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CAPITAL ADVISORS

WEEKLY MARKET UPDATE

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The Swing Producer

The impact of the energy market runs deep and wide across the geopolitical and financial world. You need to look no further than the local gas station to see the impact on your monthly budget. It's no secret that oil is also a driver of geopolitical strategy, propping up certain governments and at times leading to tense interchanges between nations. At the same time, energy prices have a significant impact on the financial markets, having been largely responsible for the big swings in earnings in the S&P 500 over the past few quarters – and **this is why we turn our attention to the topic in this week's market update.**

Crude oil prices have been north of $150 and have touched as low as $29.38 over the past 10 years (source: Macrotrends.net), settling recently into a trading range of roughly $40-55. Are these prices here to stay? No one knows for sure (and he who thinks he does will likely get bit in a big way). However, **evidence does point to prices being "range-bound" for the foreseeable future, thanks in large part to the influential role that US producers now play in the global market.**

Once highly dependent on oil imports, the US is now considered the "swing producer" in the global oil market. The advent of shale oil production and the rapid advancement of technologies in this area have resulted in the US being able to turn on and off production in major (and cost-effective) ways. The once-dominant Organization of the Petroleum Exporting Countries (OPEC) is now finding itself being relegated to a lesser role.

OPEC's members brought in less cash from selling oil in 2016 than in any of the past dozen years, according to the U.S. Energy Information Administration (EIA). Members of OPEC earned about $433 billion in net oil export revenues in 2016, the lowest since 2004. In real dollar terms, the 2016 revenue represents a 15% decline from the $509 billion earned in 2015, mainly because of the fall in average annual crude oil prices and, to a lesser extent, because of decreases in OPEC net oil exports.

Those low prices are the direct result of American shale producers, whose output contributed to a global glut that brought prices from their $100+ per barrel levels down to the $50 range they occupy today. When prices dropped to their low points, US shale producers trimmed production – only to turn it back on as prices rebounded. This flexibility puts them in

a significant position of influence in the global markets.

Those lost revenues are why OPEC, along with a group of 11 other petrostate producers (including Russia), have agreed at last to reduce their collective output in an attempt to rebalance the market. The rebalancing is going to take a lot more time than was initially envisioned, with Saudi Arabia and Russia most likely constraining production through March of next year. In the meantime, U.S. producers are seeing their own output rise and the numbers in their balance books turn black once again. Suppliers worldwide are adjusting to $50 crude, and many energy analysts believe the days of $100 oil are behind us, barring a major supply disruption.

If lower prices are here to stay, OPEC's member states are going to have to get used to lower energy revenues and tighter budgets at home, increasing the risk of domestic political instability from citizens used to generous social benefits provided by the state.

In conclusion, oil is unlike so many assets that we track on a regular basis. Apple's stock price is not going to incite a war, nor is the interest rate on a corporate bond likely to spark a coup d'etat. However, oil does have the power to do both – and to influence the value of your investment accounts (directly and indirectly) at the same time. Whether oil represents the future of energy production or not is up for debate, but we can't foresee it fading from the limelight quietly or soon.

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