

An Asset Manager's Perspective on Oil during COVID and Beyond

7th Joint IEA-IEF-OPEC Technical Meeting

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Some Context

Wellington Management is a one trillion dollar global asset manager with exposure across equities, fixed income, private equity and commodities

Our commodity efforts started in 2003

Oil is one of 50 commodities we follow

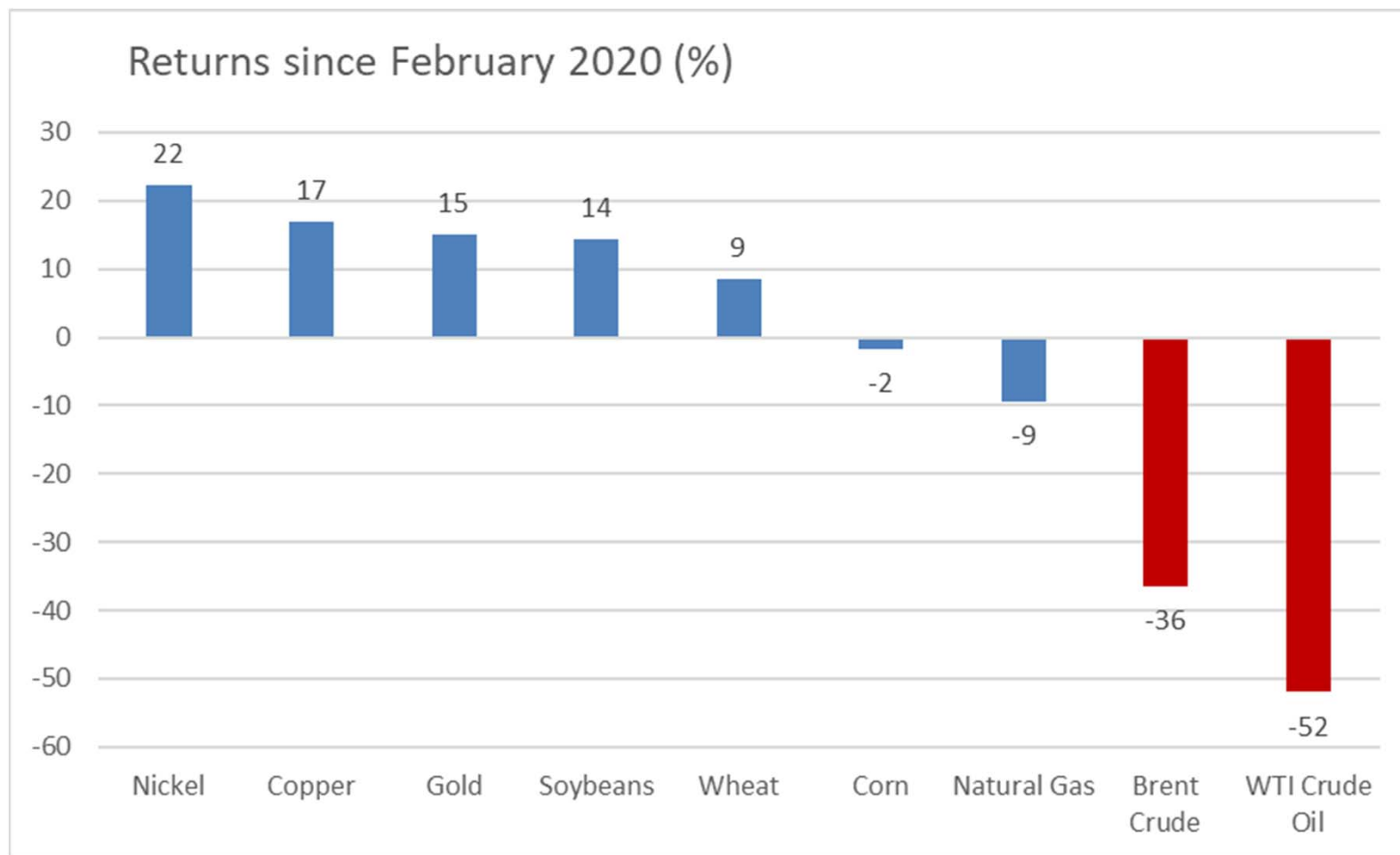
We take a long-term fundamental and valuation approach to commodity investing

Conclusions

- Oil's recovery is significantly lagging other commodities and financial markets
- The effects of COVID-19 have diverged across geographies and parts of the economy
- COVID-19 has accelerated ESG and climate trends, significantly raising the bar for investing in the oil sector
- Capital will struggle to return to the oil and gas sector

Performance of Oil vs Other Commodities

Oil weighed down by its geographical and economic exposure to the consumer

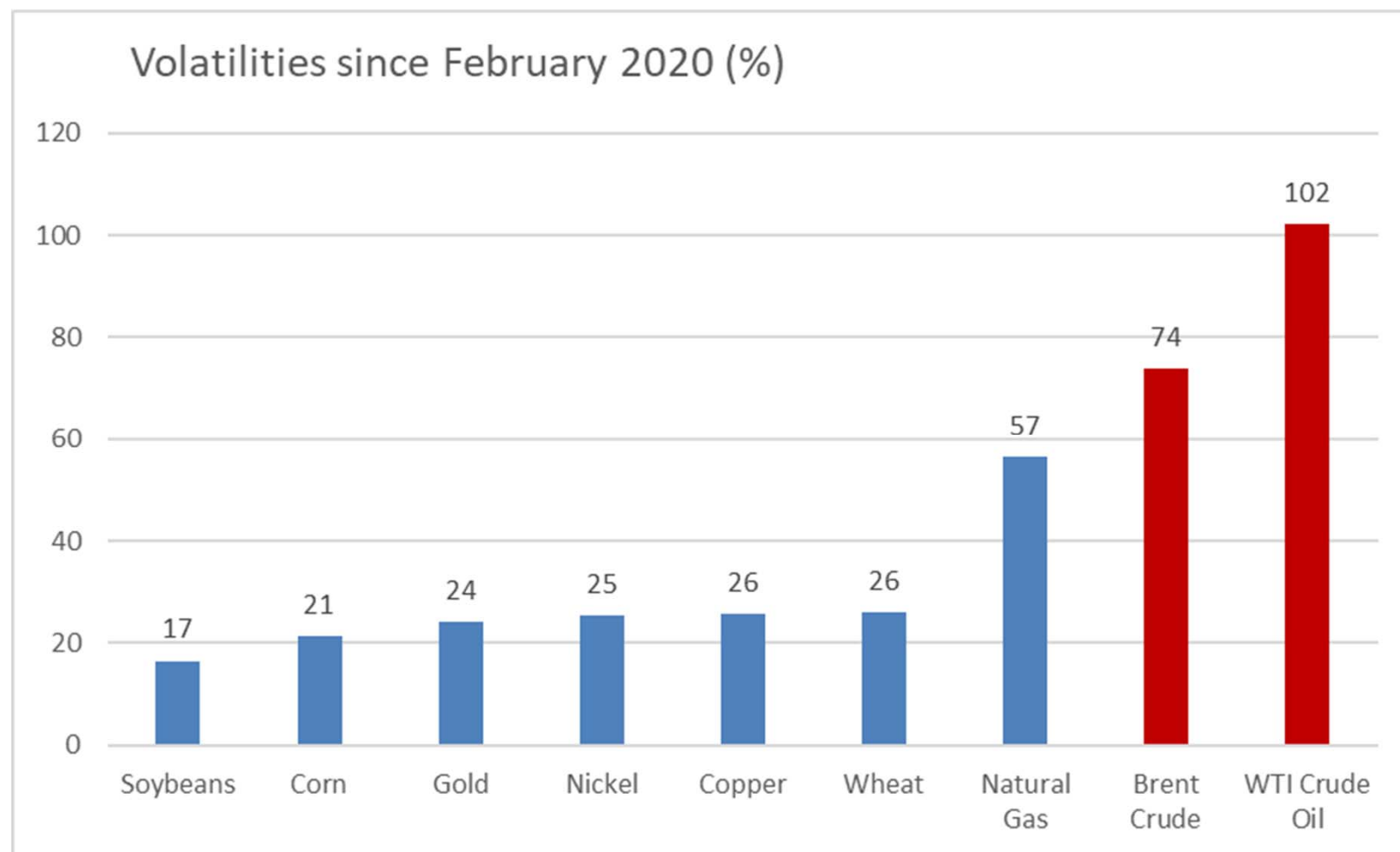


Source: Bloomberg

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Volatility of Oil and Other Commodities

Oil's volatility stands out – good for traders, bad for attracting capital

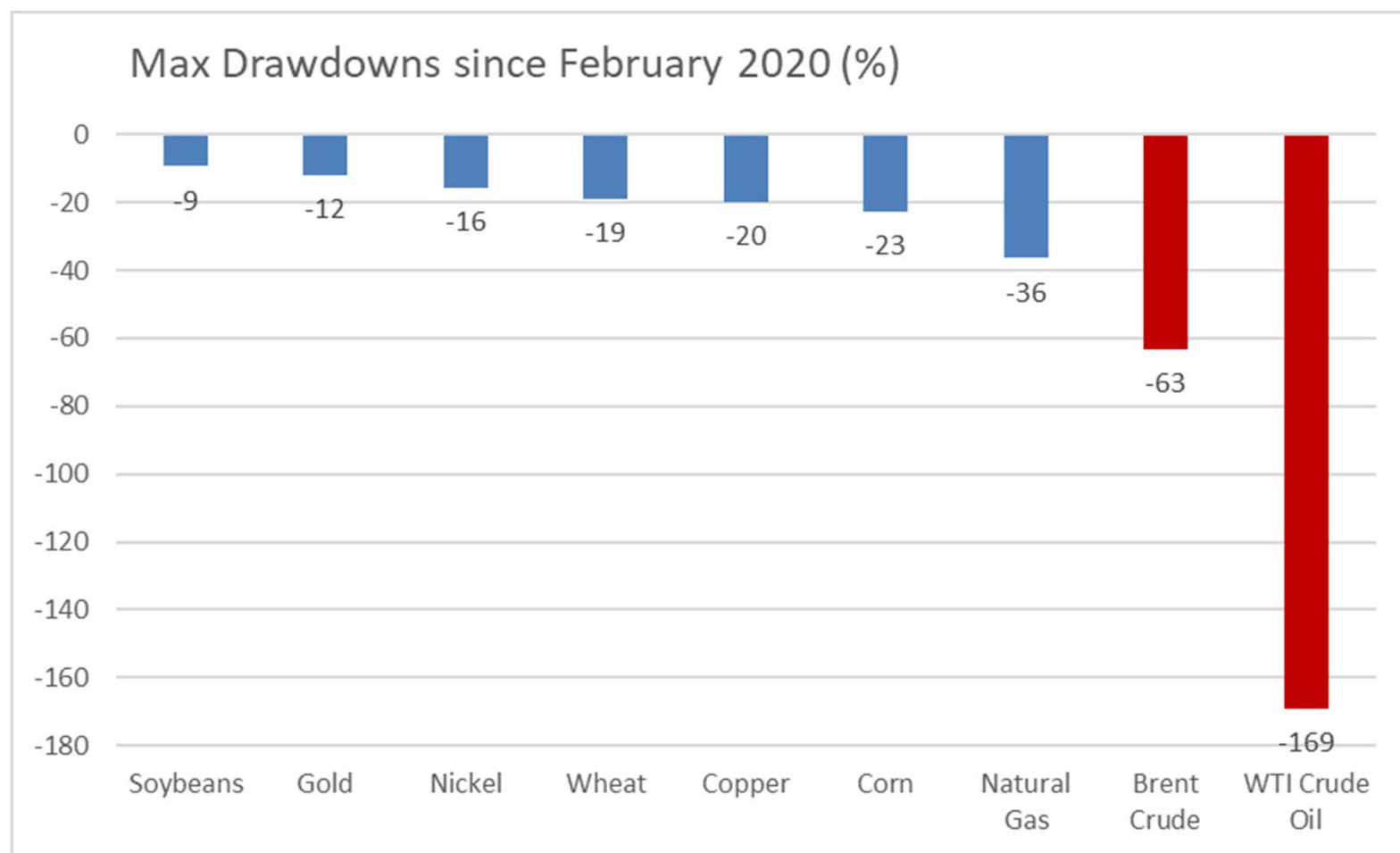


Source: Bloomberg

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Max Drawdown during the Covid-19 Period

Negative prices opened a new set of outcomes for oil prices and the asset class

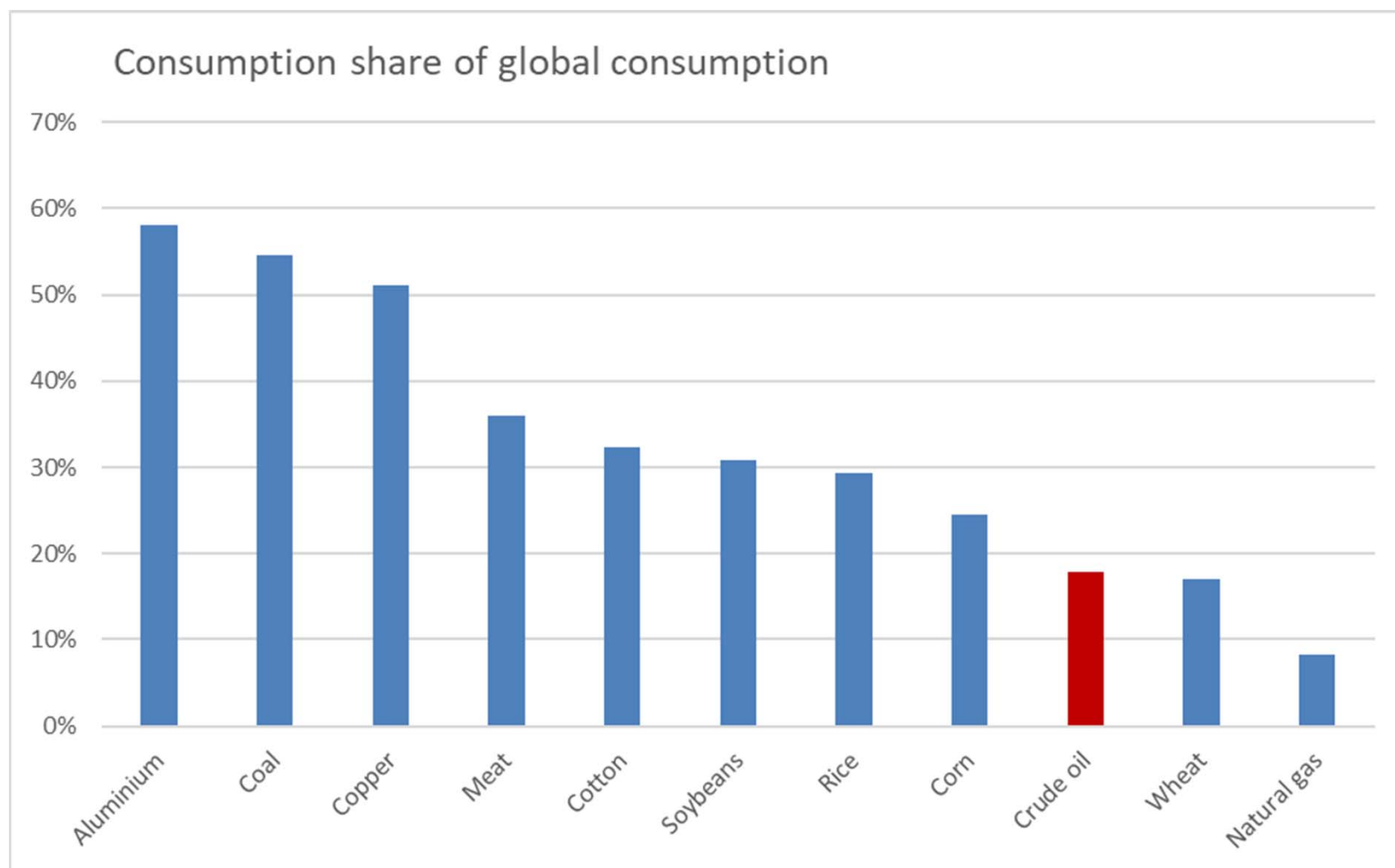


Source: Bloomberg

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Commodity Exposure to China

China represents a lower market share than most major commodities

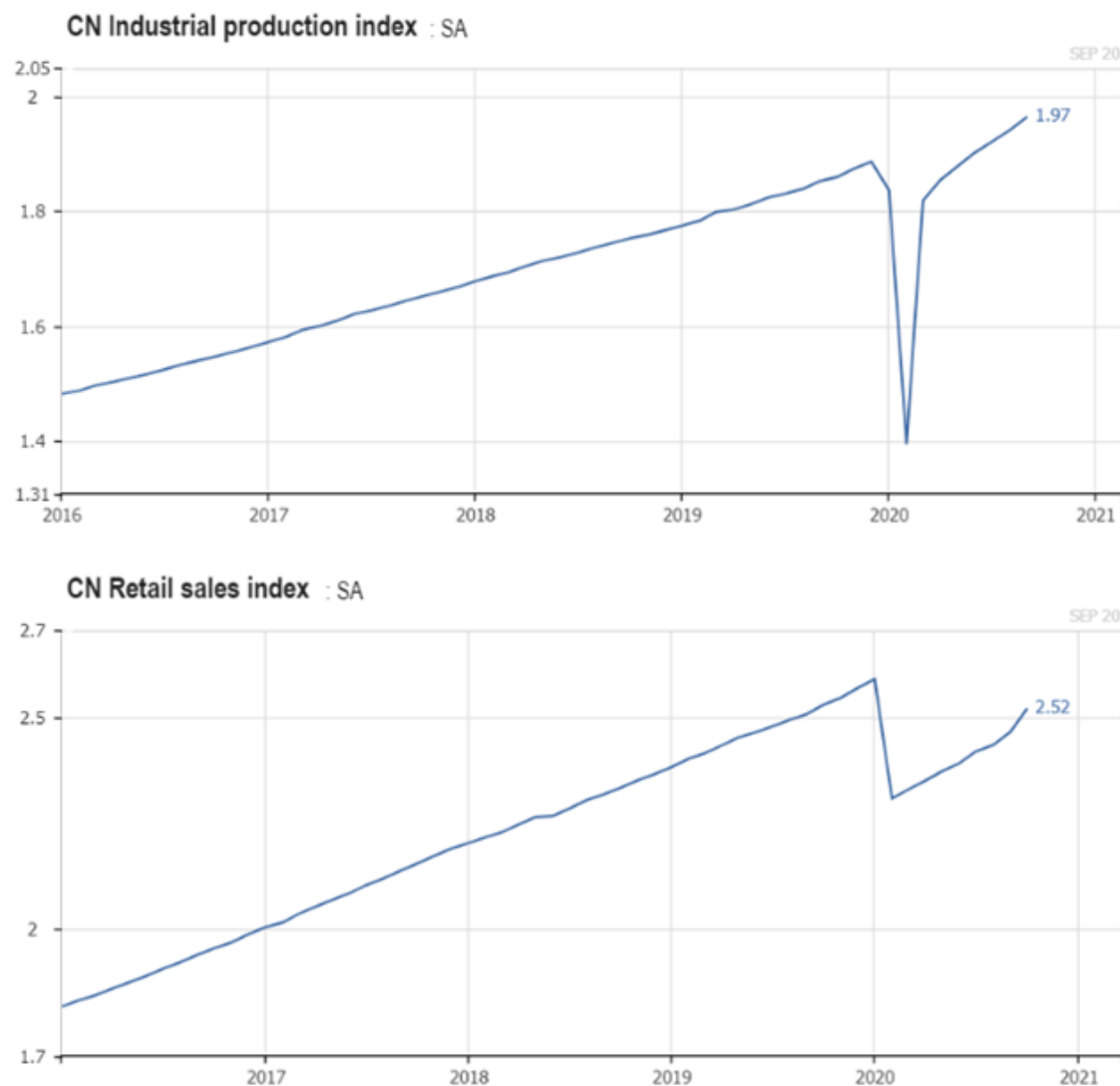


Source: Macquarie

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China's and the World's Uneven Recovery

A stark contrast between booming industrial production and lackluster retail sales

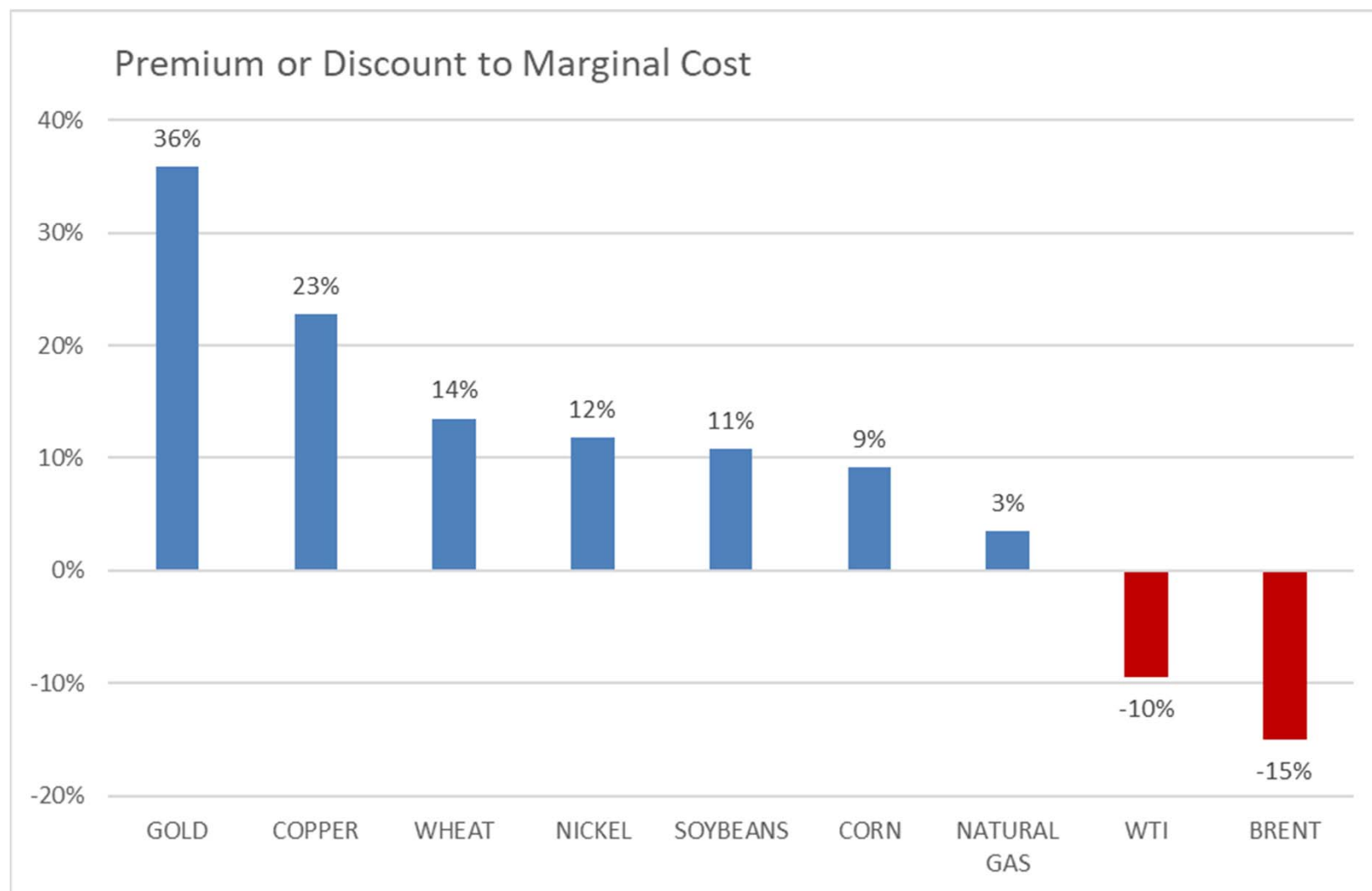


Source: Bloomberg, Wellington

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Oil Valuations vs Other Commodities

Oil's discount to marginal cost a sign the market is still looking to discourage spending and production

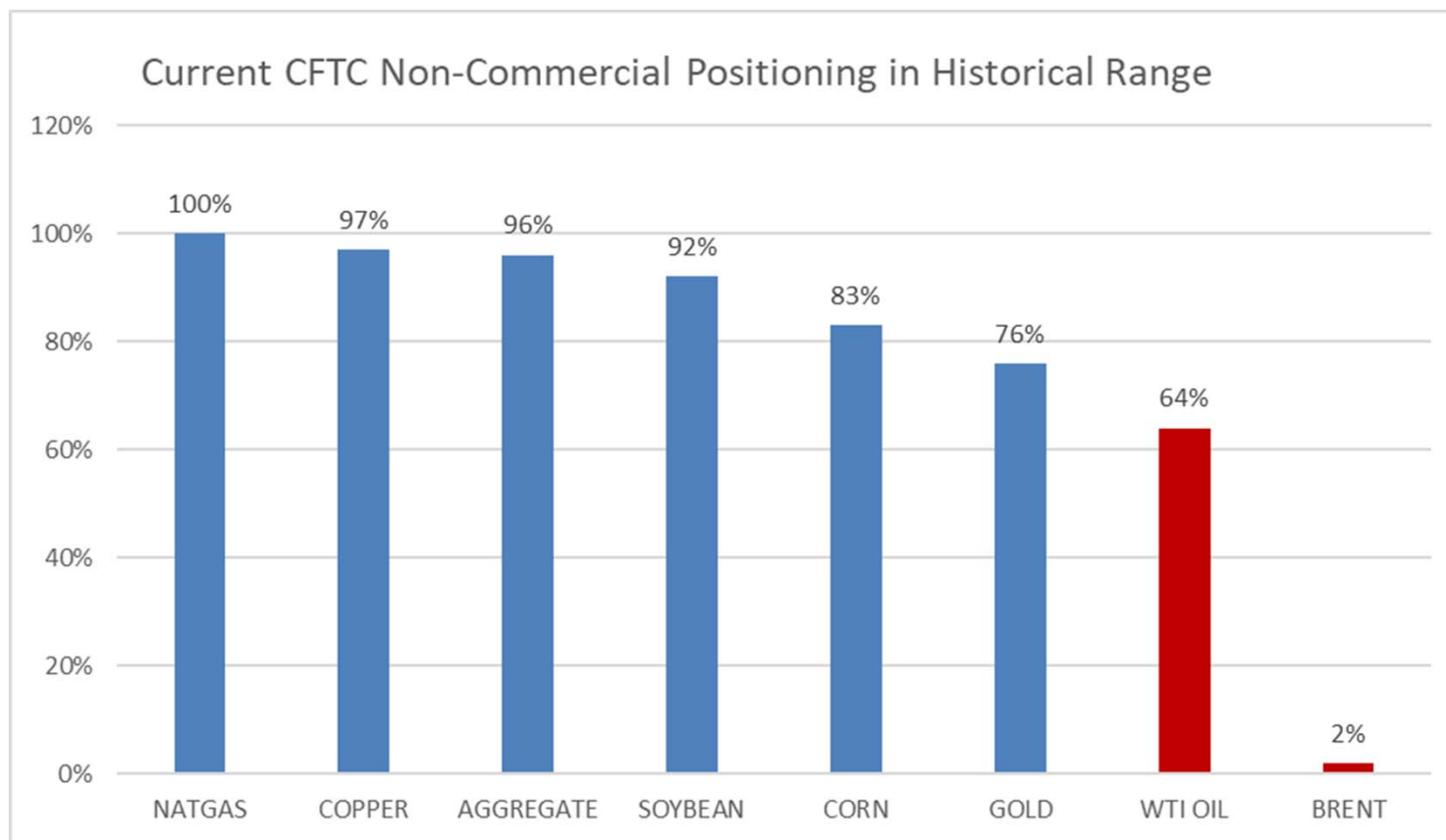


Sources: Bernstein, Bloomberg, Woodmac, USDA, Wellington

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Oil Sentiment vs Other Commodities

The market has yet to embrace oil's rebalancing in the same way as other commodities

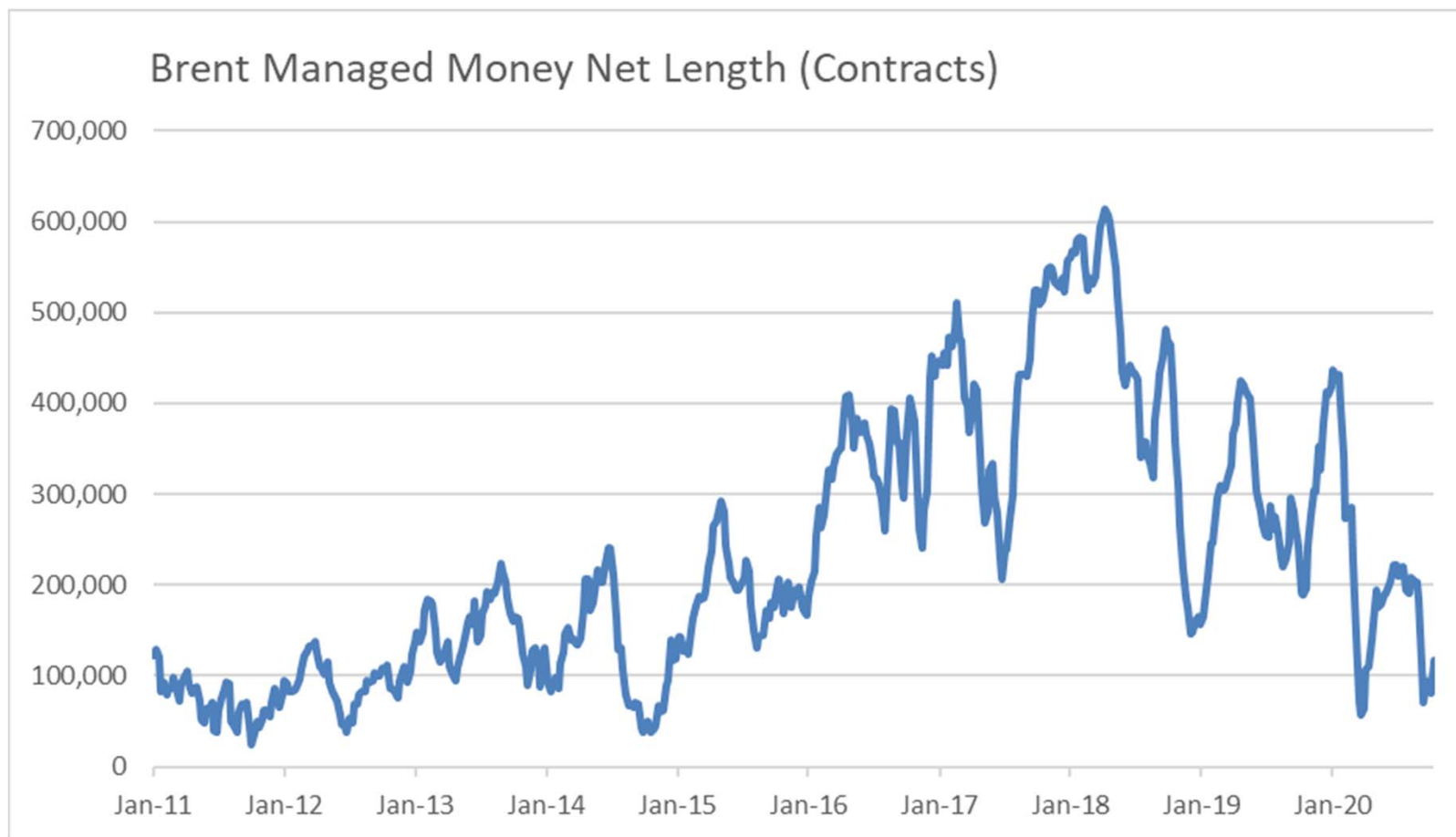


Sources: Bloomberg, CFTC

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Oil Sentiment at a Decade Low

A lack of longs and elevated shorts keep net spec length very low across the petroleum complex



Short-Term Concerns

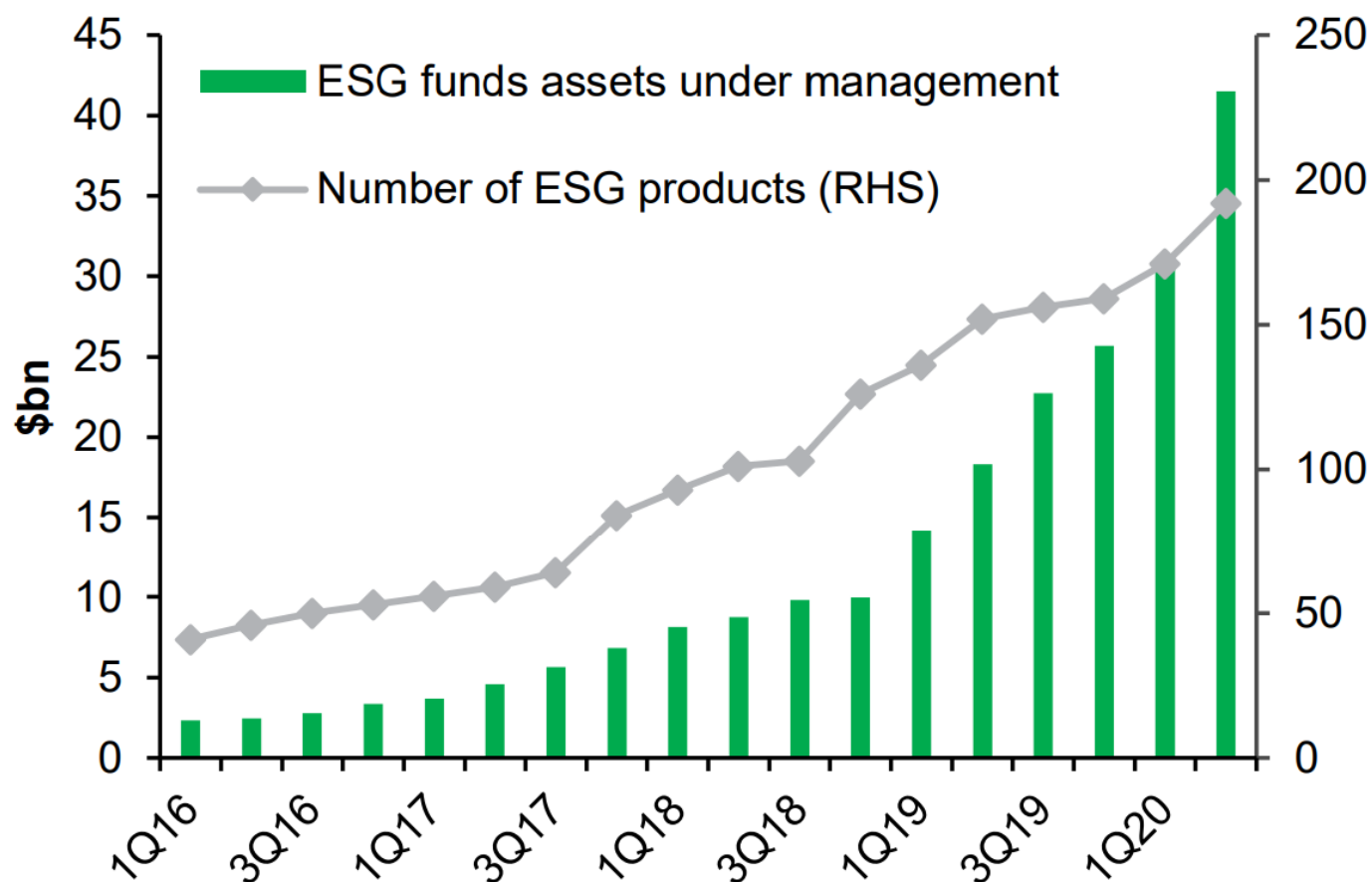
- Negative oil prices and high volatility
- High OPEC spare capacity and inventories
- Return of Iranian barrels under the removal of sanctions
- Price sensitivity of US oil production
- Languishing demand – oil viewed as the vaccine trade

Medium-Term Concerns

ESG ESG ESG

- ESG and climate-related concerns are shifting investors' focus away from oil
- Emergence of new technologies such as hydrogen are gaining strong attention
- Capital is flowing away from oil & gas toward renewable energy
- Policymakers are emboldened to pursue Green Energy plans
- The investment community is questioning the trajectory of oil demand
- The sector has become easy to ignore

ESG Investing Is Accelerating and Remains a Headwind for Oil and Gas



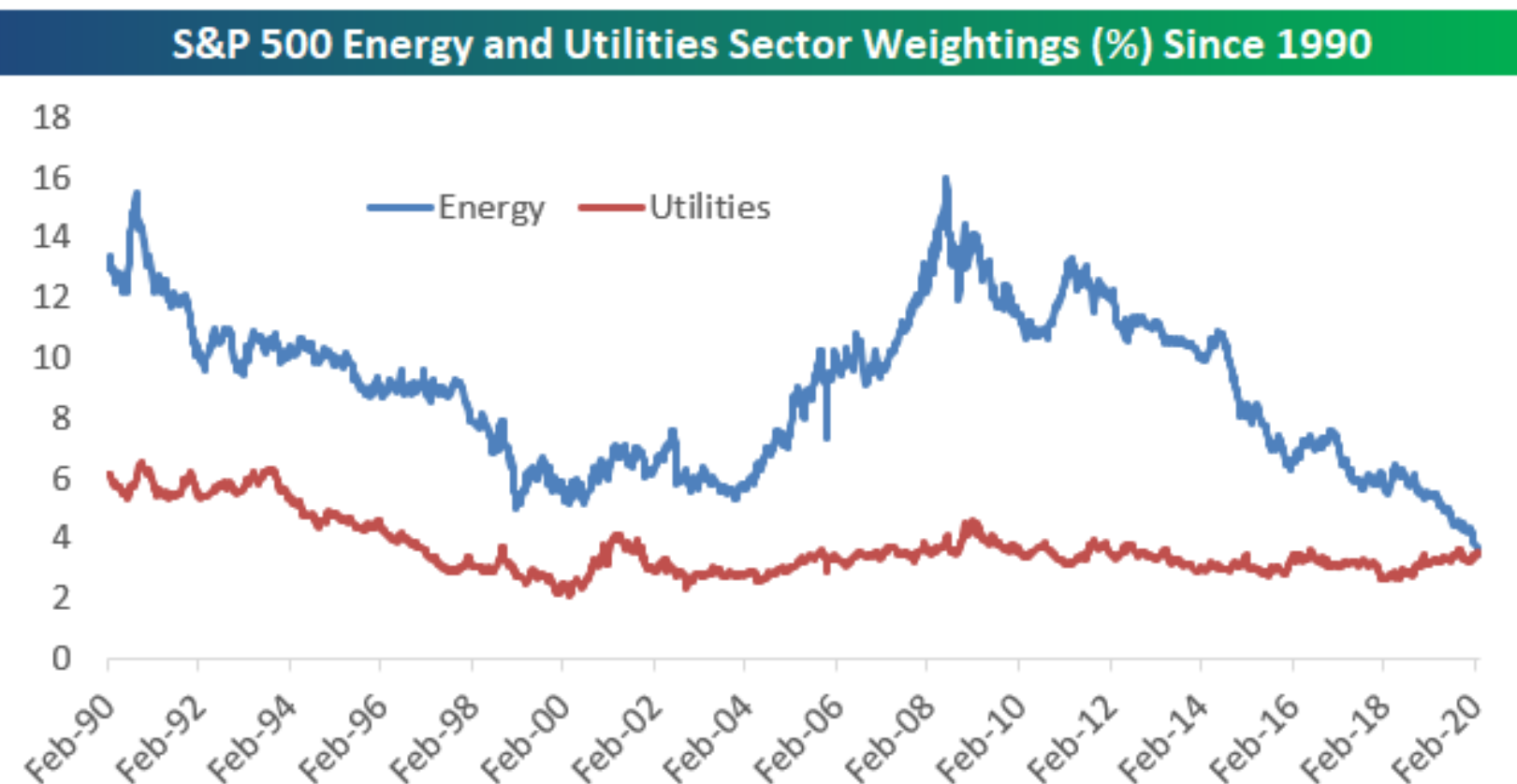
Notes: Data covers nearly 200 exchange traded funds that screen for ESG and socially responsible metrics

Source: IHS Markit

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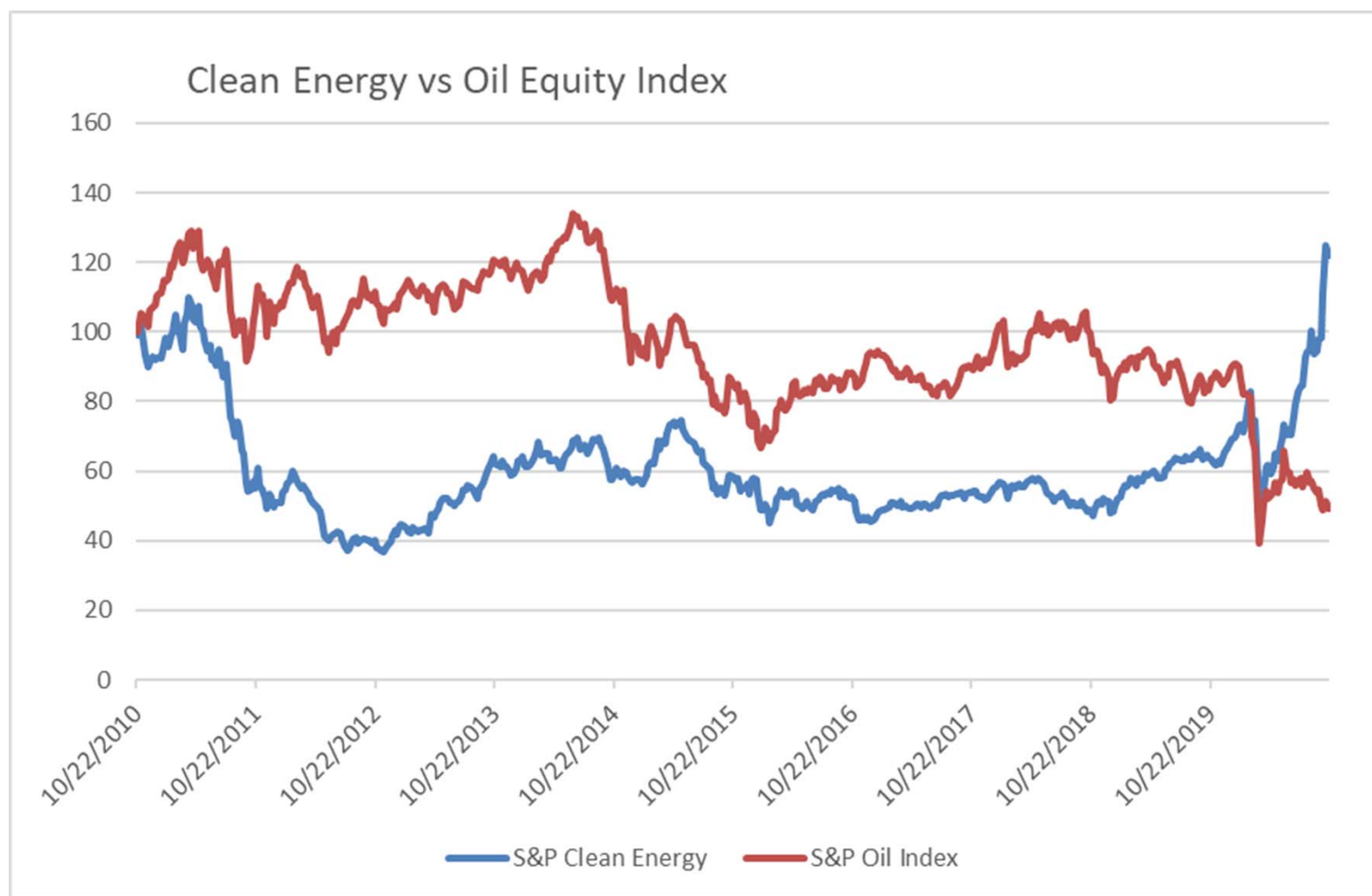
Investing in Energy is Increasingly “Optional”

Energy as a share of the equity market is hitting all-time lows;
The share in utilities is higher for the first time



Capital is Flowing from Traditional Energy to New Energy

Once linked by the oil price, these markets are now strongly disconnecting

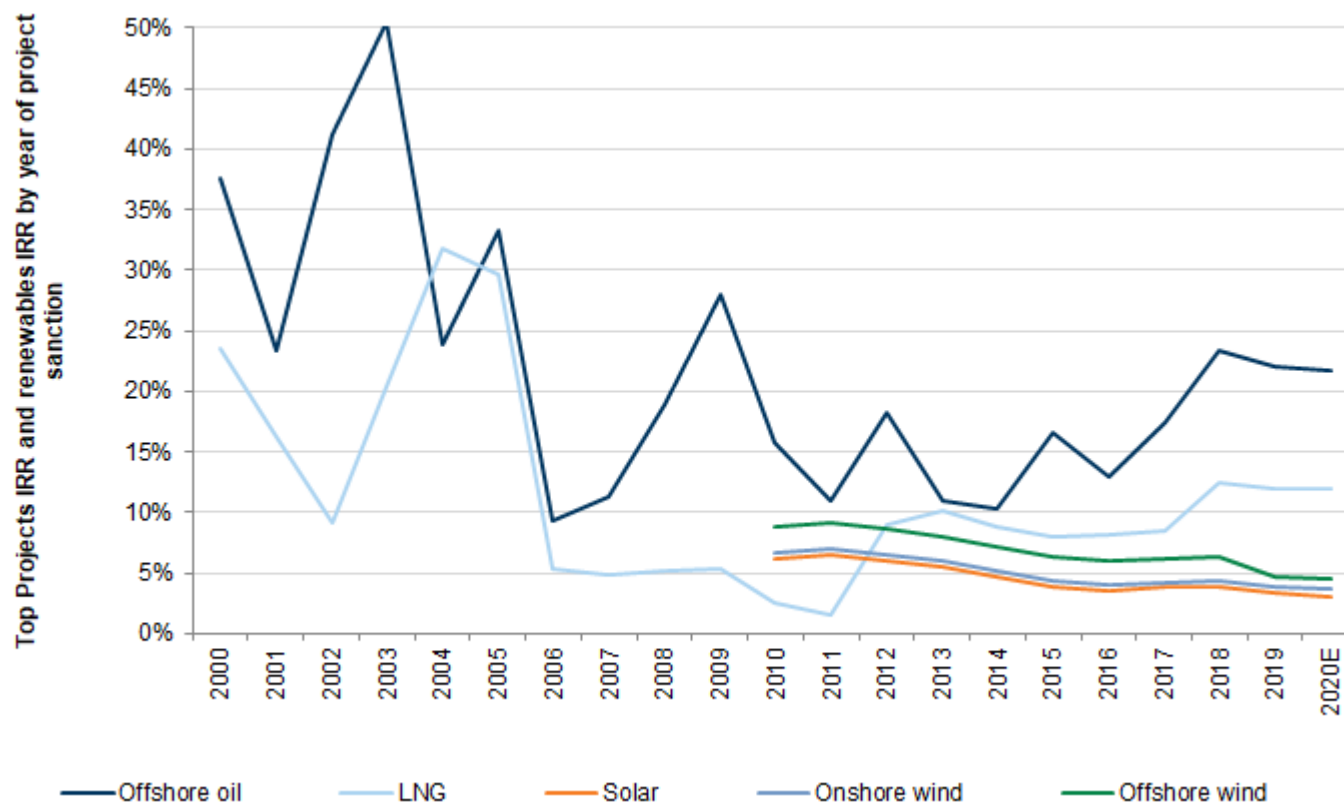


Source: Bloomberg

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Cost of Capital of Oil vs Renewable Projects

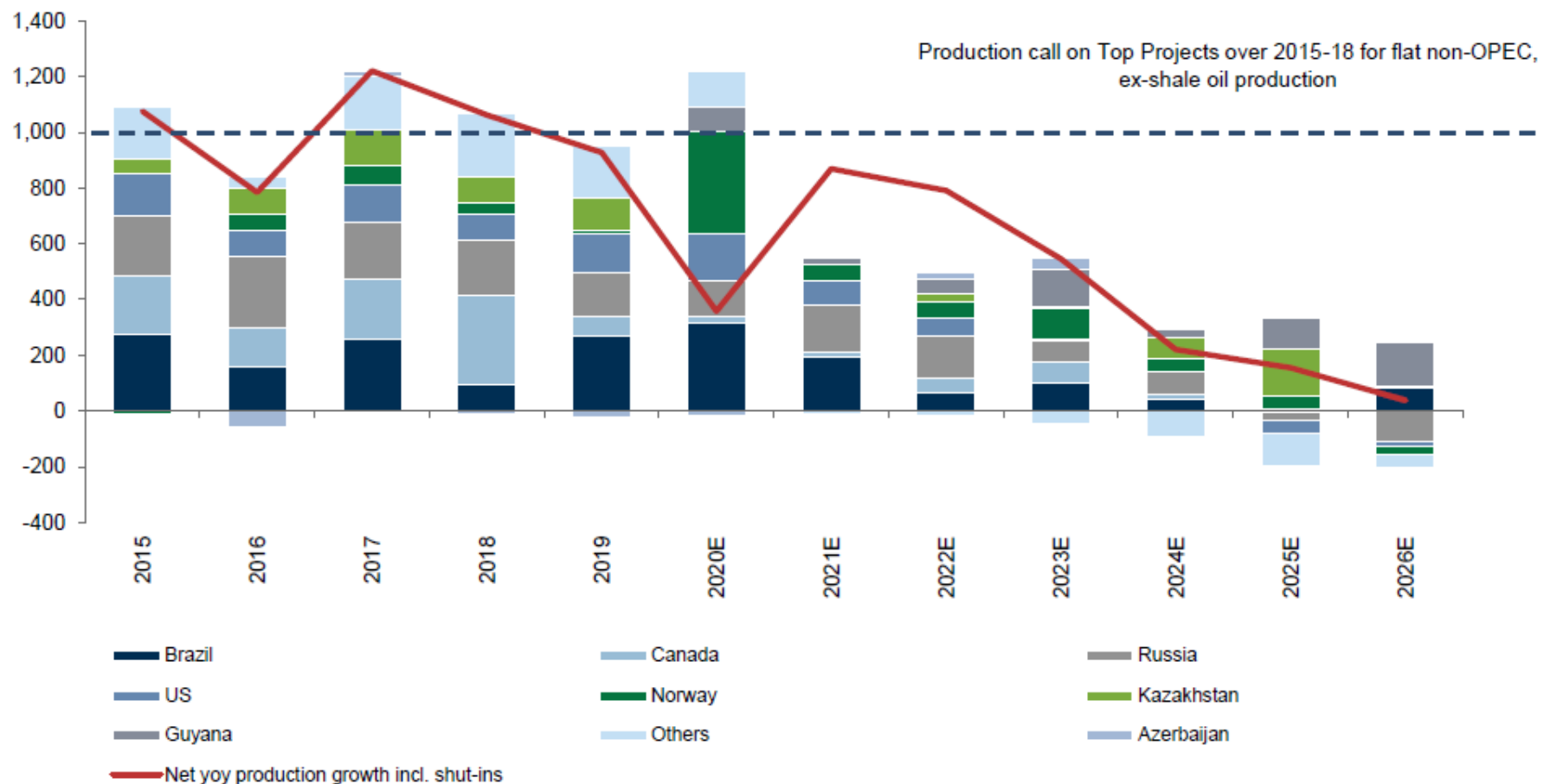
The cost of capital for oil projects has doubled to 20% in the last decade while dropping to under 5% for renewables



Future Oil Supplies

Underinvestment exposes the risk of a supply gap over the next few years

YoY oil production growth (kboe/d) from non-OPEC, excluding shale projects (excluding impact of shut-ins) and net production growth including production shut-ins impact)



Source: Goldman Sachs Investment Research

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- Capital will struggle to return to the oil and gas sector
- We will *likely* have another price cycle but it will need to be managed carefully

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Permanent Supply Destruction

Shut-in barrels may be partially impaired or need higher prices to be restored

