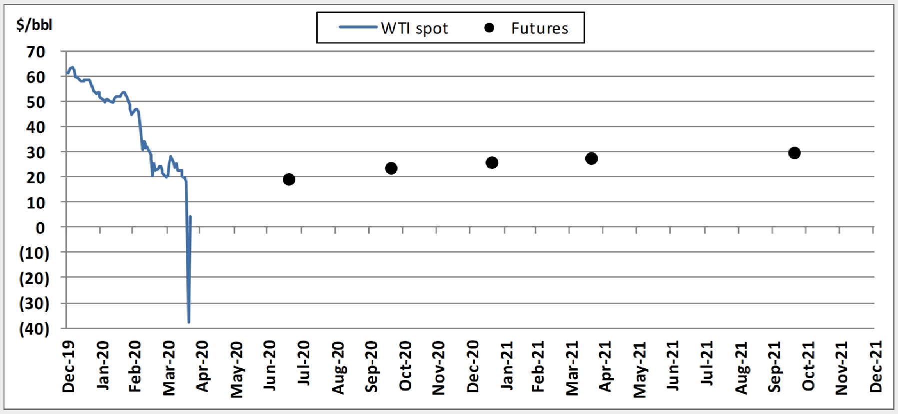
Eagle MLP Strategy Quick Note - April 21, 2020

From the EGA Portfolio Management Team



Source: Bloomberg

Oil Goes Negative For The First Time In History

On Monday and for the first time in history the front month WTI contract traded below $0/bbl. Already under pressure from oversupply, the WTI contract for May delivery started the session at $18/bbl and quickly fell to $0/bbl, and then in an unprecedented move fell to a low of -$39/bbl.

How did this happen?

Oil futures contracts have specific expirations and delivery dates, and the owner of a contract agrees to take physical delivery on delivery date. In this case, the contracts for May delivery expire (stop trading) on April 22nd. If someone is long (owns) a May contract after April 22, they are required to take physical delivery of the crude oil. Under normal circumstances this is not an issue, as speculators who cannot take physical delivery simply sell the contract to those who can (i.e., refiners, storage operators). Unfortunately, the market today is anything but normal. As worldwide demand for oil has collapsed by some estimates from 100mn bpd to 70mn bpd due to the economic shutdown, oil in storage is nearing full capacity. The storage problem is most acute in the United States, and the primary clearing area is in Cushing, Oklahoma. It is estimated there was 55mn bbl of oil stored in Cushing last week, growing at a rate of 6-7mn bpd. At that rate the experts predict Cushing storage will fill up in May at about the exact time as physical delivery is due. Anyone who owns the May contract and cannot take delivery has to sell before the April 22nd contract end date, regardless of price.

What likely happens next?

We believe storage in the United States will likely reach capacity in May or June despite efforts by OPEC+ to reduce short term supply. While there is talk of OPEC+ bringing forward production cuts to head off this issue, we believe it is unlikely to make a difference absent a change in demand. Meanwhile, rig counts in the United States have fallen by over 200 and well shut ins have begun. The US Department of Energy estimates US crude production has already fallen by over 1mn bpd and could reach over 2mn bpd depending on how quickly the economy reopens.

While the timing and pace of global economic recovery cannot be known in advance, the forward curve for WTI futures suggests the short-term supply glut will be overcome and energy prices will recover. In the meantime, the Midstream sector has proactively taken measures to protect balance sheets. We reiterate our view that stock selection is critical during this period of volatility, and we're working hard to identify the survivors we believe will be best positioned for the re-normalization of the energy market.