



CURRENT MARKET NEWS - Equity Research

U.S. Iran conflict – oil risk premium on the rise

Jon Borchardt, Senior Analyst, BMO Wealth Management – U.S.

Michael P. Stritch, CFA, Chief Investment Officer, BMO Wealth Management - U.S.

Monday, January 6, 2020

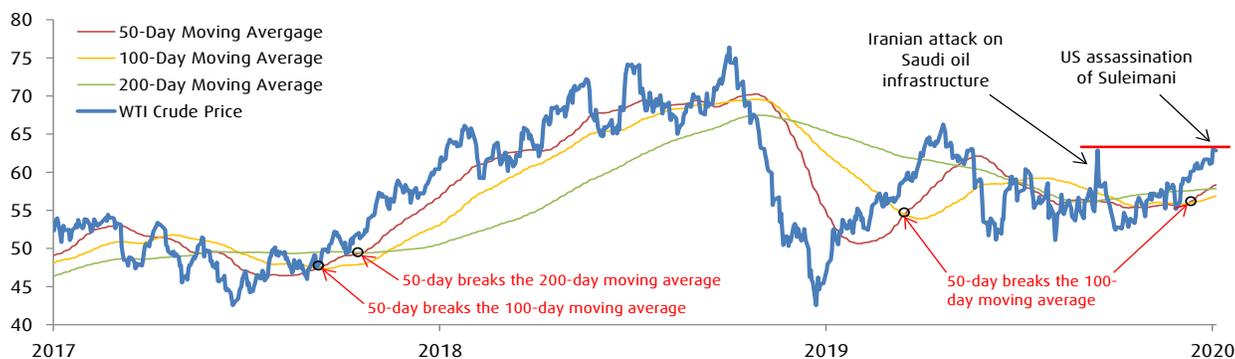
- U.S. Iran tensions flare again to start 2020
- Late 2019 crude spike supported by fundamentals, but future supply growth could limit gains
- Oil price risk premium has increased, but short term move may be down

On January 2 a U.S. drone strike eliminated Iran’s top military leader, General Qassem Suleimani. The assassination came as a result of Iranian proxies in Iraq crossing President Trump’s stated redline by killing a U.S. contractor and injuring three service members. In the wake of Suleimani’s “removal from the battle field” there has been a flood of wide-ranging speculation as to how the Iranians may retaliate. Attacks on oil assets held by U.S. companies and allies have topped the list for many pundits. This in turn has pushed oil prices higher as traders add a risk premium to account for the potential loss of barrels from the market. A similar occurrence was seen last September after Iran launched an attack on Saudi Arabia’s Abqaiq processing facility and Khurais oil field. That event caused approximately half of Saudi Arabia’s production to be temporarily offline (~4.1M barrels/day). This time around there has not yet been any tangible impact on global oil output as a result of the increased U.S. & Iran tensions. As such, oil prices may have peaked in the short term and could retrench as the market waits for Iran to make its next move.

Recall last September’s price spike was short lived as well (*see Chart 1*). Oil prices rolled over then due to a consensus view that, even with a temporary reduction in Saudi output, world oil markets were fully supplied and future demand growth was waning. Since that time increased confidence that China and the U.S. will conclude a “phase 1” trade deal, coupled with better global economic data, has powered a strong oil rally. A more positive late 2019 view on oil was also supported by additional OPEC+ output cuts announced in early December, which occurred alongside declining U.S. inventories. However, 2020 will witness significant new supply growth from non-OPEC countries including Norway, Brazil, Guyana, Canada, and the U.S, and these dynamics may cap any significant upward move for crude.

Adding it all up, a few dollar risk premium added to oil prices due to the recent U.S. Iran conflict seems like a reasonable outcome, but the market will likely need actual oil supplies to be impacted for prices to move much higher. Over the near term the upward oil price spike may actually lose momentum until the next move is made.

Chart 1: WTI Crude - Increased geo-political risk drives oil higher



Source: Bloomberg, JB (Chart 610) - CL1 Comdty (Generic 1st 'CL' Future) 1 Yr WTI Chart Daily 11FEB 2017 - 06Jan2020

For more insights and information, follow - [BMO Wealth Management - U.S. on LinkedIn](#).



Disclosure

CFA® and Chartered Financial Analyst® are registered trademarks owned by CFA Institute.

This report contains our opinion as of the date of the report. It is for general information purposes only and is not intended to predict or guarantee the future performance of any investment, investment manager, market sector, or the markets generally. We will not update this report or advise you if there is any change in this report or our opinion. The information, ratings, and opinions in this report are based on numerous sources believed to be reliable, such as investment managers, custodians, mutual fund companies, and third-party data and service providers. We do not represent or warrant that the report is accurate or complete.

To the extent this report contains information about specific companies or securities, including whether they are profitable or not, it is being provided as a means of illustrating the investment manager's investment thesis. The investment manager may or may not have invested in these securities at the time this report was prepared or is accessed by the reader. References to specific companies or securities are not a complete list of securities selected and not all securities selected in the referenced timeframe were profitable.

Other Bank of Montreal affiliates, and their agents and employees, may provide oral or written market commentary or trading strategies to clients that reflect opinions that are contrary to the opinions expressed in this report. These same persons and affiliates may make investment decisions that are inconsistent with the recommendations or views expressed in this report. We and our affiliates, directors, officers, employees and members of their households, will from time to time have long or short positions in, act as principal in, and buy or sell, the securities referred to in this report. We and our affiliates, directors, officers, employees and members of their households, may have positions in the securities mentioned that are inconsistent with the views expressed by this report.

This report is not intended to be a client-specific suitability analysis or recommendation, an offer to participate in any investment, a recommendation to buy, hold or sell securities, or a recommendation of any investment manager or investment strategy. Do not use this report as the sole basis for your investment decisions. Do not select an asset class, investment product, or investment manager based on performance alone. Consider all relevant information, including your existing portfolio, investment objectives, risk tolerance, liquidity needs and investment time horizon.

Any forward-looking statements in this report involve known and unknown risks, uncertainties and other factors that may cause the actual performance of future markets to differ materially from the projections depicted in the report. Past performance is not indicative of future results and current performance may be higher or lower than that shown in the report. There can be no certainty as to the extent or depth of any market downturn, nor any assurance regarding the nature, extent or timing of markets rebounding. When evaluating the report, you are cautioned not to place undue reliance on these forward-looking statements, which reflect judgments only as of the date of the report. Investment returns fluctuate, and investments when redeemed, may be worth more or less than the original investment.

Standardized performance returns include reinvestment of dividends, other income and capital gains, which depict performance without adjusting for the effects of taxation or the timing of purchases and sales. Performance data is presented without deducting the investment advisory fees and other charges that may be applicable. The deduction of such fees and other charges (and the compounding effect thereof over time) will reduce portfolio return. Unless otherwise indicated, traditional investment performance data generally represents a composite or representative portfolio return and is shown gross of the investment manager's advisory fees. Unless otherwise indicated, alternative investment performance data is shown as net of fund expenses, management fees, and incentive fees. Index performance data is shown as total return. You cannot invest directly in an index. Due to a system conversion, the ability to manipulate or restate client specific performance data prior to December 31, 2007, may be limited.

Any discussions of specific securities, investment managers, or strategies are for informational purposes only and should not be considered investment advice. The report does not constitute an offer to sell or a solicitation to buy any security or investment product. Any offer to sell or solicitation to buy an interest in any private security, investment product or fund may only be made by receiving a confidential private offering memorandum, prospectus, investment advisory agreement or similar documents from the investment manager, which describes the material terms and various considerations and risks relating to such security, investment product or fund.

Alternative investments, such as private equity and hedge funds, contain risks that are amplified when compared with other asset classes, such as illiquidity, stock or sector concentration, financial leverage, difficulties in valuation, and short selling. Alternative investment vehicles have minimal regulatory oversight and alternative managers have the latitude to employ numerous investment strategies with varying degrees of risk.

We are not licensed or registered with any financial services regulatory authority outside of the United States. Non-U.S. residents who maintain U.S.-based financial services accounts with us may not be afforded certain protections conferred by legislation and regulations in their country of residence with respect to any investments, investment solicitations, investment transactions or communications made with us.

You may not copy this report or distribute or disclose the information contained in the report to any third party, except with our express written consent or as required by law or any regulatory authority.

"BMO Wealth Management" is a brand name that refers to BMO Harris Bank, N.A., BMO Family Office, LLC, BMO Harris Financial Advisers, Inc., BMO Delaware Trust Company, and certain affiliates that provide certain investment, investment advisory, trust, banking, securities, insurance and brokerage products and services. "BMO Family Office" is a brand name that refers to BMO Harris Bank, N.A., BMO Family Office, LLC, and BMO Delaware Trust Company. The BMO Family Office brand provides family office, investment advisory, investment management, trust, banking, deposit and loan products and services. These entities are all affiliates and owned by BMO Financial Corp., a wholly-owned subsidiary of the Bank of Montreal. Capital Advisory Services are offered by a division of BMO Harris Bank, N.A. Member FDIC.

NMLS #401052



Broker-dealer and investment advisory services and insurance products are offered through BMO Harris Financial Advisers, Inc. Member FINRA/SIPC. SEC-registered investment adviser.

Securities, investment advisory services and insurance products are offered through BMO Harris Financial Advisers, Inc. Member FINRA/SIPC. SEC-registered investment adviser.

Not all products and services are available in every state or location or through all entities within BMO or BMO Family Office. Securities, investment, and insurance products offered are: **NOT A DEPOSIT – NOT INSURED BY THE FDIC OR ANY FEDERAL GOVERNMENT AGENCY – NOT GUARANTEED BY ANY BANK – MAY LOSE VALUE.**