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Notes from the road: Four themes shaping the next phase of energy markets



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- Markets are pricing in a rapid normalisation of Middle East oil supply following the US-Iran conflict. The talk at a resources industry conference highlights that risks remain.
- Medium-term support for the oil price comes from slowing production of US shale, which is encountering tougher geology, and a need to rebuild depleted inventories.
- Power is emerging as a key bottleneck for the AI/ datacentre industry. In the US, the hyperscalers are increasingly turning to natural gas as a solution.

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Industry leaders at J.P. Morgan's Energy, Power, Renewables & Mining Conference in New York were surprised that the oil price has declined so rapidly following the biggest oil outage in history. This has been attributed to the Trump administration talking up peace hopes, rapid inventory draws in the US and China, and Chinese state-sponsored demand rationing. Speakers highlighted risks to a rapid normalisation of oil flows, and a belief that the mid-cycle oil price has likely moved higher.

For me, four themes stood out that shape the outlook for energy markets.

1 The oil market is priced for perfection; a sobering up may be coming

Energy majors ExxonMobil, Chevron and ConocoPhillips were surprised that the oil price did not react more aggressively to the closure of the Strait of Hormuz¹. ConocoPhillips believes oil is currently 'priced for perfection' (i.e., the market is assuming barrels will return quickly) and it expects a 'sobering up' of expectations in the second half of the year. Jamie Dimon, Chairman and CEO of JPMorgan Chase, who was present at the diplomatic dinner where US President Donald Trump signed the Islamabad Memorandum to end hostilities with Iran, issued another note of caution: in his view, a lasting peace cannot be guaranteed, and the potential for flare-ups should not be discounted.

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2 The mid-cycle oil price has likely moved higher

Most attendees agreed that the mid-cycle oil price has moved higher following the conflict, reflecting a geopolitical premium and the need to rebuild inventories. My view is that US\$75/barrel is a realistic mid-cycle price for Brent, versus a prior US\$70/barrel mid-cycle assumption.

This price level is underwritten by US shale, which remains the marginal barrel (the last barrel of oil needed to balance global supply and demand). US shale is not growing much in aggregate. However, shale's high decline rate (i.e., existing production declines rapidly unless offset by new drilling) of c.30% means that it continues to set the medium-term price.

US shale breakeven prices are rising as exploration & production companies (E&Ps) have drilled the best locations and are now encountering tougher geology. There is an ongoing battle between improving shale technology and deteriorating geology. Geology is currently winning, pushing tier-2 breakeven prices higher in recent years. Several E&Ps at the conference said that tier 2 shale producers need a West Texas Intermediate price of US\$65-70/barrel to break even, which equates to roughly US\$70-75/barrel for Brent crude. After including a modest geopolitical premium, we arrive at about US\$75/barrel mid-cycle.

3 Middle East producers face different paths to recovery

Anecdotes shared at the conference pointed to sharply differing oil-producer intentions following the US-Iran conflict. Saudi Arabia wants to increase production rapidly to demonstrate it remains the key player in global oil markets. Iraq will be the slowest to ramp up, as a meaningful proportion of its wells were damaged and will require intervention. The United Arab Emirates, which exited OPEC in May, will boost production, but will take 3-5 years to reach its 5 million barrels/day target.

Tankers using the Strait of Hormuz are reportedly charging around five times the normal rate to enter the Strait (US\$20/barrel versus US\$4/barrel), reflecting the perceived risk of becoming stuck for a prolonged period. Flow through the Strait so far has been predominantly outbound, though some vessels operating under long-term shipping contracts, notably Chinese ships, have returned. ConocoPhillips' CEO, recently back from the Middle East, indicated that 1-2 million barrels/day of regional production was bombed and will take 1-2 years to come back online.

4 Gas infrastructure, refining and oilfield services: interesting opportunities for investors

Gas-to-power (using natural gas to generate electricity) for data centres was a recurring theme. Chevron has signed a deal with Microsoft to power one of the largest US data centres, located in the Permian Basin to take advantage of cheap natural gas prices. Energy infrastructure company Williams – a key player in transporting and processing natural gas in the US – appears to be making good progress on its behind-the-meter power solutions (onsite electricity generation systems at customers' facilities), while Baker Hughes is gaining momentum in the gas turbine market.

Refining markets are expected to remain strong for several years, supported by outages in Russia and the Middle East, low inventories and limited planned capacity additions. For the oilfield services sector, the outlook for oil & gas capital expenditure is improving as upstream producers seek to rebuild depleted reserves, the Middle East reactivates capacity, and new frontiers develop in Venezuela and Argentina. The CEO of sector leader SLB expects a "mini super-cycle".

Looking ahead

We expect continued volatility in energy markets and in energy equities, creating opportunities for long-term investors. Themes we are paying attention to include: powering AI/data centres, which region will drive growth after US shale plateaus, and which companies have the resource depth and execution skills to deliver shareholder value.

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