September 2016

OPEC agrees to agree

The S&P 500 lost momentum over the month of September (-0.12%), after making 8 all-time new highs in August. While the S&P 500 was down marginally, the trend of the S&P/TSX Composite Index outperformance continued, delivering +1.2% versus the S&P 500. Much of this was due to solid performance by gold and natural gas companies. International equities were the top performers however, up +1.25% as a result of strong performance on the FTSE 100, the UK's main equity market.

The big news over the month was OPEC's announced oil production cut, a move not seen since 2008. Not wanting to show their hand, the oil cartel has decided to withhold details of the production cut until their next scheduled meeting this November, a potential signal they don't have any details to give. That aside, markets decided the announcement was worth $3/barrel, with black crude up over 5% on the day. While the reaction was welcomed, we believe it's too early yet to get excited about the impacts of the deal until we have more information. And OPEC has proven to be highly prone to infighting and has historically lacked internal accord. As such, we think the prudent course of action is to take a wait and see approach.

What we do know is they've targeted a potential range of 32.5 to 33.0 million barrels per day (bpd), only slightly lower than August's 33.2 million bpd level. This implies a production cut of anywhere from 200K to 700K barrels. In the context of the current (June 30th) 400K bpd supply glut, should OPEC deliver closer to the lower end of their implied range, we would expect oil prices to fall. At the higher end of the range (~700k barrels) the market would potentially be back into a supply deficit scenario. Still, we would hardly classify this potential deal as a game changer. For one, it does not factor how other oil producing nations will react to higher oil prices. Canada for example, is at 85% of production capacity, post-wildfires, and would be more than happy to bring this back up to 100%. Higher prices could encourage a negative feedback supply loop, whereby higher prices lead to more oil, which then leads to lower prices.

What's more, Saudi Arabia's offer to cut production by 500k (presumably a big part of the deal, if not all of it) has been received with a significant amount of skepticism. Conveniently, they've already increased production this year by 500k which sets them up nicely for an equivalent production cut. As well, the offer coincidentally (or not so much) comes in advance of the IPO of their state-owned oil assets (Aramco) which could potentially be construed as a pump 'n dump strategy in the making. For now, the OPEC announcement leaves more questions unanswered, making it difficult to assess the potential impacts.

In terms of positioning, the Active Balanced Portfolios remained neutral across asset classes. That is to say, we view both bonds and equities in the same light. Within our equity positioning, we are, not surprisingly, underweight Canadian equities, offset by an overweight position in the US and a neutral position in international equities.