**HIGHLY CONFIDENTIAL**

**November 15, 2017**

# Good Morning

**Overview**

- Hydrocarbon prices declined again overnight. **NYMEX crude oil down $0.69 to $55.01 per barrel; ICE Brent off $0.74 to $61.47 per barrel; NYMEX natural gas down $0.015 to $3.087 per mmBtu.**

**News/Views**

- Yesterday's decline in oil prices was largely attributed to the IEA's "downbeat" assessment of global refined product demand. With respect, however, this is giving too much credit to the IEA. Their revisions to the estimated rate of growth in world oil demand was a mere fraction of the standard error of estimate of the imperfect data we are all stuck with. Also, the IEA does not hold the patent on accurate forecasting any more than anyone else. Nonetheless, it was an easy theme for the neopress to pick up on and many smaller funds use the IEA as their primary source of global demand and supply.

- In any event, yesterday's activity confirms thus far what our short-term valuation model we have developed was telling us, i.e. that crude oil has been overvalued on a fundamental basis since the prompt NYMEX crude oil contract traded around $53.50 per barrel. We had been hoping for one last exhaustive move up to equal the 2017 high close to $58.00 per barrel, but thus far a few funds have decided to bail. The news from the IEA was enough of an excuse to pull the trigger.

- Even more ammunition has now come from the API. Late yesterday the API reported that for the week ending November 10 U.S. commercial crude oil inventories increased by some 6.5 million barrels to 461.8 million barrels in contrast to consensus expectations of a draw, but fell at Cushing by 1.8 million barrels, helping to account for the modest recovery in the NYMEX calendar spread despite the decline in the flat price. The API also reported that primary gasoline inventories increased by 2.4 million barrels in contrast to analysts' expectations of a decline, while distillate fuel oil supplies fell by 2.5 million barrels, more than the market was looking for.

- Thus, it will be more important than ever to see whether the EIA data confirm the API report or not later this morning. We will therefore run our exercise of inputting the key API crude oil stats into our EIA balances and see what the picture might look like. The API reported that refinery crude oil runs retraced by 289 MB/D while gross imports rose by 652 MB/D to 8.1 MMB/D. If we hold our other variables constant and input the *rate of change* of runs and gross imports into our balances, it would imply an EIA-based crude oil stock build of about 2.0 million barrels. Inputting the *absolute level* of gross imports would imply an inventory gain of almost 2.5 million barrels.

- We have assumed that gross exports rebounded last week to almost 1.4 MMB/D, which is a bit shy of the four-week mean. This strikes us as a reasonable but perhaps somewhat conservative assumption given where the appropriate differentials stand. If we plug in a recovery back to 2.0 MMB/D, it would imply a stock draw of about 1.9 million barrels. We will therefore guess that the odds probably favor somewhat more constructive crude oil stats from the EIA. However, even if on an EIA basis crude oil stocks declined last week by 1.9 million barrels, it is probably not enough to pull the prompt NYMEX crude oil contract back to the 2017 high in and of itself.

- Not three days ago we saw some previously bearish analysts calling for $75.00 per barrel crude oil by year end. Sentiment appears to have shifted, but it is premature to suggest that the consensus is now universally bearish. We are bothered by the way the equity market is trading these days, and we may decide to dust off and update our recession scenario we ran back in June.

- At this juncture, however, we see no reason to amend our long-standing Base Case for 2018, which calls for a retracement in the prompt NYMEX crude oil contract back to the upper $40s in the first quarter before staging a significant recovery in the second. While we were waiting for more time decay on 2018 NYMEX crude oil puts, given the decline in energy equities and the possible turn in market sentiment we established a small initial long position in the January $53.00 puts yesterday at the settlement for our model energy portfolio.

W.H. Brown III

# WHB Energy Research, LLC Model Portfolio

| Asset Class | | L/S | Vol. | Date Executed | Cost/Price | Capital Utilized | Pct. Cap. Alloc. | Impl. Weight | 14-Nov-17 Close/Settlement | Profit/Loss |
|---|---|---|---|---|---|---|---|---|---|---|
| **Equities** | | | | | | | | | | |
| **Indexes** | | | | | | | | | | |
| 1 XLE | | L | 26200 | 9-Jun-17 | $64.86 | $1,699,332 | 16.99% | 100% | $68.14 | $85,936 |
| **Independent Producing Companies** | | | | | | | | | | |
| 1 HES | | L | 10,000 | 20-Jun-17 | $42.69 | $426,872 | 4.27% | 100% | $44.91 | $22,228 |
| 2 APC | | L | 6,600 | 11-Jul-17 | $44.49 | $293,634 | 2.94% | 69% | $48.05 | $23,496 |
| 3 APA | | L | 9,600 | 8-Aug-17 | $44.23 | $424,603 | 4.25% | 100% | $41.88 | ($22,555) |
| 4 MRO | | L | 35,500 | 25-Jul-17 | $11.92 | $423,160 | 4.23% | 100% | $14.84 | $103,660 |
| **Options** | | | | | | | | | | |
| 1 HES Jan 4750 Calls | | S | 100 | 17-Aug-17 | $0.98 | $9,800 | 0.10% | 2% | $1.46 | ($4,800) |
| 2 APA Jan 4750 Calls | | S | 33 | 17-Aug-17 | $1.02 | $3,366 | 0.03% | 1% | $0.70 | $1,056 |
| **Realized Equity Position Profit/Loss** | | | | | | | | | | $114,184 |
| **Total Equity Position Profit/Loss** | | | | | | | | | | $323,205 |
| **Commodities** | | | | | | | | | | |
| **Futures Positions** | | | | | | | | | | |
| 1 CL | | | | | | $0 | 0.00% | 0% | | $0 |
| 2 CL Calendar Spread | CLZ-CLH8 | L | 150 | 9-Jun-17 | ($0.72) | $63,750 | 0.64% | 15% | ($0.46) | $39,000 |
| 3 RBOB Crack | | | | | | $0 | 0.00% | 0% | | $0 |
| **Options Positions** | | | | | | | | | | |
| 1 CL | CLZ 42 Put | L | 73 | 11-Jul-17 | $1.72 | $125,195 | 1.25% | 50% | $0.01 | ($124,465) |
| 2 CL | CLZ 45 Put | L | 43 | 27-Jul-17 | $1.46 | $62,780 | 0.63% | 25% | $0.01 | ($62,350) |
| 3 CL | CLF 53 Put | L | 50 | 14-Nov-17 | $0.57 | $28,500 | 0.29% | 11% | $0.57 | $0 |
| 4 CL | CLF 60 Call | S | 150 | 8-Nov-17 | $0.68 | $102,000 | 1.02% | 41% | $0.35 | $49,500 |
| 5 CL | CLF 61 Call | L | 150 | 8-Nov-17 | $0.50 | $330,000 | 3.30% | 132% | $0.25 | ($36,750) |
| **Realized Commodity Position Profit/Loss** | | | | | | | | | | $798,550 |
| **Total Commodity Position Profit/Loss** | | | | | | | | | | $663,485 |
| **Other Asset Positions** | | | | | | | | | | |
| 2 E Mini S&P 500 Dec 2200 Put | | L | 40 | 13-Sep-17 | $10.50 | $42,000 | 0.42% | 10% | $1.05 | ($18,900) |
| **Realized Other Asset Position Profit/Loss** | | | | | | | | | | ($42,400) |
| **Cash Deposits Into Fund** | | | | | | $0 | | | | |
| **Cash Withdrawals From Fund** | | | | | | $0 | | | | |
| **Available Cash(a)** | | | | | | $5,965,008 | 59.7% | | | |
| **Total Profit/(Loss) On Equity, Commodity, and other Asset Positions** | | | | | | | | | | $925,390 |
| **Total Assets** | | | | | | | | | | $10,925,390 |
| **Rate of Return on Initial Capital(b)** | | | | | | | | | | 9.3% |

**Notes:**

**(a) Initial capital less full value of equity positions and initial/maintenance margin requirements for commodities.**

**(b) Before fees and commissions.**

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