# Market Insights

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## Market Review

The TSX closed the month of May up a mere 2.6% since the beginning of the year. Copper and Natural Gas are the biggest decliners while Silver and Oil were the biggest gainers, booking increases of 7% and 13% respectively to date. Oil seems to have bottomed, as Raymond James' strategist Jeff Saut correctly called back in early February of this year.

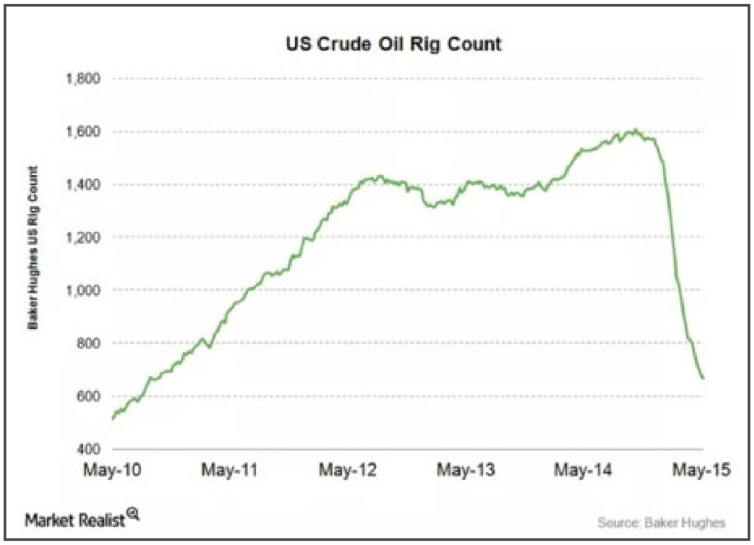
| | December 31, 2014 | May 29, 2015 | Performance |
|---|---|---|---|
| TSX | 14,632 | 15,014 | 2.61% |
| TSX Venture | 695 | 692 | -0.43% |
| Copper | $2.92 | $2.81 | -3.77% |
| Gold | $1,184 | $1,189 | 0.42% |
| Silver | $15.59 | $16.70 | 7.12% |
| Nat Gas | $2.91 | $2.64 | -9.28% |
| Oil (WTI) | $53.27 | $60.30 | 13.20% |

## Current investment climate

The TSX exchange is virtually unchanged from the beginning of the year (Table 1). Interestingly it is actually down a few points, as I write this, from the close of June 2104. Peeling back the layers reveals a bifurcated Canadian stock exchange with the Healthcare and Technology sectors having experienced a tremendous increase since the beginning of the year. In fact, the Healthcare Sector alone is up nearly 40%. On the other side are the Energy and Material sectors, which we all know have both experienced drastic corrections. Individual companies in underperforming sectors provide attractive entry points at the moment. The possibility for capital gains growth and the attractive dividend many of the undervalued companies pay out are both appealing.

Over the past months I have received quite a few inquiries into the dynamics of the Energy sector, so I thought that I would take this opportunity to provide some background context. We have all seen headlines such as OPEC proclaiming a surplus in oil production and refusing to lower their production to maintain market share. OPEC has not been the alone in this call—popular media quickly chimed in on the call for the production surplus. Virtually every time I have turned on BNN or CNBC in the past eight months, there has been talk of a large surplus in oil production. The fact of the matter is that the markets were considerably more balanced than what OPEC spoke about and point to a more balanced supply demand situation.

With the media sensationalism running high, important variables determining crude oil prices were completely overlooked.




**1)** The oil and gas drilling activity as measured by the Baker Hughes rig count for North American is down 991 rigs from 1866 a year ago. Clearly with a 53% drop in oil rigs exploration has stalled, inevitably resulting in a drop in oil production.

**2)** The second important input variable to consider is the global oil production decline rate is between six and nine percent; therefore 5,700,000 to 8,500,000 bpd is set to disappear annually due to the structural depletion of global production. Furthermore, most of the production growth in the past 4 years has come from unconventional sources. The drop in US oil production will likely not be smooth but rather quick as the decline rate of unconventional or Fracking can be up to 80% while decline rates of traditional vertical drilling activity is closer to 20%. Hence, US oil production will drop very quickly once the drop in exploration takes hold. The strain on global oil production due to the increased decline rate over the past several years means that the world needs to find a new Saudi Arabia in less than two years.

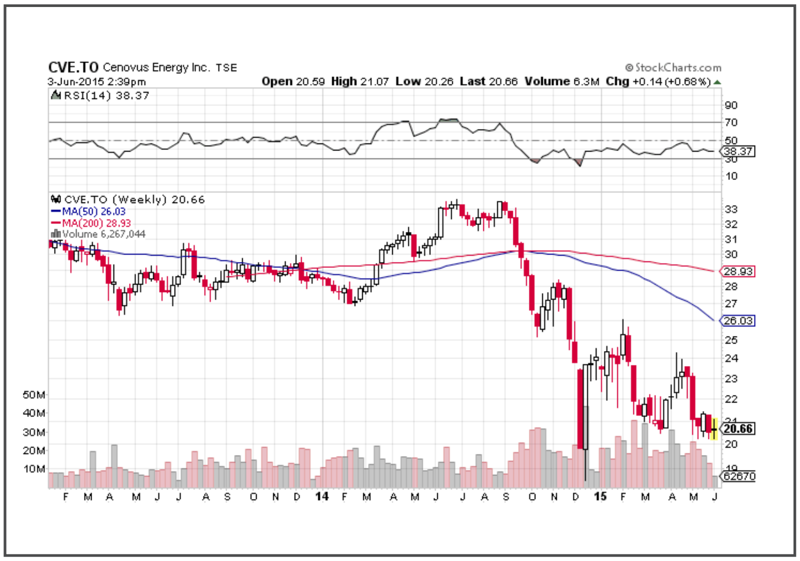
> “Every two years the oil industry needs to build a new Saudi Arabia”
>
> Peter Voser, CEO Royal Dutch Shell, 1 October 2013

**3)** Another important variable to consider is the consistent long term growth of demand. Natural Resources Canada has forecast demand growth to be 1% per annum for the next 15 years, in-line with most other authorities on this subject. The global demand for oil will need to increase from a current 95 million bpd level to 105 million bpd. The need to explore and find new sources of oil are simplely staggering and virtually impossible at current oil prices.

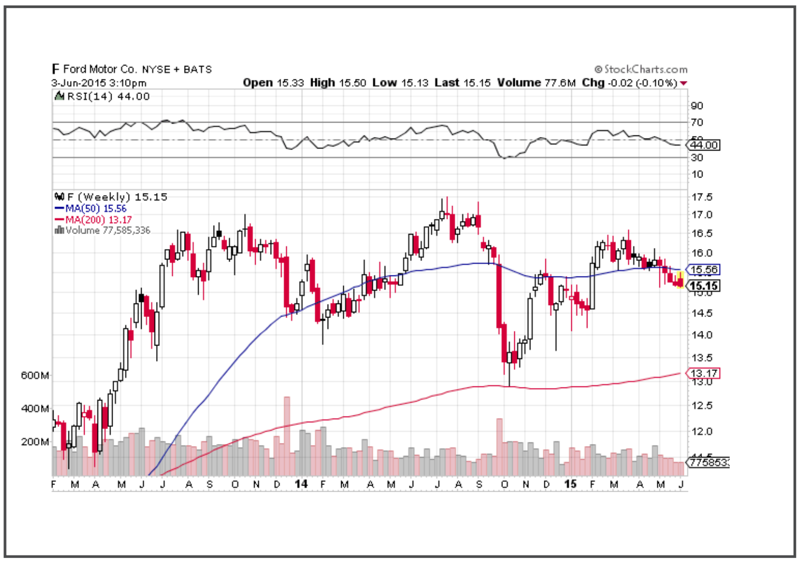
In summary, the coming month’s data will start reflecting a decline of oil and gas production and will again spur on investment in the Energy Sector. In anticipation of renewed interest in the Energy Sector careful thought should be given to the asset allocation percentage of the Energy Sector. I believe the Energy Sector allocation should now be equal to that of the Financial Sector in the TSX.

## Companies I am Watching

This month we look at one Canadian Oil company and an automotive company.




**Cenovus Energy ($20.52, May 29, 2015)** produces around a total of 284,000 barrels per day. The company posted a strong first quarter recently and demonstrated an ability to create strong cash flow even in these times of low commodity prices. Cenovus has an attractive 5% dividend yield and is trading near historic low prices.




**Ford Motor (USD$15.17, May 29, 2015)** is trading toward the lower end of its trading range of the past two years and, with the average age being 11 years for vehicles in North America, we can expect there will be significantly more new cars sold in the near future. Ford has a dividend yield of nearly 4% at current prices.

Chart 4-Stockcharts.com