SAFETY ▪ STRENGTH ▪ STABILITY

UNIT TRUST CORPORATION

ADVISORY SERVICES DEPARTMENT

Newsletter

www.ttutc.com/advisory-services

Q1 2016 | ISSUE 5

Low Oil Prices, the New Normal?

The oil industry is full of economic booms and busts. Over the period of 2010 to 2014, world oil prices remained relatively stable at $110 a barrel as shown in Chart 1. However, in 2015, oil prices plunged globally by almost 70 per cent in the wake of rising oil production and concerns about global economic growth. As at February 15, 2016 crude oil stood at $29.67 per barrel, a price that has not been seen since the Great Depression (1929-39). The Energy Information Administration (EIA) projects that average oil prices will hover around $70 per barrel in 2020, while oil executives anticipate that it could be much longer until prices return to a range of $90 or $100 per barrel.

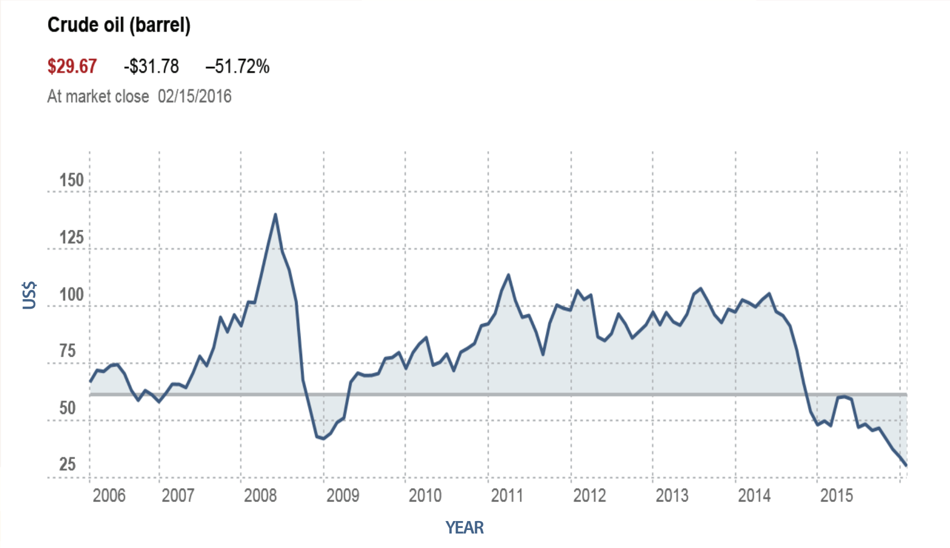

CHART 1 | Historical Oil Prices 2006 – 2016

What is the Reason for the Drop in Oil Prices?

The slump in oil prices can be attributed to the simple economic factors of demand and supply. We are experiencing a sluggish world economy, where markets have been consuming much less oil than projected, coupled with the OPEC, which has produced more oil than markets expected. There are three main reasons for the continued slump in oil prices, which are:

1. Increased U.S. Oil Production

The United States' domestic production has nearly doubled over the last several years as they have been able to extract oil from shale formations previously considered unviable. This shale oil* drilling has increased the United States' oil production by a third as shown in Chart 2, to nearly 9 million barrels a day, which is just 1 million less than Saudi Arabia's output. As a result, Saudi, Nigerian and Algerian oil that once was sold in the United States is suddenly competing for Asian markets, and producers are forced to drop prices.

2. OPEC's Refusal to Cut Production

Another leading factor in the decline of crude oil prices is that the Organisation of the Petroleum Exporting Countries (OPEC), a cartel of oil producers, is unwilling to stabilise the oil markets by restricting supply. Prices of OPEC's benchmark crude oil have fallen 50% since the organisation decided against cutting production at a 2014 meeting in Vienna (see Chart 3 for historical production levels). If OPEC does not cut production, the result is a further oversupply of oil, placing downward pressure on crude oil prices for the long term.

** Shale oil is an unconventional oil produced from oil shale rock fragments by pyrolysis, hydrogenation, or thermal dissolution. These processes convert the organic matter within the rock (kerogen) into synthetic oil and gas. The resulting oil can be used immediately as a fuel or upgraded to meet refinery feedstock specifications by adding hydrogen and removing impurities such as sulfur and nitrogen. The refined products can be used for the same purposes as those derived from crude oil.* **Source: Wikipedia**

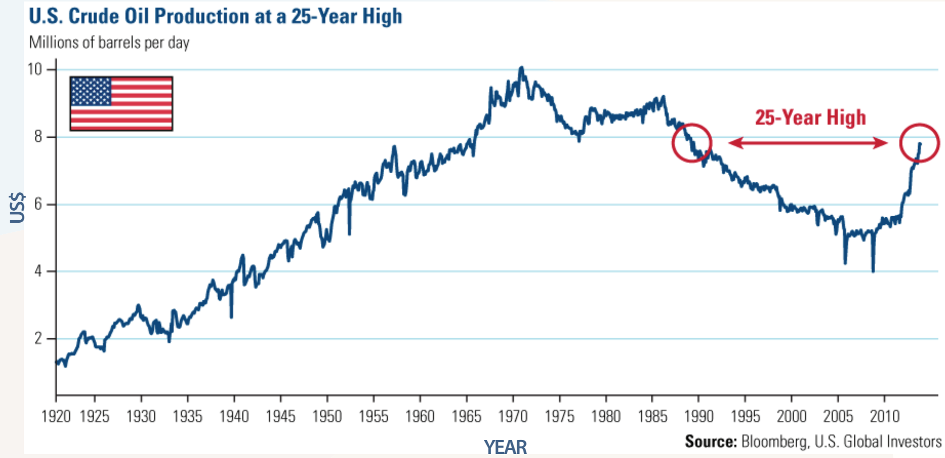

CHART 2 | U.S. Crude Oil Production 1920 - 2015

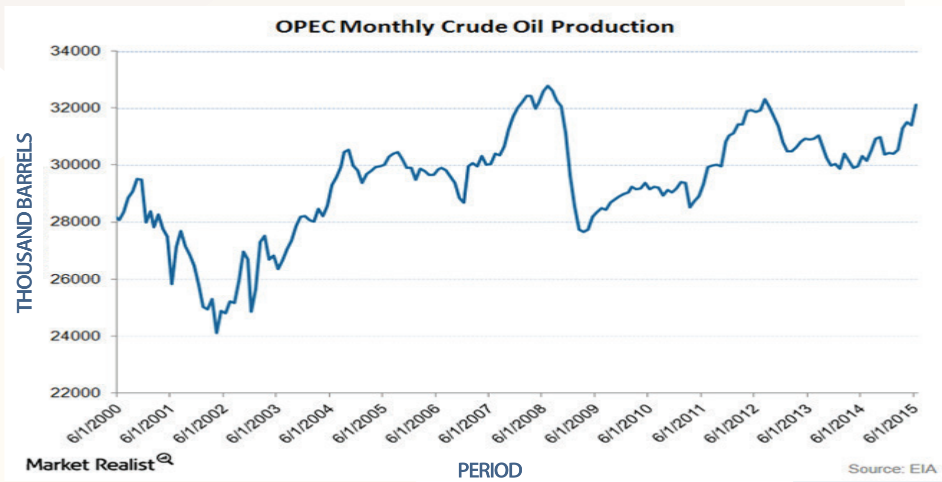

CHART 3 | OPEC's Crude Oil Production 2000 - 2015

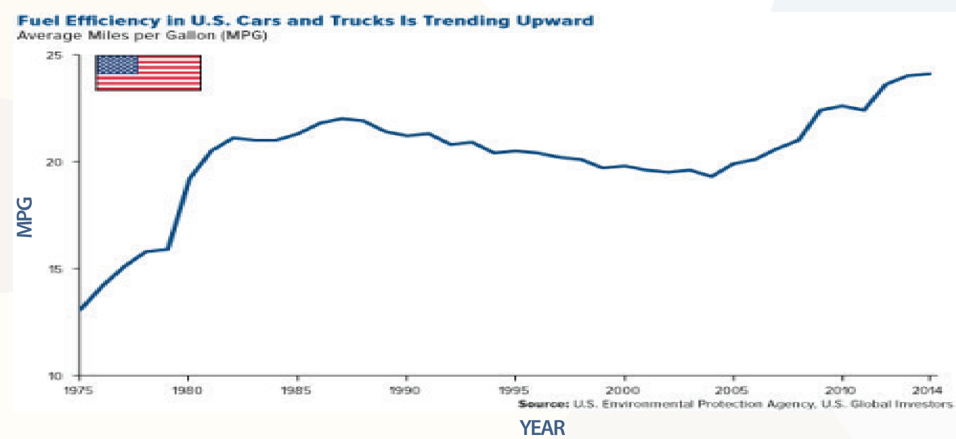

CHART 4 | U.S. Vehicle Fuel Efficiency 1975 - 2015

3. Declining Demand for Oil

While supply is increasing, demand for crude oil is decreasing. The economies of Europe and developing countries are weakening. China's devaluation of its currency suggests its economy may be worse off than expected. Given that China is the world's largest oil importer, it is a huge hit to global demand. In addition, vehicles are becoming more efficient, which has caused the demand for fuel to lag; see Chart 4.

How Will This Impact Global Economies and Financial Markets?

Countries that are net importers of oil will benefit somewhat from higher household income, lower input costs and improved external positions. US consumers are expected to have more disposable income as they spend much less at the gas stations. However, the most impacted would be low to middle income earners, where the amount spent at the pump is a higher percentage of their disposable income. Consequently, oil exporters will generate less revenue, and their national budgets and external balances will be under pressure. Currency pressures will also be significant for oil exporters such as Russia, Venezuela and Trinidad and Tobago, increasing the risks to financial stability.

Ultimately, an investor must understand the dynamics of the financial markets before making any sudden decisions to buy or sell their investments. While some stocks may be perceived to be winners due to the low oil prices, they also have the potential to trap investors. For example, it is expected that airline company stocks will perform well as fuel costs have gone down. However, these same airline company stocks will be negatively impacted if there is an overall cutback in business and leisure travel as individuals and companies view the global economic outlook as negative. Ultimately, investors should position their investment portfolios for an extended period of lower consumer prices, lower interest rates and lower inflation.

How Does This Impact Your Investments at UTC?

To benefit from the drop in oil prices, it is important that you analyse your current investments, as well as look to potential investments in the market to enhance your returns. Generally, stock markets have recovered from every downturn to surpass previous highs. The investors that buy when the market is down go on to do better in the long run than those who sit out or, worse, sell when things get bad. It is impossible to accurately predict when the market will revert. It is better to ride the temporary ups and downs, understanding that our Funds such as the Growth and Income Fund and North American Fund, which have exposure to equities, are about long-term growth, not short-term performance.

Based on the outlook for the global economy and financial markets, investors should stay diversified, but with a significant exposure to our equity funds and likely a lower exposure to real assets, such as real estate, which perform better during periods of higher inflation. Additionally, investors should consider Exchange Traded Funds (ETFs), which provide full diversification at a minimal cost and positions can also be acquired or sold off at any time.

Don't panic
This is a current event that may not be around for the long term. Your long-term investments should emulate a long-term view of the markets.

Average Down
Selling off your investments after they have already taken a hit is likely to be more harmful. It is better to either hold your position or buy some more to reduce your average cost of investment.

Reduce Risk
If you do have a short-term goal, you should look at switching your investments to short-term, low-risk mutual funds, such as our US Dollar Income Fund and TT Dollar Income Fund.

Monitor
It is important that you keep up to date with what is going on with your investments and in the economy generally, so you are not acting on dated information.

Talk to Your Financial Advisor
Your Financial Advisor will ensure that you make decisions on your investment portfolio based on your long-term goals and objectives and not based on short-term fluctuations in the markets. Your Advisor can also recommend investment strategies that will assist you in weathering market fluctuations and managing your portfolio risk.

Mail: Ms. Amoy Van Lowe
Vice President
UTC Advisory Services
3rd Floor, UTC Financial Centre
#82 Independence Square
Port of Spain

Tel: 624-8648 Ext. 8113

Email: yourwealthmanager@ttutc.com

www.ttutc.com/advisory-services

About the Advisory Services Department

The Advisory Services Department of the Trinidad and Tobago Unit Trust Corporation was established to serve our valued clients seeking financial and investment advice and solutions from a trusted service provider. We will assist you in enhancing your personal wealth and financial well-being by providing you with financial counselling, investment advice and solutions.

SAFETY ▪ STRENGTH ▪ STABILITY

UNIT TRUST CORPORATION