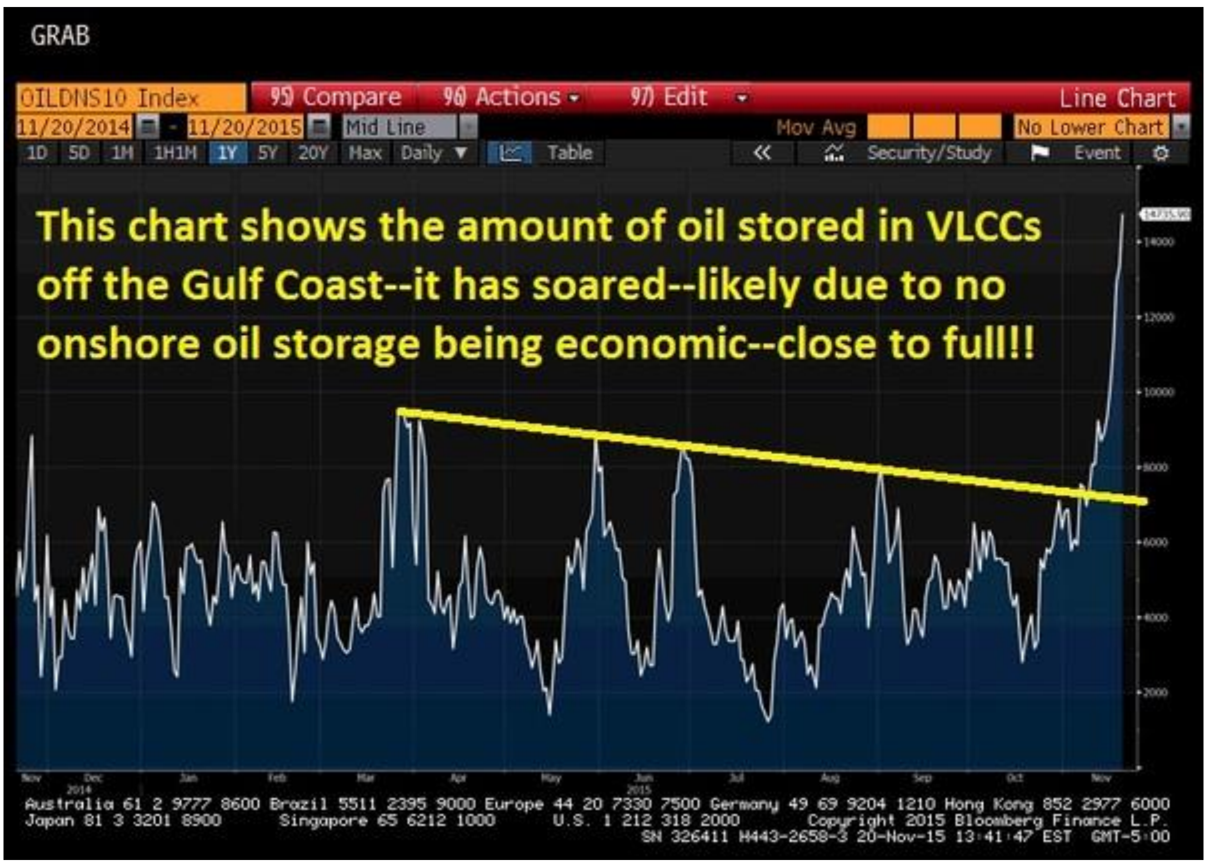
The EIA estimates total working storage capacity in the US Gulf Coast (PADD III) is **273.3 million barrels** (http://www.eia.gov/petroleum/storagecapacity/table1.pdf) with 222.2 million barrels of total storage at tank farms and 75.2 million barrels at refineries and a minimum base inventory level of 24.1 million barrels.

On November 6, the DOE (Dept of Energy) reported PADD III inventories of 252.6 mln barrels – above the April 24 high of 243.9 mln barrels – *that leaves only 21 million barrels of capacity*. And inventories are likely up again in the past two weeks.

If 400,000 bopd cannot leave Cushing, where WTI is priced, and oil is still trying to get into Cushing to either be stored or moved on down to the Gulf Coast--that means inventories get bloated fast, and prices have to drop dramatically to incentivize barrels to leave Cushing. Again, WTI is priced at Cushing.

So with Seaway being closed, there is a lot of oil that can't get south to the Gulf Coast.

At the same time, we now have a lot of oil that can't get north to the Gulf Coast--from the Gulf of Mexico. There is a lot of crude oil sitting in oil tankers offshore the Gulf Coast (if you have one of those fancy expensive Bloomberg terminals you can use the symbol OILDNS10 <Index> to follow this) spiked from 6.36 million barrels at the end of October to 14.74 million barrels this week, as the following chart shows:

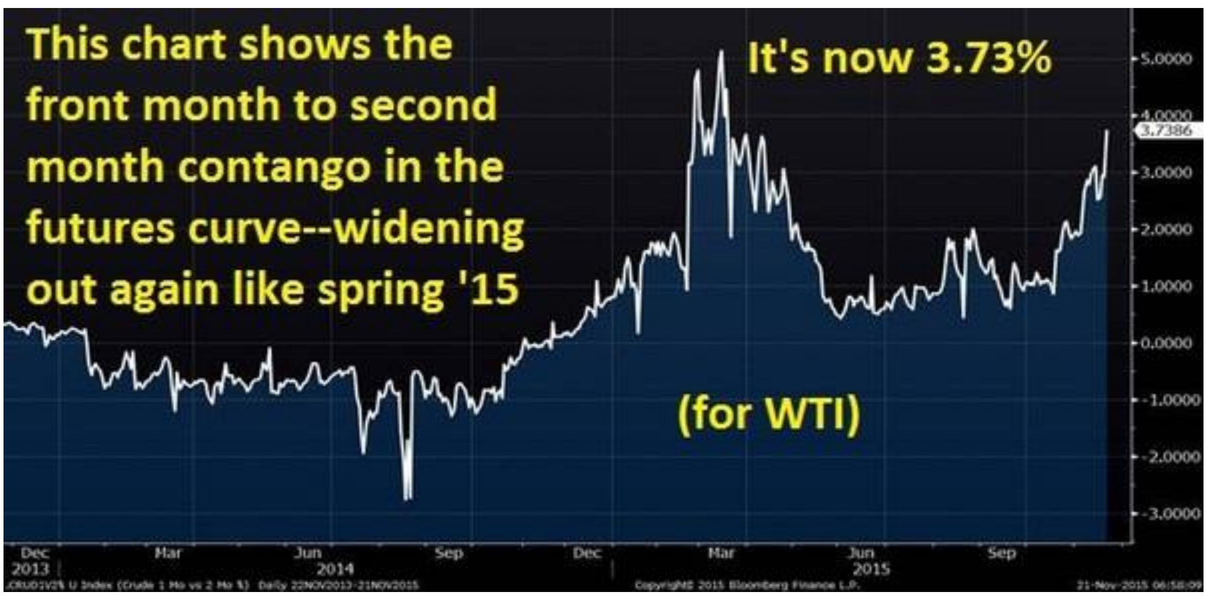


So oil is backing up north of the Gulf Coast at Cushing. It's backing up south of the Gulf Coast in a much larger flotilla of VLCC--Very Large Crude Carriers. Um...to me, this intimates storage in the Gulf Coast is basically full.

And that's what the increasing *contango* in the oil market is saying as well.

Many people believe front-month to second-month crude oil futures contango is mostly driven by inventory levels, with *contango* representing the cost of crude storage.

Now, on Friday, the front-month to second-month contango spiked almost a full per cent – at the same time the Seaway Twin was shut – to about 3.75%. Front-month to second-month contango is approaching levels seen in the spring, as the following chart shows:



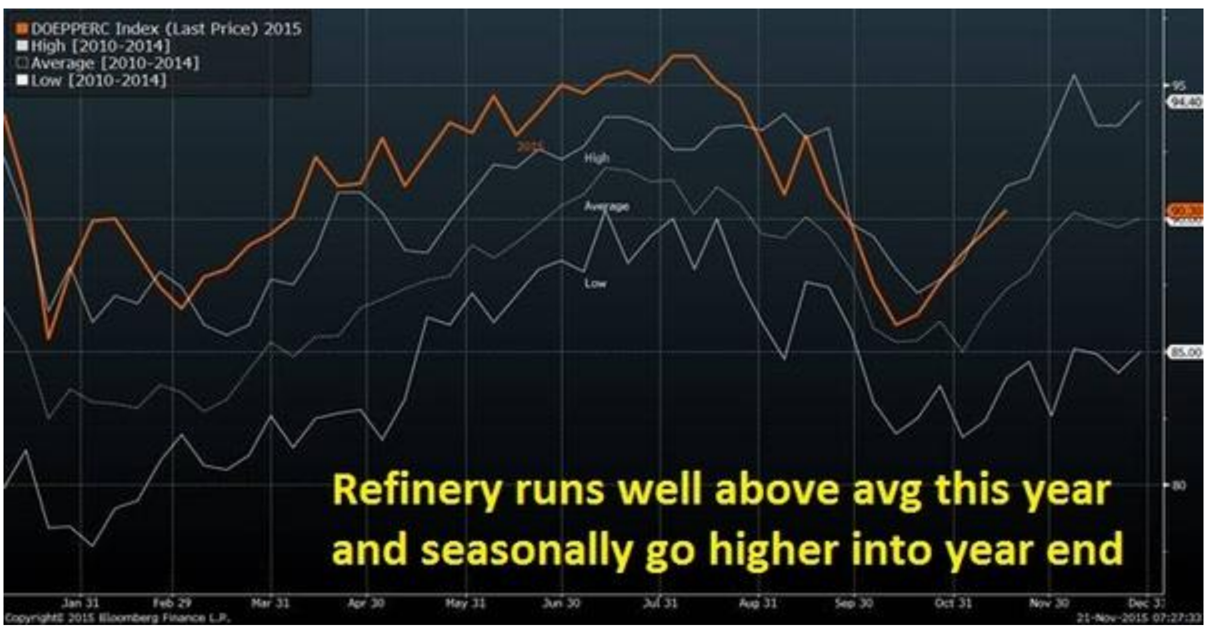
Contango is where the futures price is higher than the current, or spot, price. It's considered bearish--vs the opposite, which is called *backwardation*, where the futures price is lower. This is considered bullish. So right now, that means Feb 16 WTI prices are 3.73% higher than Jan 16 prices.

So the higher the contango, the more bearish that is for the commodity. What I've just tried to explain is that in both the financial world and the physical world, there are strong signs that the North American oil price could see some serious weakness in the coming 4-8 weeks. But there is also a good chance this is likely just temporary.

You see, the spike in Gulf Coast/US crude oil inventories is mostly due to lower refinery runs (lots of fall turnarounds (turnarounds=maintenance downtime) after the US refinery industry ran as high 96.1% in July--big record). That had dropped to 86% on October 9. It's now sitting around 90%.

So there's a good chance that the spike in crude inventories is entirely related to lower refinery throughput (crude oil production is declining (slowly), imports are lower and end-product demand (gasoline etc) remains firm), making it a short term situation.

I say short term because by mid-December refinery throughput should get close to summer levels and oil inventories could (should?) start to go down in a bigger way. You can see this is a regular seasonal pattern in US refinery utilization in the five year chart below (current year, 2015, is orange):



SO HOW DO I MAKE MONEY OUT OF THIS INFORMATION?

Due to high Gulf Coast (and offshore) crude oil storage levels, over the next few weeks there could be more pipeline and logistical problems like the Seaway pipeline--if it is indeed shut because US onshore storage is basically full.

IF storage is very close to full, the storage operators will charge producers A LOT of money for the to use whatever is left.

How that increase in the cost of storage shows up is--a decline in front-month WTI crude oil futures relative to second-month futures (as well as relative to Brent).

These signs I've just told you about make me think storage is closer to full and the Market will experience higher contango and therefore sharply lower WTI prices.

So I think there's a very good chance that front-month futures most likely break through the technically-important $40.00 level. It's also quite possible that the Market could see front-month to second-month contango breach the 5% mark and WTI crude could trade toward a $10.00 discount to Brent crude for a short while, as it did this spring (the March average was -$9.41/Bbl).

Assuming Brent crude remains at $44.00 per barrel, that means the downside in WTI crude prices to $34.00 per barrel.

This SHOULD be very bullish for US refiners--BUT they are already trading very near year highs despite very average refining margins right now (just over $7.50/bbl). They seem to have already priced this "WTI-blowout" scenario in. And sadly, there is no ETF that just does the Brent-WTI spread.

So here is a paired-trade for investors to consider:

1. Short USO-NYSE, a highly liquid ETF that is the front month WTI proxy. New subscribers can read my full report from March 30 2015, OGIB Bulletin #164 on how/why to do this. It's in the Members Centre chronological list.

2. Buy BNO-NYSE, the long-Brent oil ETF. BNO is *not* a levered ETF so it doesn't reset itself every day; it tracks Brent very well.

Under this idea, WTI will have to go lower to account for storage costs. So if WTI goes lower, then USO goes lower and I make money. It's that simple.

Now if I'm wrong, I think I still come out ahead to flat on this trade. As WTI declines, and because I think this WTI blowout is a temporary situation (demand picks up seasonally and US production actually declines faster than it has to date), that makes a higher contango for WTI than Brent.

So if the Brent/WTI spread collapses from the current $4.47/bbl instead of going to $10/bbl, the higher WTI contango bails me out of this.

When each ETF has to "roll" their contracts forward, the contango creates a loss for the ETF--but the USO will lose a lot more money because its contango is higher (worse).

But because I'm SHORT the USO, that contango makes me money.

So my theory is that this is one of those trades where if I'm completely wrong I make 2-4% pretty quickly and if I'm right I make 10 or 15%.

I think as refinery utilization increases, US crude oil inventories begin to draw a bit, but it may be three or four weeks until draws are meaningful enough that enough storage capacity frees up for crude oil pipelines and infrastructure to work properly.

It will be very important to monitor crude oil stored in tankers offshore the Gulf Coast (again--OILDNS10 <Index> on Bloomberg) to get a signal onshore capacity is available and operating efficiently enough to bring crude onshore.

OGIB WEBINAR CONFERENCE CALL

PINECLIFF ENERGY--CEO PHIL HODGES

MONDAY NOVEMBER 30, 115 PM PST; 415 PM EST

Pine Cliff Energy is a very low cost, very low decline natural gas producer in western Canada. IT IS NOT AN OGIB PORTFOLIO STOCK. It is a very counter-intuitive investment, in one sense, considering how bearish I am on natural gas. On the other hand, they are one of the very few producers with not just positive but FREE CASH FLOW (FCF) at $2.50/mcf.

They have been very disciplined in not overpaying for assets for the last 2-3 years. They do all their growing via M&A. FCF comes from very low sustaining capital requirements--due to very low decline rates. That frees up most of the capital to grow organically or pay down debt. This team is paying down debt.

I wrote a story on them in the public blog 2.5 years ago, in July 2013. You can read it here: *http://oilandgas-investments.com/2013/natural-gas/pine-cliff-natural-gas/* . Their strategy hasn't changed and their execution has been excellent.

I don't know when natural gas prices will turn up any more than I do oil. But **Pine Cliff** should be on everybody's radar screen for Canadian exposure--as one of the lowest cost producers with the lowest decline rates, it will be among the first to get big leverage to any jump in natgas prices. With its latest acquisition it will be producing 23,800 boepd--92% dry gas with a 12% decline rate.

Webinar Participant Link:
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Callers should dial in 5 min prior to the scheduled start time and enter the following passcode to join your call. They will hear a custom Oil & Gas prompt upon entry.

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-Keith