Long Brent Futures

Thesis: The current administration's energy policies have been inadequate to mitigate the structural oil investment and supply deficit. The SPR release and other incentives/policies in place to deal with the deficit will end up reinforcing it, causing longer-dated prices to rise even if closer-to-spot markets are choppier.

SPR release

- The US has started releasing 1m bpd over the next 6 months (180 mmbbls total) from the SPR, with the possibility of US allies also releasing 30-50 mmbbls. Historically, SPR releases have been ineffective in suppressing price trends (Appendix A). Some (Trafigura) argue that such large releases pose storage-access and distribution bottlenecks.
- The release also won't do much to keep down future prices for a couple reasons. First, repurchases will be needed (see longer-dated futures rally on the news). Second, at this point, SPR is more of a political tool than an economic one. Artificially lower prices and release uncertainty will keep demand higher and supply low. An emptier SPR will also increase upside price risk.

Other supply-side

- Since record supply cuts in 2020, OPEC+ has slowly clawed up production targets. However, the group has consistently missed these targets (Appendix B). These failures can be attributed to geopolitical instability via Ukraine and Yemen, systemic structural shortfalls, and idiosyncratic events such as weather and maintenance.
- The IEA has estimated that markets could lose up to 3m bpd of Russian oil. OPEC+ does not have the capacity to replace most of this, and probably wouldn't anyway. The real figure could be lower and it's uncertain where this will go.
- Finally, transition risks with antagonising guidance and bad incentives have structurally suppressed new output and energy capex in the US/West (Appendix C). There is little evidence of a volte-face, with Biden recently proposing a tax on unused leases. (This won't do anything - if companies don't want to produce, they'll give up the leases.) These types of policies won't help fix the supply issue. A lot of new investments and a policy regime shift are necessary to make up for embedded future deficits.

Demand incentives

- Normally, high prices drive substitution and conservation. However, Western governments have adopted policies that counter some demand-destruction balancing. Governments in Europe and Canada (and maybe America soon) have pushed emergency measures like oil tax cuts and other stimulus to help consumers deal with elevated prices. The effect is persistent demand.

Trade expression: While we could express this through shorter-term futures like the front-month, given the catalysts and the outlook on the policy regime and structural supply/demand, longer-dated futures seem more attractive. I was also considering oil companies, but some of these catalysts (especially admin energy policy) seem more clearly expressed through futures than through equities.

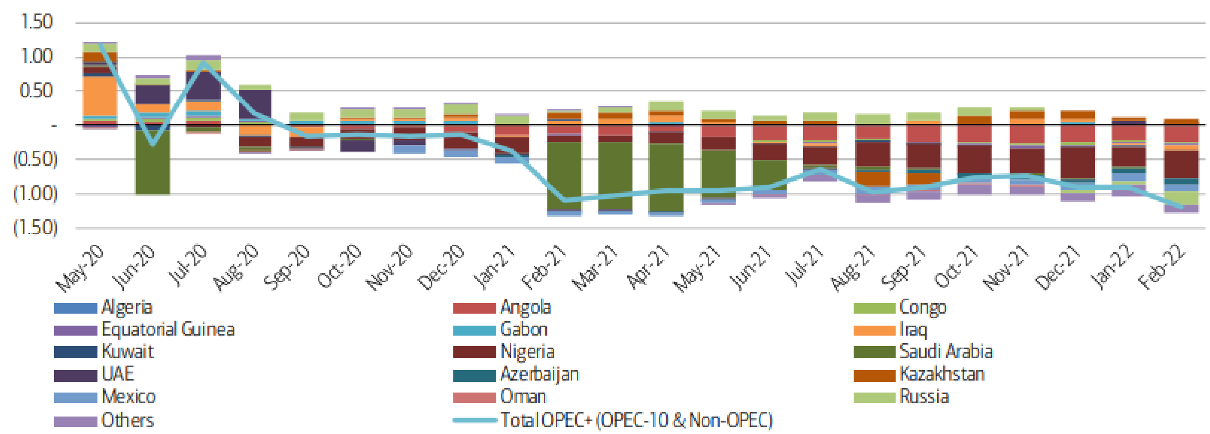
Appendix

A. Historical SPR releases and subsequent WTI movements

B. OPEC+ output shortfalls, H20-G22

Exhibit 1: OPEC+ Quota compliance (mmb/d)

OPEC has failed to fulfil quota production each month since September 2020, with the deficit currently >1mmb/d



Source: BofA Global Research, IEA Oil market report
Others: Others: Bahrain, Brunei, Malaysia, Sudan and South Sudan

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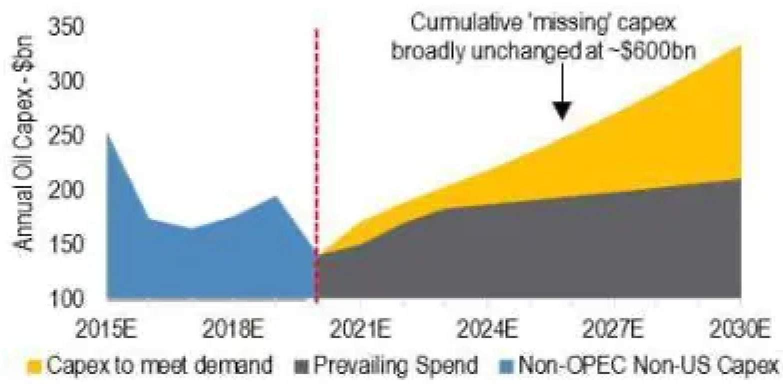
C. Structural oil investment deficit

Figure 6: … We estimate required spend to meet demand is ~$600bn higher vs the prevailing outlook (2021-25 underspend $135bn).



Source: J.P. Morgan estimates, Company Data.