# DOWGATE CURIOUS INVESTOR

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## Draining the Tanks

While measures of inflation have fallen, they remain above target levels, and the recent sharp oil price increase is a concern. Memories are short but recall that this inflationary cycle began with rising energy prices and diesel shortages in 2021. Central banks will watch nervously and ask themselves if disinflation is transitory. For this reason, despite this week's rate pauses, they will keep monetary policy tight for as long as possible. Huw Pill, the Bank of England Chief Economist, recently described the forward rate path as more like Table Mountain than the Matterhorn.

Central banks use monetary policy to control inflation, while OPEC+ uses supply management to control oil prices, the foundational benchmark for other energy forms that underpin all advanced economies. This week, 15,000 delegates from over 100 countries gathered in Calgary, Canada, for the annual World Petroleum Council (WPC), the Jackson Hole for oil. The largest and most visible contingent was from Saudi Arabia, the world's swing producer. Saudi's energy minister, Prince Abdulaziz bin Salman (ABS), Crown Prince Mohammed bin Salman's (MBS) half-brother, is OPEC+'s equivalent to Jay Powell.

| 22/09/2023 | Value | YTD (%) |
|---|---|---|
| FTSE 100 | 7662.23 | 2.76 |
| FTSE 250 | 18570.89 | -1.48 |
| S&P 500 | 4330.00 | 12.78 |
| Gold $/lb | 1925.70 | 5.48 |
| Brent Oil $/bl | 94.97 | 15.68 |
| Copper $/lb | 3.75 | -1.55 |
| UK 10 yr yld | 4.29% | 15.96 |
| US 10 yr yld | 4.48% | 15.46 |

In his speech to the WPC, ABS explained that the desire to manage oil price volatility was in the long-term interests of both oil producers and consumers. OPEC+ has everyone's interests at heart, and he claimed that its conduct is equivalent to central bankers controlling inflation. But his words highlight a growing policy divergence between the oil-consuming nations and the producers. While the IEA reiterated that global oil demand will peak before 2030, Saudi Aramco's CEO openly accused it of being politically motivated and misleading. China, meanwhile, leverages its position as Saudi's largest oil customer to try and decouple the oil trade from the US$.

But the US dollar remains the unit of account for most global debt. As the dollar index (DXY) rises (up 5% in the last eight weeks), financial conditions tighten for the rest of the world. Indeed, overall global liquidity measures, such as the combined broad money supply of the top five currency blocs, stagnated in Q3, creating headwinds for equity markets.

However, dollar liquidity and the US Treasury market have benefitted from two one-off boosts. The first was the prolonged drawdown of the Treasury General Account ahead of the Federal debt ceiling deadline in June, while the second derived from draining the Fed's reverse repo facility. As strategist Lyn Alden pointed out, the reverse repo facility is a stored-up "battery" of liquidity leftover from the COVID stimulus measures now being drained by heavy Treasury Bill issuance. This liquidity battery has only a few months of charge left.

While monetary policy drains liquidity reserves, US energy policy has similarly drained its oil tanks, or Strategic Petroleum Reserve (SPR). Following releases of resources in 2021 and 2022, the US SPR has just 350m barrels remaining, half the amount of a decade ago and 17 days' supply at current consumption. Critically, lower oil inventories and a foreign policy aim of reconciling the Saudis with Israel have lessened Washington's leverage over pump prices as it approaches election year.

Since early Summer, OPEC+ has used its enhanced position to engineer a 25% oil price increase via just a 1-2% supply reduction, value-enhancing for large oil producers like Saudi Aramco. Unsurprisingly, as the Wall Street Journal reported, the $2.5tn valued Aramco is now considering a share offering to fund Saudi Arabia’s ambitious economic regeneration plans. The suggested $50bn sell-down would represent only 2% of Aramco's equity but also the World’s largest ever equity capital markets transaction.

And if this deal were to happen, China would be first investor in line. As Saudi's most significant oil customer, it is trying to recruit Saudi into its BRICS family of nations. Furthermore, owning a slice of Saudi oil reserves would be seen as an attractive alternative to its portfolio of US Treasuries. (A 2% stake in Saudi Aramco would be worth about 6% of China's current US Treasury holdings without giving up much yield).

Structurally higher inflation and interest rates combined with multi-decade low oil inventories is a fragile investment environment that the world last saw in the late 1970s, which most investors did not experience. A broad spread of asset types helps mitigate the cocktail of potential consequential risks from this set-up. High-yielding assets, value equities, and tangible real assets are components of a durable portfolio. But once the tanks of oil and dollar liquidity are drained, meaning the supply of credit and oil remain tighter for longer, exposure to energy and value equities, ideally income-generating, become a greater priority.

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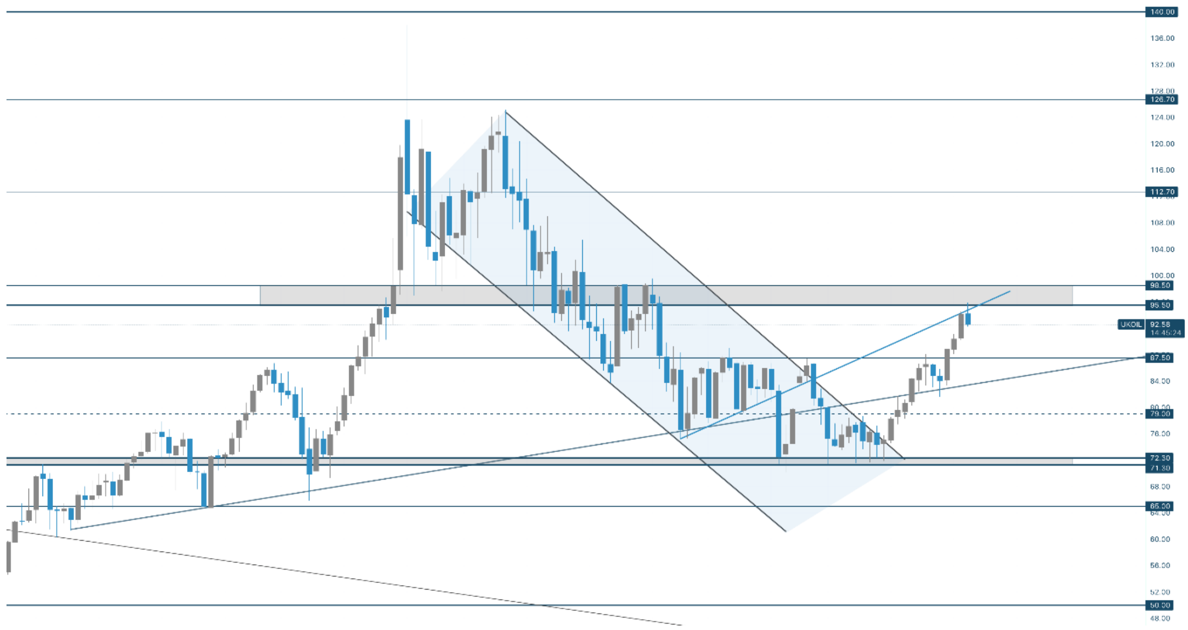
## Jackson’s Chart – Brent Oil Weekly (An Analysis by Jackson Wray)



In Issue 5 of the Curious Investor, we highlighted some levels to watch out for in the coming months. Since then, we have seen the price continue to move north following confirmation of a break of the previous lower high of $87.50. Following this confirmation, the price has moved towards the next area of importance indicated in Issue 5, located at the $95.50 zone and blue trend-line. At this point, momentum has stalled, with the current weekly candle proposing a resting point for price appreciation. It is important to watch this close, as a retracement to retest the previous $87.50 level could provide the oxygen required to continue the move through the $95.50-$98.50 region. It is also important to note that there are Fibonacci retracement targets between the $87.50 support and trend line. A deeper pullback cannot be ruled out.

## Further Reading & Listening

- Saudi cuts send world diesel prices soaring
- February 2023 newsletter: Fixing Inflation
- Aramco, Exxon CEOs push back against forecasts of peak oil demand
- Bank of England hold rates after inflation shock
- Powell: Fed will ‘Proceed Carefully’ on Interest Rate Increases

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