# The negative price of oil pushes asset managers towards renewables

23 April 2020 by **ALESSIO TRAPPOLINI**

## Many governments are leveraging this situation to unlock fossil fuel subsidies and use the stimuli as an incentive for clean energy development programmes. Asset managers watch and wait

It was only for a few hours. And it involved only one contract, the one expiring in May 2020. But the historic scale of the decline of **WTI oil futures contract prices below zero** caused a huge uproar among investors.
Also because, according to observers, it represents the compelling factor that will force the corporate world to a definitive shift **towards green investments.**

**Oil below zero, what is happening?**
The oil market is in an exceptional situation. Nobody, not even the most pessimistic analyst would have ever dared to forecast the **WTI price** – for the contract expiring soonest, in May – to be negative by as much as 37 dollars.
The sell-off occurred for strictly practical reasons. "What happened on the WTI futures contract was caused by the financial investors' inability to take delivery of the oil contemplated in the futures contract. None of us financial operators is in any condition to **physically take delivery** of the oil upon expiry of the futures contract. Consequently, we must all roll the position or close it", explained Luca Riboldi, Head of Investments at Banor Sim.

**And if nobody wants to buy?** This is the problem that occurred on Monday evening. Almost nobody was willing to buy the futures contracts expiring on Tuesday because nobody could cope with the physical delivery.

**Market distortion**
"This inefficiency, which is merely technical in nature, is only indirectly related to an **imbalance between supply and demand** in the oil market. On the contrary, it depends on how predominant financial positions are compared to those of commercial operators. The more the former prevail, the more distortion there is, given that only commercial operators can actually take physical delivery", as the Banor expert explained.

**What will be the consequences of Monday's sell off?**
Riboldi identified at least three.
**Danger of redemptions.** Some professional financial operators may have registered significant losses on Monday. They will be reflected in the need to liquidate positions onto other asset classes to cope with any redemptions;

**Tension on ETFs.** The situation in the US oil market could become considerably worse. Many oil companies will go bankrupt without honouring their debts. This will have an impact on the performance of US high yield ETFs, in which many of these obligations are included;

**Focus on cash price.** It is most likely that the price of oil will continue to drop in the coming days. The June expiration date is currently quoted at 21 dollars. Most of that price includes high storage costs. The price of oil on the cash market is what counts and it will drive the movements of the futures. It is equally very probable that, in the coming days, we will witness further drops in the price of oil inasmuch as the demand from some high-consumption sectors, such as airlines, will remain completely absent. The only good news could come from the US, where they are contemplating both cutting production and increasing strategic reserves.

**The asset managers' moves**

For the stock market, i.e. the shares in oil companies, some companies are anticipating **negative scenarios** and they could proceed to cut their dividends.

"We estimate that the big integrated oil companies like **BP** and **Shell** are quoting the price of oil at about 45 dollars per barrel, and we note that the long-term price of crude oil is 55 dollars per barrel. The cuts in the supply of black gold are tougher and more structural than cyclical in this recession period, a factor which deprives oil production of the potential for recovery in 2021 and beyond. These cuts will have a lasting effect that will extend beyond the Covid-19 crisis", argued Tal Lomnitzer, Senior Investment Manager of the Global Natural Resources Team at Janus Henderson Investors.

**Shift towards renewables**

It is quite probable that the low prices of crude oil will accelerate the existing trends, given that governments are leveraging this situation to unlock fossil fuel subsidies and use the stimuli as an incentive for **clean energy** development programmes.

"JHI Global Resources strategy has been **downplayed** with respect to oil producers, with a preference for those companies that benefit from the **low-carbon transition** currently underway, like **developers of renewable energies** and suppliers of equipment, or gas producers", continued Lomnitzer. "We are not exposed to oil services companies where the burden of lower spending from oil companies will be felt. Funds are highly liquid. The risk/return ratio is continually reassessed, considering that moves which sometimes require months or years to implement have been undertaken in days or weeks", he noted.