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Attack on Aramco

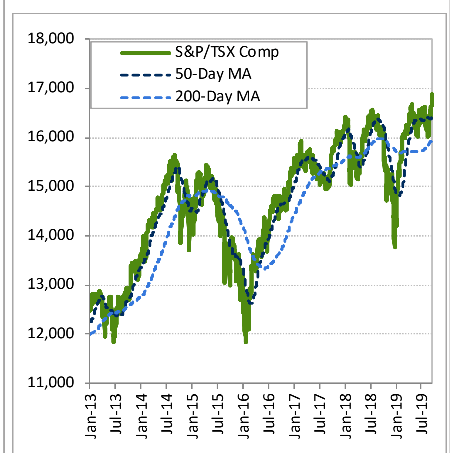
This week the market's attention shifted away from trade wars to a potential military conflict in the Middle East. By now, most are aware of the overarching details: Saudi Arabia's main oil processing and storage facility Abqaiq, which processes roughly 7 mln/bpd, was attacked forcing the shut down of more than 5 mln/bpd of capacity. This is the most significant disruption to global oil supply in modern history, as it represents about 5% of global production. Spot WTI and Brent oil prices jumped 15.5% and 12.4%, respectively on the news, but as it became evident the Saudis will have much of the production back online in the coming weeks both benchmarks retreated.

- There have been numerous oil price spikes over the past 46 years, although the current price action is unusual. Considering price data from 1973, we can identify 27 times oil (WTI) spiked more than 10% on a daily basis. Measuring the commodity's performance following the initial spike reveals an initial retracement followed by a continuation in the upward trend. One month after the spike, WTI slipped 2.2% on average, but was 7.4% and 10.8% higher over the next 3 to 6 months
- Turning to the energy sector performance, we would anticipate a similar pattern and expect to see the sector outperform. While the sector does follow the pattern, we were surprised to see the lack of outperformance relative to the commodity. Another interesting find was that the Canadian energy sector outperformed the US energy sector; however the periods we consider do not capture the US energy renaissance nor the current malaise hampering our energy patch.

Equity Market YTD Returns (%)

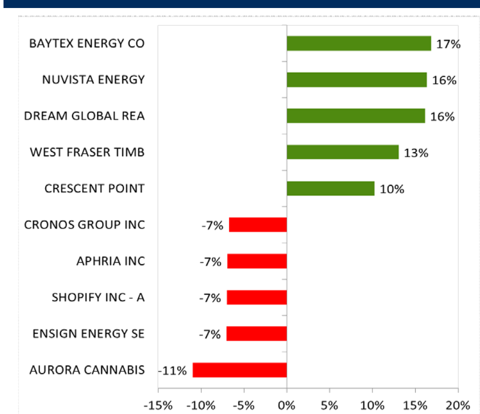
Canadian Sectors	Weight	Recommendation
Consumer Discretionary	4.2	Underweight
Consumer Staples	4.0	Overweight
Energy	16.8	Underweight
Financials	32.3	Overweight
Health Care	1.5	Underweight
Industrials	11.0	Market weight
Technology	5.3	Market weight
Materials	11.2	Market weight
Communications	5.6	Market weight
Utilities	4.5	Market weight
Real Estate	3.6	Market weight

Technical Considerations	Level	YE Target
S&P/TSX Composite	16,877	15,600



Source: Bloomberg, Raymond James Ltd.
Sectors are based on Bloomberg classifications

S&P/TSX Top 5 Gainers/Laggards*



S&P/TSX Market Internals

Weekly Advance	137	55%
Weekly Decline	102	41%
Advance-Decline	35	
New 52 wk high	8	3%
New 52 wk low	1	0%
No. Stocks Above 50-d	157	63%
No. Stocks Above 200-d	165	66%
Arms Weekly Index	0.69	Neutral
RSI (14-day)	66.3	Neutral
50-DMA	16,422	Uptrend
200-DMA	15,981	Uptrend

*Source: Bloomberg, Raymond James Ltd; * 5-day price return*

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Other factors helping to contain a more significant spike in prices, assuming a conflict is avoided, are: 1) Saudi Arabia has significant oil in storage (close to one month of exports). This should allow a few weeks to address the outage without impacting global supply; 2) if the outage lasted longer, the US, China and most OECD countries have emergency stockpiles that could be tapped to supplement Saudi reserves. President Trump has already authorized the use of their strategic reserves in order to maintain price stability; and 3) the US is reluctant to be dragged into another Middle East military conflict but this is the greatest risk if the situation escalates.

Oil prices could now be reflecting a heightened risk premium that we suspect may last for the foreseeable future. If we do see an escalation, which results in significantly higher prices for oil, we believe this would be a clear negative for the global economy, which is ill-equipped to absorb a major spike. If we use recent history as our measuring stick, the global economy can likely deal with oil prices up to the US$80-$85/bbl; above this level we would expect to see an impact to global GDP growth. A spike to US$100/bbl or above would have materially negative implications for the outlook on the global economy and equity markets.

Spike Perspective

There have been numerous oil price spikes over the past 46 years, although the current price action is unusual. Considering price data from 1973, we can identify 27 times oil (WTI) spiked more than 10% on a daily basis. Measuring the commodity's performance following the initial spike reveals an initial retracement followed by a continuation in the upward trend. One month after the spike, WTI slipped 2.2% on average, but was 7.4% and 10.8% higher over the next 3 and 6 months.

WTI Oil Spikes; 10% or More

	Initial Spike	1 mth	3 mth	6 mth
Average	+12.6%	-2.2%	+7.4%	+10.8%
Median	+12.4%	-1.7%	+2.2%	+5.3%
Min	+10.2%	-44.8%	-72.0%	-68.0%
Max	+17.8%	+30.8%	+95.9%	+99.5%

Source: Bloomberg

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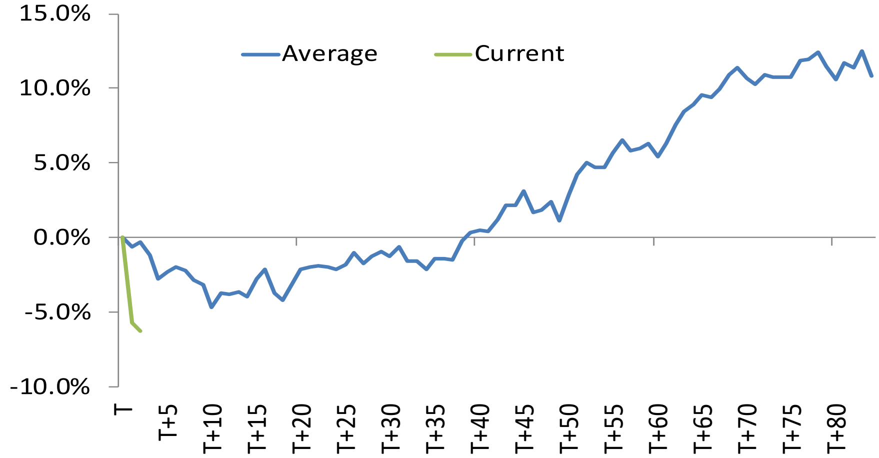
WTI Average Performance After a 10%+ Spike



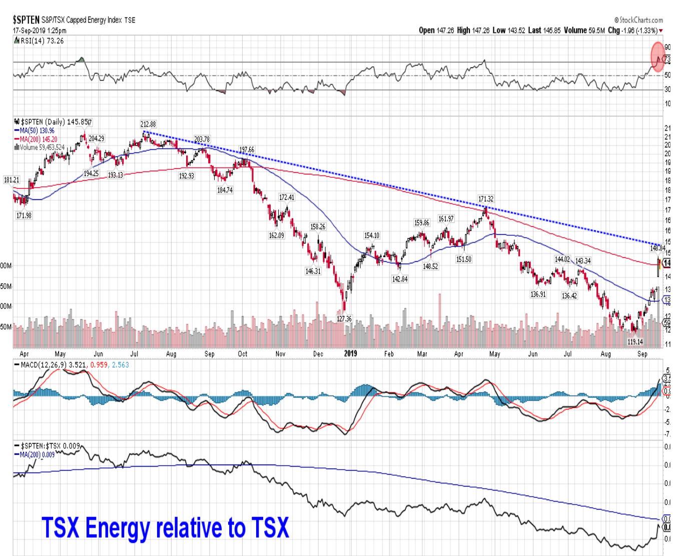
Average	1 mth	3 mth	6 mth
S&P/TSX energy	-0.7%	+1.4%	+2.4%
S&P 500 energy	-1.0%	+1.1%	+0.6%

Source: Bloomberg; note only 22 data points used as sector data available only after 1988

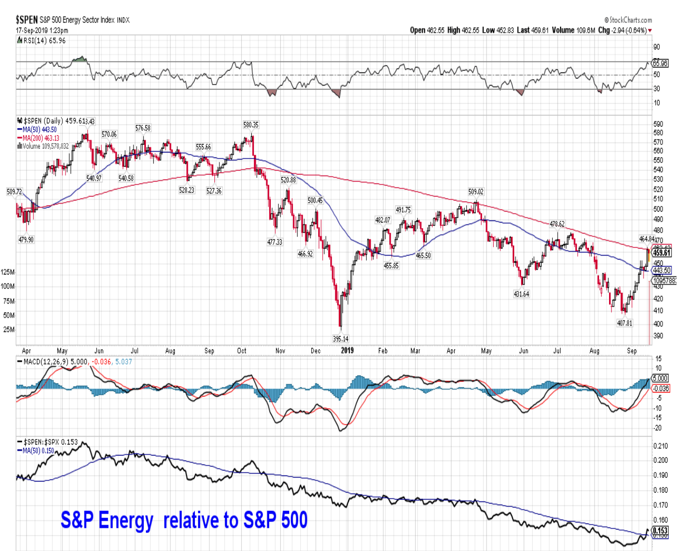
What Does the Chart Say?

Both the S&P/TSX and S&P 500 energy sectors are attempting to overtake overhead resistance around their respective 200-day moving averages. The recent bounce has been fuelled by last week's factor rotation into value pockets of the market (like energy) and this week's oil spike. However, we would caution investors from chasing the rally until we have a convincing break higher.

S&P/TSX Energy Fails at 200-d MA…



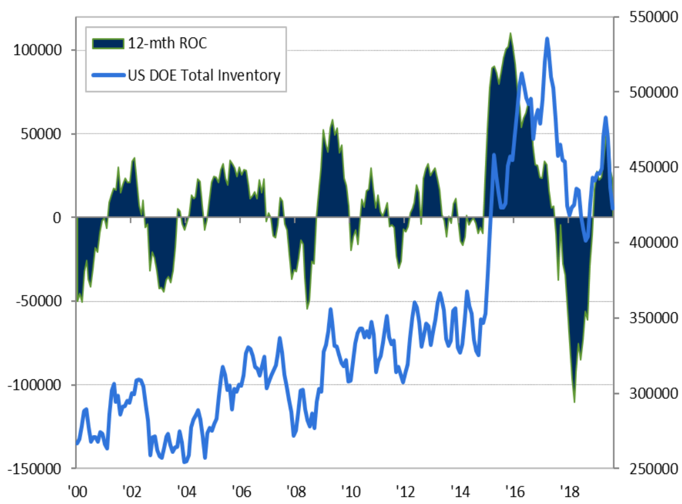
…Same Goes for S&P 500 Energy



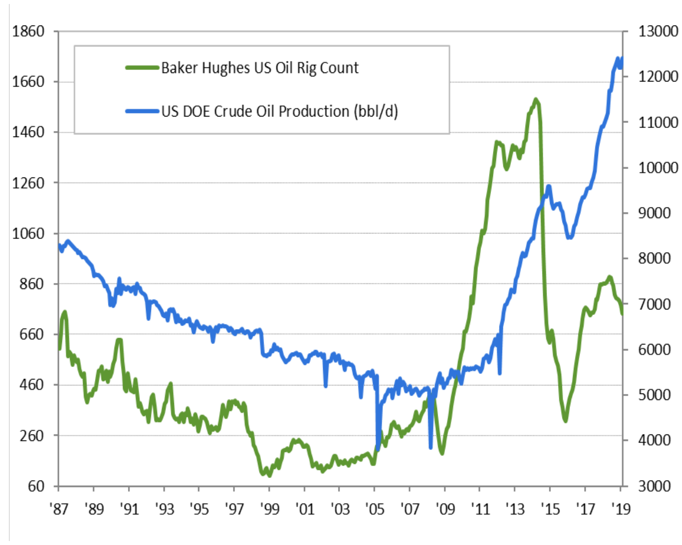
Source: stockcharts.com, Raymond James Ltd.

While questions remain about the health of the global economy and thus the demand outlook, the supply side of the equation appears more bullish. The 12-month rate of change in US total inventories for oil, US production and drilling rigs are all painting a more bullish outlook.

US Total Inventories Falling…



…US Rig Count and Production Stalled



Source: Bloomberg

Gaining Exposure

While we currently recommend underweighting the energy sector, if you wish to gain exposure we would suggest sticking with quality. Higher quality energy companies will participate in any rally, while still providing the safety of higher margins, free cash flow and strong balance sheets plus paying you to wait via dividends.

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