



MORNING BRIEFING

June 20, 2019

Oil & Libra

See the [pdf](#) and the [collection](#) of the individual charts linked below.

(1) There's power in US energy independence. (2) OPEC and global GDP pushing oil in opposite directions. (3) Oil rallies on Trump/Xi meeting news. (4) Agencies cut oil forecasts. (5) US rig count falling but oil still gushing. (6) Plastics, solar, and electric cars shape oil's future. (7) Facebook says, "Trust us with your money...really." (8) Tech giant wants to be a banking giant, too.

Energy: Blowing Hot & Cold. The importance and power of US energy independence was palpable in the past week. Two oil tankers were attacked in the Strait of Hormuz and the price of oil barely budged. The United States says Iran was behind the attack and President Donald Trump deployed another 1,000 troops to the region. Iran denied the allegations and threatened to abandon a nuclear accord that limited its stock of uranium within 10 days.

Despite the heightened tensions, the price of Brent crude oil remained around \$60. What could be causing such calm among normally twitchy traders? I asked Jackie to take a look. Here's what she learned.

(1) *US oil output great again.* The muted response to Iran's alleged attacks comes at an opportune time. The world knows that the US no longer needs the oil produced by the Middle East. Thanks to the fracking revolution, US production has climbed from 6.0 million barrels per day (mbd) at the start of 2012 to 12.2 mbd in April ([Fig. 1](#)). The remarkable jump in production means US is on the verge of becoming a net exporter of black gold ([Fig. 2](#)).

So, while Iran's actions are problematic, they are no longer solely a US problem. The rest of the world—specifically Europe, China and India—will have to step up and put pressure on Iran. A global coalition may result in a swifter solution once Iran realizes it's taunting the oil-consuming world, not just the US.

(2) *Geopolitics matters.* What did make the price of oil move this week was Monday's news that OPEC and Russia plan to meet early next month to discuss whether to continue their policy of cutting oil output by 1.2 mbd or even cut some more.

The following day, on Tuesday, Trump tweeted that he and China's President Xi Jinping would have "an extended meeting" to discuss trade at the G20 meeting in Japan next week. If an agreement can be reached, it might mean increased economic growth both in China and in the US and that would be good for oil demand.

The economic outlook brightened a bit more on Wednesday when Federal Reserve officials acknowledged that "uncertainties" about the economy had increased since their last meeting and implied the Fed would cut interest rates in the future if the economy weakens. The price of Brent crude

oil rose 2.2% Tuesday and Wednesday ([Fig. 3](#)).

Demand growth estimates have been trimmed in recent days and months as the US/Chinese tariff war has slowed the global economy. "OPEC predicts that global demand will rise by 1.14 [mbd] this year, 70,000 B/D less than previously expected because of escalating trade disputes," a 6/17 *Journal of Petroleum Technology* [article](#) reported. It quoted an OPEC report that stated: "Significant downside risks from escalating trade disputes spilling over to global demand growth remain."

Last week the International Energy Agency reduced its forecast for 2019 global oil demand to 1.2 mbd in its June report, down from a 1.3 mbd estimate in its May report and 1.4 mbd in the April report. The agency also called out slower-than-expected global growth at the start of the year, due in part to the slowdown in global trade. Oil demand growth should reaccelerate and increase by 1.4 mbd in 2020, the 6/14 [report](#) states.

Likewise, the US Energy Information Administration (EIA) is calling for 2019 demand growth of 1.2 mbd this year and 1.4 mbd in 2020 in its 6/11 [analysis](#). It reduced its 2019 estimate by 0.2 mbd in this month's report and reduced its 2019 Brent crude oil price forecast by \$3 to \$67 per barrel.

Despite the reduction in demand forecasts, the market isn't nearly as oversupplied as it was a few years ago. The EIA forecasts that world petroleum and other liquids supply and demand are expected to be: 100.85 mbd and 101.14 this year, and 102.82 mbd and 102.56 in 2020.

US petroleum inventories have been creeping higher since March as they often do in advance of the summer driving season ([Fig. 4](#)). US rig counts have dropped in both the oil and gas fields, but production has yet to respond ([Fig. 5](#) and [Fig. 6](#)).

(3) *Trashing plastics*. The production of plastics has become an important source of demand for petroleum. There are growing calls for increased plastic recycling and the ban of single-use plastics. Demand will be affected by how strict the compliance to and enforcement of those calls is in the future.

If regulations don't change, BP's [2019 Energy Outlook](#) assumes "non-combusted" oil demand will be 25 mbd by 2040, up from 15 mbd in 2017. If recycling rates double to 30% and plastic regulations tighten, then demand could be closer to 22 mbd by 2040. Single-use plastics accounted for just over a third of plastics produced in 2017. If governments ban single-use plastics, instead of demand doubling to 6 mbd, it would fall to about 1 mbd. For the entire energy complex, it would mean total demand would plateau in 2025 instead of 2035.

(4) *Solar charged up cars*. The BP report isn't very optimistic about the benefit electric vehicles and solar power will have on overall energy demand and supply. The report warns that the rise in global prosperity will lead more folks to use car transportation (either by buying their own car or taking a taxi) instead of using busses or trains. BP expects electric vehicles to grab 15% market share by 2020, but that seems conservative given the number of vehicles coming to market and some of the rules banning combustion engines in Europe.

In addition, the BP report looks at solar power in a section on electricity generation. Renewable energy grows to produce about 30% of the world's electricity, up from just under 10% in 2017. The report doesn't break out how much of the solar power is generated by utility-sized solar arrays or from individual homes.

We've long thought that if price points fell enough, it would make sense to have a solar-powered home and an electric car. Tesla's acquisition of SolarCity, though expensive and bogged down by conflicts of

interest (it was founded by two of Musk's cousins) has not yet produced the optimistic results expected.

Tesla did create solar roof tiles to replace ugly solar panels. And now that production of the Tesla 3 is running smoothly, Elon Musk said that the company plans to focus its attention on solar roofs and Tesla's PowerWall battery, a 6/10 Earthtechling [article](#) stated. We've seen conflicting reports on pricing. One says the new roof tiles are below the competition's price and another that says they're far more expensive. Either way, we'll be watching Musk's renewed focus on solar. For if he's successful, energy forecasters might have to revisit their assumptions.

(5) *By the numbers.* The S&P 500 Energy sector started the year strong along with the price of Brent crude oil. But since its peak on April 24, Brent has fallen 16% and the Energy sector has given back most of its gains. Here's how the Energy sector's ytd returns through Tuesday's close compare to the other 10 S&P 500 sectors' returns: Information Technology (24.6%), Real Estate (21.7), Consumer Discretionary (20.8), Industrials (18.6), Communication Services (17.9), S&P 500 (16.4), Consumer Staples (14.6), Financials (14.2), Materials (13.8), Utilities (13.2), Energy (7.9), and Health Care (6.5) ([Fig. 7](#)).

Analysts are optimistic the market will improve next year. They've penciled in a 0.2% decline in revenue this year and a 6.9% increase in 2020 ([Fig. 8](#)). In the same fashion, earnings are forecast to drop 9.7% this year and rebound by 30.5% in 2020 ([Fig. 9](#)). The sector's forward P/E is 14.7, down sharply from three years ago when the industry had little in the way of earnings ([Fig. 10](#)).

Disruption: Facebook Targets Banking. KISS—keep it simple stupid—is a basic sales technique that gets drummed into any beginner's head. It actually has its roots as a design principle noted by the US Navy in 1960, according to a Wikipedia entry. The idea behind KISS is that most systems work best if they are kept simple. So simplicity should be a design goal and unnecessary complexity avoided. Kinder, gentler versions of KISS include: Keep it Simple, Silly and Keep it Short and Simple.

Facebook was not using KISS when designing its payment system. Libra seems awfully complicated, especially considering the much simpler alternatives that already exist. Yes, we know, Facebook has 2.4 billion users. But that doesn't mean they'll opt for the Facebook wallet—unless Facebook makes its alternative cheap enough to warrant the additional complexity. The company's website does state that its wallet “helps keep costs low by cutting fees.” Let's take a quick look at what was announced and some of the hurdles:

(1) *What is it?* Facebook divulged its plans for a new cryptocurrency called Libra. The company, along with Visa, MasterCard, PayPal and others, plan to set up a consortium—the Libra Association—that will govern the new cryptocurrency. Each of the firms will kick in about \$10 million to create the coin, which will be linked to a basket of established currencies, like the dollar, to make it stable.

Facebook will not control the coin or the consortium. Libra Association will be entirely separate from Facebook's social media operation. Consumers can buy and use Libra through whatever digital wallet they choose. One of those options will be Facebook's new wallet, Calibra, which will launch next year. Facebook sees Calibra offering a variety of services, including bill pay and the ability to purchase items by swiping a code on your cell phone, as is available with Apple and Google.

US consumers will convert dollars into Libras and store them in Calibra. When consumers want to take money out of the wallet, they'll need to exchange Libra for dollars. The app will show the exchange rate you'll receive. Using a bank's digital app seems a lot easier.

(2) *Trust.* Given its recent history, Facebook is going to have to work to convince the government and

consumers to trust its new system. If Facebook can't keep fake accounts off its system, why in the world would you trust them with your money? Facebook will require users to have a government-issued ID to sign up for Calibra. Doing so is necessary to comply with laws and prevent fraud.

(3) *Show me the money.* Facebook aims to make Calibra available everywhere in the world. One way it might be able to lure consumers to its new service is by offering lower fees than are charged by current financial intermediaries. The company's website says: "Transaction fees will be low-cost and transparent, especially if you're sending money internationally. Calibra will cut fees to help people keep more of their money."

If it aims to be a money transmitter, Facebook will face a regulatory morass. It will "have to comply with U.S. anti-money-laundering rules, verifying who is sending transactions through its platform and reporting suspicious transactions to the government. It also would have to form an internal anti-money-laundering program, train key personnel and conduct independent compliance reviews. The Treasury Department's Financial Crimes Enforcement Network has said those requirements extend to cryptocurrency companies," a 6/18 *WSJ* [article](#) reported.

Competitors are already responding. Earlier this week Blockchain firm Ripple bought \$30 million of shares and warrants in MoneyGram International, according to a 6/17 Reuters [article](#). The two are partnering on cross-border payments and foreign exchange settlements.

(4) *A history lesson.* Facebook is not the first to create an asset based on a basket of currencies. The International Monetary Fund created special drawing rights (SDRs) in 1969 as a reserve asset that would supplement IMF member countries' official reserves, according to its [website](#). At the time, the dollar was pegged to the price of gold and there wasn't enough liquidity in dollars or gold for either of them to be used as a reserve at the IMF or at other countries. So, the IMF created SDRs.

The value of one SDR initially equaled one US dollar or 0.88671 grams of gold. Shortly after it was created, however, the US broke the dollar's peg to gold and allowed our currency to float. The SDR was then tied to a basket of currencies. Today that basket consists of the US dollar, euro, Chinese renminbi, Japanese yen, and British pound sterling.

The broad use of SDRs as a reserve never materialized. There isn't enough liquidity in SDRs, creating new SDRs is cumbersome, and SDRs can only be used by the IMF, its members, and certain designated entities. It's far easier to use existing, floating currencies as reserves.

CALENDARS

US. Thurs: Leading Indicators 0.1%, Jobless Claims 220k, Philadelphia Fed Manufacturing Index 10.4, EIA Natural Gas Report. **Fri:** IHS Markit M-PMI & NM-PMI Flash Estimates 50.5/51.0, Existing Home Sales 5.25mu, Baker-Hughes Rig Count, Brainard, Mester. (DailyFX estimates)

Global. Thurs: Eurozone Consumer Confidence -6.5, UK Retail Sales Including & Excluding Fuel 2.7%/2.4% y/y, Japan All Industry Activity Index 0.70%, Japan CPI Total, Core, and Core-Core 0.7%/0.7%/0.5% y/y, ECB Publishes Economic Bulletin, BOE Bank Rate 0.75%, BOE Asset Purchase Target £435b, BOJ Rate Decision, Carney, Lowes. **Fri:** Eurozone, Germany, and France C-PMI Flash Estimates 52.0/52.5/51.4, Eurozone, Germany, and France M-PMI Flash Estimates 48.0/44.6/50.9, Eurozone, Germany, and France NM-PMI Flash Estimates 53.0/55.3/51.6, Canada Retail Sales 0.2%, Japan M-PMI Flash Estimate, Tenreyro. (DailyFX estimates)

STRATEGY INDICATORS

Stock Market Sentiment Indicators ([link](#)): The Bull/Bear Ratio (BBR) rose again this week as bullish sentiment moved back above 50.0%. The BBR climbed for the second week to 2.74 after sliding the prior five weeks from 3.16—which was the first reading above 3.00 since October—to 2.31 (lowest since mid-February). Bullish sentiment advanced 7.8ppts the past two weeks, to 50.5%, after a five-week plunge of 13.7ppts, from 56.4% to 42.7%—which was the fewest bulls since the first week of this year. The move to the bullish camp came entirely from the correction camp, which fell 7.7ppts the past two weeks to 31.1%, after soaring 13.0ppts the previous five weeks—from 25.8% to 38.8%—which was the highest percentage since just before Christmas. Bearish sentiment ticked down from 18.5% to 18.4% over the two-week period. The AAll Ratio climbed to 44.0% last week after a four-week decline from 65.0% to 34.6%. Bullish sentiment increased to 26.8% after decreasing three of the previous four weeks from 43.1% to 22.5%, while bearish sentiment fell to 34.2% after rising from 20.2% to 42.6% the prior six weeks.

S&P 500 Earnings, Revenues, Valuation & Margins ([link](#)): Consensus S&P 500 forward revenues were at a record high for the first time in 10 weeks, and forward earnings rose for a ninth straight week to their second straight record high since early December. Analysts expect forward revenues growth of 5.3% and forward earnings growth of 7.6%. Forward revenues growth is down 1.0ppt from a seven-year high of 6.3% in February 2018, but is up from a 31-month low of 5.0% in mid-February. Forward earnings growth is down 9.3ppts from a six-year high of 16.9% last February, but that's up from a 34-month low of 5.9% in late February. Prior to the passage of the Tax Cuts and Jobs Act (TCJA), forward revenues growth was 5.5% and forward earnings growth was 11.1%. Turning to the annual growth expectations, analysts expect revenues growth to slow from 8.3% in 2018 to 4.5% in 2019 and 5.3% in 2020. They're calling for earnings growth to slow sharply from 24.1% in 2018 to 3.0% in 2019 before improving to 11.0% in 2020. The forward profit margin was steady w/w at 12.2%, and is down just 0.2ppt from a record high of 12.4% in mid-September. That compares to 11.1% prior to the passage of the TCJA in December 2017 and a 24-month low of 10.4% in March 2016. Analysts are expecting the profit margin to fall from 12.2% in 2018 to 11.8% in 2019 before rising to 12.5% in 2020. The S&P 500's forward P/E rose 0.3 point w/w to 16.5, but is down from an eight-month high of 17.0 in late April. That's up from 14.3 during December, which was the lowest reading since October 2013 and down 23% from the 16-year high of 18.6 at the market's valuation peak in January 2018. The S&P 500 price-to-sales ratio improved w/w to 2.01 from 1.98. Still, that's up from 1.75 during December, when it was the lowest since November 2016, and down 19% from its then-record high of 2.16 in January 2018.

S&P 500 Sectors Earnings, Revenues, Valuation & Margins ([link](#)): Consensus forward revenues rose w/w for five of the 11 S&P 500 sectors and forward earnings for 4/11 sectors. Materials, Real Estate, and Utilities were the only sectors to have both measures rise w/w. Forward revenues and earnings are at or around record highs for 4/11 sectors: Consumer Discretionary, Health Care, Industrials, and Tech. Forward P/S and P/E ratios are now well above their multi-year lows during December 2018 for all sectors, and are near or above their 2018 highs for four sectors: Communication Services, Real Estate, Tech, and Utilities. Due to the TCJA, the profit margin for 2018 was higher y/y for all sectors but Real Estate. The outlook for 2019 shows higher margins are expected y/y for just 4/11 sectors: Consumer Discretionary, Financials, Industrials, and Utilities. The forward profit margin rose to record highs during 2018 for 8/11 sectors, all but Energy, Health Care, and Real Estate. Since then, it has moved lower for nearly all of the sectors, but early signs of a bottom are appearing. Here's how the sectors rank based on their current forward profit margin forecasts versus their highs during 2018: Information Technology (22.2%, down from 23.0%), Financials (18.7, down from 19.2), Real Estate (15.7, down from 17.0), Communication Services (14.8, down from 15.4), Utilities (13.0, matching its record high in mid-May), S&P 500 (12.2, down from 12.4), Materials (10.3, down from 11.6), Health Care (10.5, down from 11.2), Industrials (10.4, matching its record high in mid-March),

Consumer Discretionary (7.7, down from 8.3), Consumer Staples (7.4, down from 7.7), and Energy (7.2, down from 8.0).

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