Investment Insight

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Never let a good crisis go to waste. *The current price of oil and its ramifications for investors continues to be a talking point among analysts. In his recent blog which borrows the Churchill quote as its heading, Allianz Global Investors' oil and gas specialist Chris Wheaton made some interesting points on the subject. In this week's* ***Inside Track*** *we shares some extracts.*

Go with the flow. *Recent flow data shows that institutional equity investors are increasingly favouring European over US equities. Doubtless encouraged by the relative price attractiveness of European equities and the impending ECB asset purchases, this enthusiasm for European equities has translated into a substantial outperformance so far this year.*

Should the trend continue for the remainder of the year it will only be the second year in the past six that European markets have outperformed the US, so the catch-up is welcome. In ***Pic of the Week*** *we take a closer look.*

The Inside Track

Chris Wheaton is a Portfolio Manager specialising in the Oil & Gas sector at Allianz Global Investors. The following are some interesting extracts from his recent blog "*Never let a good crisis go to waste*".

This Churchill quote is apposite given his role in defining the borders of Saudi Arabia in 1921! Is the OPEC cartel, dead, or worse, ineffectual? No, but it's evolving. What was most interesting about the OPEC meeting in November was the emergence of a new cartel-in-waiting. Little notice has been paid to a meeting that was held on Weds 26th November – the day before the main OPEC meeting – between Saudi Arabia, Russia, Mexico and Venezuela, the four countries with most to lose from lower oil prices. Had these four been able to agree on a production cut shared between them, oil would be $70/barrel not $50/barrel.

And here's a paradox: $70/barrel is better than $50/barrel. Why? The problem with the $50/barrel oil price is that it is not the right one to enable a steady stream of investment to balance oil supply and demand over the next 2 decades and I believe it risks sharp spikes in prices back to unaffordable levels as in 2007-2008. If this 'Gang of Four' do get their act together, then we will have stability return to oil markets – if they don't, we may have a crisis.

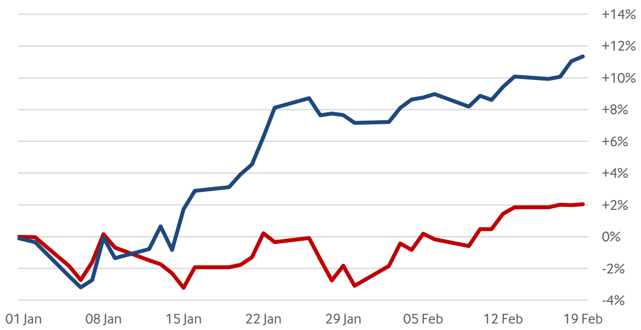
However, this crisis presents not just danger, but also huge opportunity for the oil industry. Paradoxically this period will be good for the oil industry longer-term, even if it feels terrible. Now, it's payback time for the years of neglect of shareholders by Big Oil. The oil industry has accepted rampant cost inflation from its suppliers for far too long, cushioned by higher oil prices.

Return on shareholders' capital and cash generation for shareholders have been steadily eroded as suppliers have taken ever larger slices of the cash flow cake. In the next 6 months, we will see capex cuts, cost cuts, cancellations and postponements of major investments. Oil companies realise that the dividend stream – shareholders' payback on the capital they have at risk – have to be protected. Our analysis suggests that big oil can preserve dividend streams for at least 2 years at or below $60 per barrel oil prices.

Pic of the Week

To date, 2015 has been a year of strongly contrasting fortunes for European and US equities. For the first year in several, it's the European markets that have stolen a march on the US. However, it's the size of the difference that is perhaps most remarkable. As the chart illustrates, Europe, despite all its economic and political woes, is almost 10% ahead of the US on a local currency basis just eight weeks into the year. Contrarian investors have anticipated a resurgence of European equities for quite a while now, but the year still has a long way to go.

European vs US equities



Week ahead: Key events

23/02 US Existing Home Sales & Dallas Fed Manufacturing Activity
24/02 Germany GDP
24/02 EU CPI & US Consumer Confidence
25/02 US New Home Sales
26/02 US Unemployment & UK GDP
26/02 EU Confidence Indicators
26/02 US Durable Goods & Initial Jobless Claims & CPI
26/02 Japan Retail Sales
27/02 US GDP & Pending Home Sales & University of Michigan Sentiment

Market View

	Last 7 days	YTD	5Y Ann.
Global equities	+1.1%	+4.1%	+9.4%
US equities	+1.4%	+1.9%	+13.6%
European equities	+1.7%	+11.3%	+8.4%
Emerging market equities	-0.2%	+3.0%	+1.1%
Irish equities	+1.3%	+11.0%	+14.3%
Commodities	+0.4%	-0.9%	-5.2%
Hedge funds	+0.6%	+1.0%	+1.2%

Economic indicators	*Bond yields*	*Inflation*	*GDP YoY*
Ireland	+1.1%	-0.6%	+3.5%
Germany	+0.4%	-0.4%	+1.4%
USA	+2.1%	+0.8%	+2.5%
China	+3.3%	+0.8%	+7.3%

Currencies	*Current*	*YTD Δ*
EUR:USD	1.14	-6.1%
EUR:GBP	0.74	-5.2%
EUR:CNY	7.11	-5.8%
GBP:USD	1.54	-1.0%
Bitcoin	243.73	-23.2%

Commodities	*Current*	*YTD Δ*
Gold	1,209.21	+2.1%
Copper	5,766.25	-9.4%
Oil	60.51	+2.2%
Wheat	523.50	-11.9%

Central Bank rates	*Current*
Eurozone	0.05%
USA	0.25%
UK	0.50%

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