# Primary Concerns

5th June 2018

contact[at]phenixcam.ch

## Material Witness - *insights from the Manager*

Too good to be true

*- The notional portfolio was running exceptionally well until crude's sudden fall. In actual practice, however, most of those gains would have been preserved under our approach.*

*Thierry Ralet, CEO & Founder*

## Mark to Market - *observations from the front line*

Be careful what you wish for

*- rising reserves, falling costs, positive cash flow, reduced debt. The EIA says the Oil Patch enjoyed them all last year. Then we ran out of pipelines...*

*Sean Corrigan, Chief Investment Strategist*

## Material Witness - *insights from the Manager*

**Too good to be true**

The paper portfolio we are running at present on a month-to-month basis, solely for illustrative purposes, showed a positive return of +1.3% in May, mainly due to gains in the energy complex and in agriculture, combined with a small contribution from precious metals.

We would again point out that the model's returns do not reflect the full benefit of our unique methodology because they do not incorporate the effects of the intra-month rebalancing we will regularly be carrying out. The better to illustrate the advantages of our approach, we also report results on an excess return basis—i.e., without the additional earnings to be made on the underlying collateral. Indeed, if investors were to follow our suggestion of designating some part of their existing bond holdings to this purpose—for which commodities are a natural, negatively-correlated hedge—the impact on the portfolio could be even more favourable.

In this instance, several curves changed their shape during the month and so would have invited remedial action. Crude oil and Brent were an exceptional example. Long of both in the model based on BCOM and long of Brent in the GSCI model, an intervention on the 21st or 22nd, would have seen all positions in these contracts cut, pending their re-inclusion at the terminal rebalancing. As simple as it sounds, such an adjustment would have added 98bp to the performance realised at month-end.

Conversely, cocoa could theoretically have undergone several such reversals during the month – though being held at the small scale it is, this perhaps would not have had as significant an impact on the performance as it might have had on the trading costs!

Moving into June, the much-flatter structure of the WTI curve means that it did not generate any clear signal. With one of our models slightly long and the other neutral for Brent, by contrast, we maintain our long there, though with a reduced exposure to reflect the relative lack of corroboration between the analyses. Agriculture moves back to a short position (cotton excepted) and the model once again stays short of precious metals.

From a broader perspective, the general increase in volatility which has taken place in recent weeks has led us to tone down our exposures on both long and short sides and to maintain what is almost a complete balance between the two in dollar terms.

**Thierry Ralet**

**CEO & Founder**

th.ralet[at]phenixcam.ch

+41.79.471.63.02

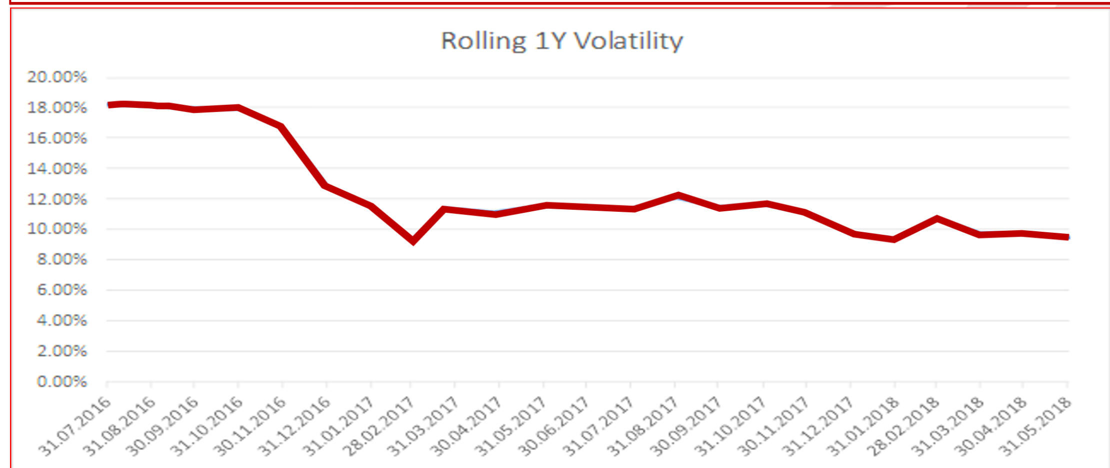
## The story so far...

**Performance Attribution 2018**

| | Jan | Feb | Mar | Apr | May | Jun | Jul | Aug | Sep | Oct | Nov | Dec | Tot |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| BCOM - Energy | 55.7 | -117.2 | 76.6 | 127.5 | -14.0 | | | | | | | | 128.7 |
| BCOM - Livestock | -9.6 | -4.2 | -1.5 | 44.3 | -9.1 | | | | | | | | 20.0 |
| BCOM - Grains | -50.7 | -120.0 | 36.7 | -42.8 | 39.6 | | | | | | | | -137.1 |
| BCOM - Metals | 18.7 | -8.2 | -16.2 | -70.0 | 4.2 | | | | | | | | -71.6 |
| BCOM - Precious Met. | - | 22.2 | - | - | 11.3 | | | | | | | | 33.5 |
| BCOM - Softs | -22.0 | -7.4 | 22.3 | 12.4 | -4.2 | | | | | | | | 1.1 |
| GSCI - Energy | 168.3 | -65.6 | 131.8 | 270.1 | 95.0 | | | | | | | | 599.7 |
| GSCI - Metals | 13.2 | -6.0 | -11.3 | -53.5 | 1.4 | | | | | | | | -56.2 |
| GSCI - Precious Met. | - | - | - | - | 4.8 | | | | | | | | 4.8 |
| GSCI - Agriculture | -60.9 | -68.7 | 88.2 | -38.9 | 19.2 | | | | | | | | -61.1 |
| GSCI - Livestock | -7.8 | -5.3 | 70.2 | 2.8 | -14.2 | | | | | | | | 45.8 |
| Total Alpha | 105.1 | -380.4 | 396.8 | 252.0 | 134.2 | | | | | | | | 507.6 |

**Performance since inception (AUG-15)**

| | 2015 | 2016 | 2017 | 2018 | ITD |
|---|---|---|---|---|---|
| Portfolio CAR | 27.4% | -9.8% | 17.1% | 5.0% | 12.9% |
| Benchmark | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% |
| Alpha (bp) | 2736 | -982 | 1707 | 500 | 1295 |
| Volatility | 19.6% | 12.8% | 9.8% | 6.4% | 13.6% |
| IR | 1.39 | -0.76 | 1.75 | 0.78 | 0.95 |



## Mark to Market - *observations from the front line*

### Be careful what you wish for

After having rallied some 70% - or roughly $30/bbl – since last June's lows, it was probably inevitable that oil would suffer a setback of some sort. From late April highs of 744,000 net longs, the speculative element has, indeed, since liquidated about an eighth of its position and will probably have been found to have set a new low for the year, come the next weekly update.

Adding to the confusion, despite a well-reported drop in global oil inventories of 400 million barrels relative to their trailing norms - a reduction of 9 days' worth of supply globally and of an even more impressive 15.6 days in the US alone- the degree of backwardation in the curve (the premium of near months over more deferred ones) has paradoxically collapsed along with the headline price, with the July-August WTI spread plummeting from 60¢c/bbl to just 5¢ in six short weeks.

Adding to the consternation, the WTI-Brent spread has simultaneously exploded, rocketing from just under $3 to almost a full $11/bbl these past three months - at which elevated level it represents a hefty premium of around one-sixth for European over benchmark US crude.

Though the proximate cause for the Herd's loss of nerve is being sought in Saudi hints that, at this month's upcoming OPEC gathering, they might not seek to renew the cap on production, agreed back in the dark days of autumn 2016, and hence that market tightness might finally be about to end.

Certainly, for that to be true, one would have to ignore the fact that OPEC's supposed willingness to do so is directly linked to the Trump Administration's abrogation of its nuclear bargain with Iran – not to mention the renewed impetus being given, in the form of further, aggressive sanctions, to its undeclared war on Russia – neither of these developments exactly guaranteed to increase hydrocarbon output, one might imagine. Nor does the descent into hyperinflationary Hades in Venezuela, nor signs of political and industrial unrest in Brazil, seem to figure much in the paper traders' equation.

But before we simply conclude that the market is going down because it is going down – and later inventing itself a rationale for its desire – there are clues in the physical oil market as to what is at work. For here we find the American shale heartlands are suffering from ever lower well-head prices – a widening cash 'basis' in the parlance – with double-digit discounts to the Cushing price being posted, all largely due to fears that the extraordinary success of the folk extracting oil from the ground has far outpaced efforts to supply them with the necessary means to deliver and store it.

In the West Texas Badlands of the Permian basin, output is now running at 3.2Mbpd, with over one in five of the drilling rigs at work anywhere in the world engaged here. With frack spacing a quarter and frack lengths double (and even quadruple) what they were just a few, short years ago; with increased numbers of bores being drilled from each well pad and with shorter completion times, too, this bonanza is on the verge of becoming a victim of its own success. Prices in the Permian have dropped precipitously as a result. Last week, WTI Midland crude was assessed by Platts at a discount of $18.80/bbl to the same oil at the Magellan East Houston coastal hub, a mere 500 miles away.

Several commentators have noted that pipeline capacity is almost full; that the railways are groaning – in part because all that fracking requires prodigious quantities of sand and other proppant; that road transport is too small-scale and costly and hence that prices will have to keep falling inland until those less efficient transport media become competitive on the world market, until producers reluctantly start to throttle back on their activities or – something not quite so loudly voiced – until America's belligerent foreign policy starts to choke off supply elsewhere in the world.

The good news? Demand in the States has been coming in stronger than expected with gasoline consumption up 1% YOY and distillate a whopping 6.6%. so far in 2018 Truck tonne-miles are rising at almost 10% a year – close to the fastest pace this century – and the widely-watched Cass Freight index is at its best levels since the peak of the cycle a decade ago. Light truck sales – with some offset from falling 'sedan' figures – are also up nearly 10% YTD. Heavier trucks and tractors are also said to be booming.

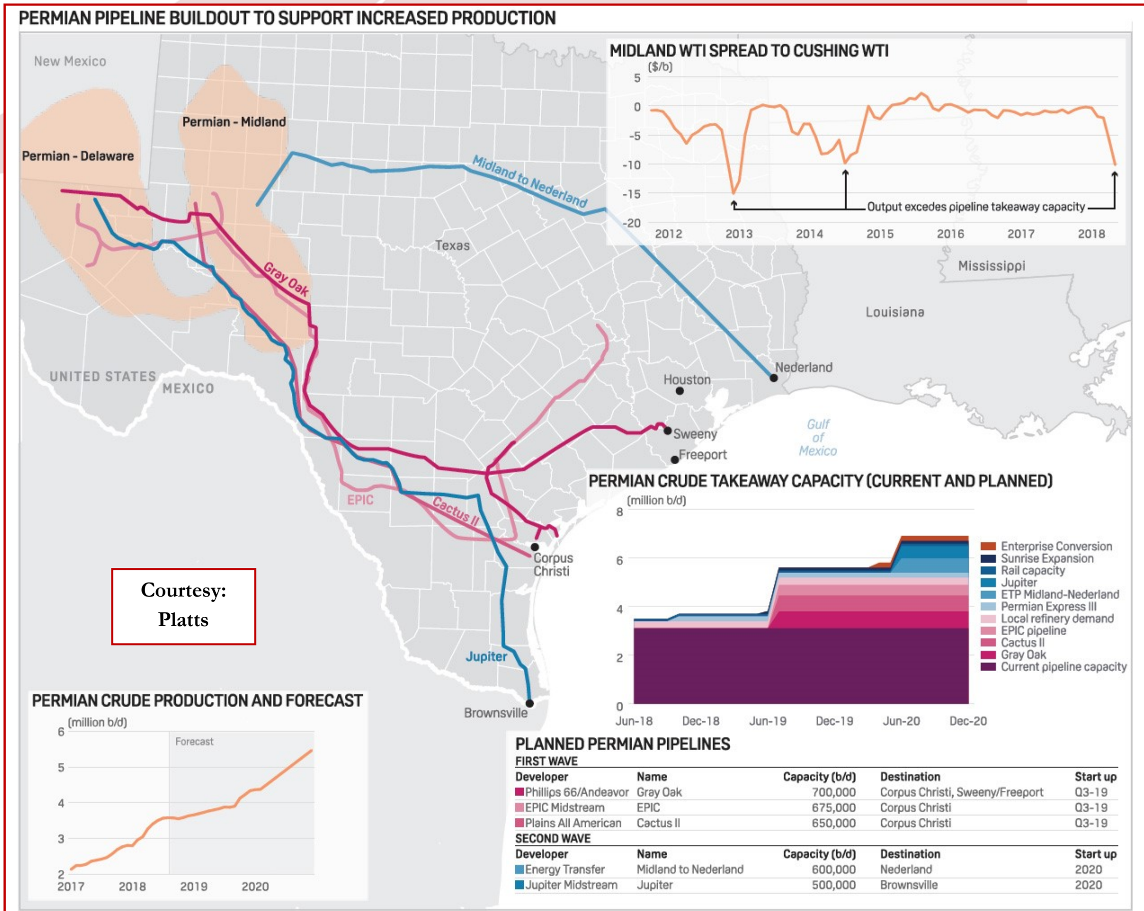
Export demand is also firm and, sometime over the next 18 months, new IMO regulations which mandate low sulphur diesel use in shipping will boost demand for America's sweeter crudes, as well hiking overall demand by around 2.5Mbpd—roughly a Canada or a Korea— though, by then, of course, new US pipeline capacity will have come on stream to help offset some of that demand.

And the bad news? Double-whammy gains from a unidirectional oil price gain led by the front end seem a good deal less certain to underpin returns in the immediate future, requiring far more nimble management of commodity portfolios in general.

.

**Sean Corrigan**

**Chief Investment Strategist**




PLANNED PERMIAN PIPELINES

FIRST WAVE

| Developer | Name | Capacity (b/d) | Destination | Start up |
|---|---|---|---|---|
| Phillips 66/Andeavor | Gray Oak | 700,000 | Corpus Christi, Sweeny/Freeport | Q3-19 |
| EPIC Midstream | EPIC | 675,000 | Corpus Christi | Q3-19 |
| Plains All American | Cactus II | 650,000 | Corpus Christi | Q3-19 |

SECOND WAVE

| Developer | Name | Capacity (b/d) | Destination | Start up |
|---|---|---|---|---|
| Energy Transfer | Midland to Nederland | 600,000 | Nederland | 2020 |
| Jupiter Midstream | Jupiter | 500,000 | Brownsville | 2020 |

Source: S&P Global Platts, S&P Global Platts Analytics

Courtesy: Platts

## Disclaimer

**The following statements are intended to inform investors of the uncertainties and risks associated with investments and transactions in transferable securities and other financial instruments. Investors should remember that the price of Shares and any income from them may fall as well as rise and that Shareholders may not get back the full amount invested. Past performance is not necessarily a guide to future performance and Shares should be regarded as a medium to long-term investment. Where the currency of the relevant Fund varies from the investor's home currency, or where the currency of the relevant Fund varies from the currencies of the markets in which the Fund invests, there is the prospect of additional loss (or the prospect of additional gain) to the investor greater than the usual risks of investment.**

- This Fund achieves its market exposure through the use of commodity-linked financial derivative instruments.
- Commodity prices and therefore the value of commodity-linked financial derivative instruments can be more volatile than investments in traditional securities.
- At times the Fund may be concentrated in one or more individual commodities which may further increase volatility.
- Although the majority of the Fund's assets will be invested in cash, cash equivalents and short-dated instruments, investors should be aware that the Fund may not benefit from the returns arising from those investments and that those investments will serve primarily as collateral for financial derivative instruments (principally swaps).
- Investors may see the value of their investment fall as well as rise on a daily basis, and they may get back less than they originally invested.
- Investors should be aware that, in response to certain market circumstances, for temporary defensive purposes the Fund may have very limited, if any, exposure to commodity-linked financial derivative instruments.
- The Fund is denominated in USD but may have exposure to non-USD currencies.
- The Fund will be managed with reference to the volatility of its benchmark but not with respect to the benchmark's constituents.
- The Fund uses financial derivative instruments to achieve its investment objective.
- The Fund's investment approach is speculative and entails risks. There can be no assurance that the investment objective of the Fund will be realized.
- Commodities investing may be subject to a higher degree of market risk because of concentration in a specific industry, sector or geographical sector.