Oil & Gas Market
– Quarterly Update

OILPRICE.com

From the Analysts at OilPrice.com

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If you're reading this update, you probably want some idea of where oil and natural gas are heading in the mid- to long-term.

And while our time machine is currently on the fritz and we can't tell you with certainty what a barrel of oil is going to cost 3 – 6 months from now, our more than 400 assets around the globe have given us many clues that we'll share with you here.

Here's what you're about to learn…

First, we'll give you our prediction right upfront, along with six key reasons we came to the conclusion we did.

Second, only a fool would try and predict the future without a clear understanding of the past. That's why we'll walk you through the past several decades' worth of oil price "cycles" – an industry term for what might be called recessions in the stock market. This will help you understand where today's oil price levels fit into a larger context.

Third, we'll give you a quick education on the dynamics of supply and demand in the oil markets, which should really help you understand how we reached our conclusions.

Fourth, we'll take you inside of OPEC, and reveal why they hold the key to oil prices moving forward – here's a hint: It's not the demand side of the equation that's going to move the needle.

Fifth, we'll share our "Elite 8" oil and gas companies that we think make good investments if our analysis pans out.

And finally, we'll briefly touch on our forecast for natural gas moving forward.

James Stafford here again...

I'm the Publisher of OilPrice.com…

And I'm glad you're part of the OilPrice family.

Over the past two decades I've built up my own Intelligence network of 400 global assets.

All in-the-know people who bring us unique research, information on breaking deals, merger and acquisition whispers, boots-on-the ground reports, exclusive data and more.

In short, these assets… combined with our own operatives… bring our clients the Intel they need to increase revenue and profitability.

My team has worked anonymously behind-the-scenes…

Providing Intelligence packages for the Central Intelligence Agency, the Department of Defense, Exxon, Chevron, and British Petroleum… To name just a few of our hundreds of clients.

But we've just recently begun an experiment:

Publishing some of our basic research to regular, everyday individual investors for free...

Including the Quarterly Report you are now reading.

So please let us know if you like it by sending an email to tkool@oilprice.com.

(Also, don't be shy about telling us what we can do better to help you profit from the energy and natural resource sectors.)

Regards,

James Stafford
Publisher, OilPrice.com

And Our Crystal Ball Says…

The crude oil price cycle that started in mid-2014 appears to be coming to an end.

Our forecast is that West Texas Intermediate (WTI) will rebound to $50/bbl (per barrel) by the end of June, 2016 and will ramp to $70/bbl by year-end.

But forecasting is a tough business, and despite our hundreds of assets across the globe, we still haven't gotten our hands on a crystal ball.

Collectively, our team here at OilPrice.com has survived six major downward oil price cycles and several small ones.

Each cycle is different, but they call them "cycles" for a reason – they eventually come to an end and then the price of oil re-

sumes its relentless march higher.

Why should the long-term trend be forever up and to the right?

Well, there are a couple of very good reasons that also happen to be very easy to understand…

1. **This world runs on oil.** It is the primary source of energy on this planet. And as hard as we try, we cannot come up with a substitute. American's high standard of living depends on a steady supply of oil based fuels and products.

2. **The cheap oil has been harvested.** It will take much higher oil prices than we've seen in the past to attract the capital necessary to find & develop the oil supplies of the future. By 2020, humans will be consuming over 100,000,000 barrels per day of hydrocarbon based liquid fuels, the majority of which will be refined from crude oil.

But knowing that the long-term trend is up… that, eventually, the entire oil and gas sector will come roaring back in favor… might not in and of itself give you a plan of action when it comes to investing in this space.

That's where these quarterly updates on the oil and gas market come in.

With them, we hope to give you an edge in the market. Most investors, as in most areas of the market, just follow the herd.

The way to get in front of the herd in the oil markets in particular is to arm yourself with as much accurate information as possible about the direction of commodity prices.

With access to information like you're reading right now, you're in a great position to profit from one of the most explosive sectors of the market.

Each Oil Price Cycle is Different

Having some idea of where commodity prices are heading is critical to investors trying to make money on energy stocks.

And the first step to knowing that is understanding where things have been, and why.

In general, not many analysts expected oil prices to go as low as they have, primarily because few of us actually thought that Saudi Arabia would be willing to accept the huge impact that cheap oil would have on their wealth.

Through the end of 2015, the Saudi Foreign Wealth Fund has lost over $150 Billion. If oil stays under $40/bbl, it is estimated that the nation's wealth will decline by another $200 Billion in 2016.

Whenever you think you've had a bad day in the market, think what it must feel like to lose $500,000,000 every day, day-after-day.

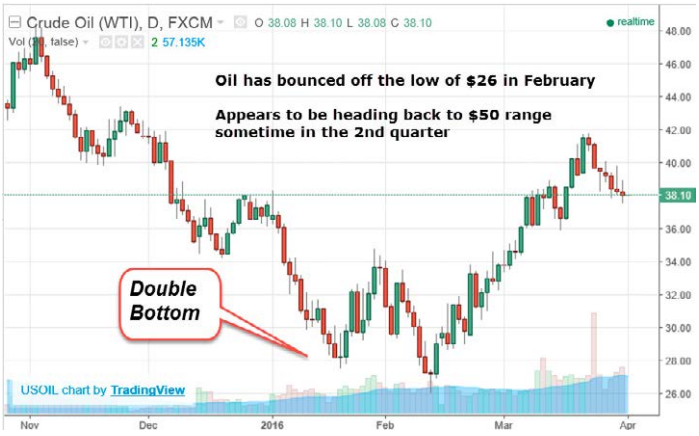
Oil prices started coming down in early 2014 because the U.S. shale plays were adding more oil supply and because the costs of finding and extracting oil were coming down.

In other words, global supply began to exceed global demand. It was simple economics 101.

Then the dynamics of the global oil market changed dramatically in November 2014. That's when OPEC announced that it intended to "defend market share" and allow oil prices to weaken, rather than cut output to support higher prices.

Global oil prices had enjoyed a stable average at or above $100 per barrel for more than four years. After OPEC's announcement, the price immediately fell into the mid-$60 range and went to the mid-$40s before finding a support level.

In the 2nd quarter of 2015, oil prices rebounded and appeared to be stabilizing in the low $60s. All indications were that they would hold in that range.



At the June, 2015, however, OPEC member Saudi Arabia decided to produce above their quota and the other OPEC members did the same in self-defense, because most of them needed every penny of revenue they could get.

All of this additional supply pushed oil's price off of a cliff until it bottomed in February, 2016.

Everyone knows that Saudi Arabia controls OPEC, so if all they wanted to do was stop the rapid growth in U.S. shale oil production growth, $60/bbl would have done the trick.

However, Saudi Arabia may have other agendas, like "putting the hurt" on Russia and Iran. Maybe they just wanted to remind the United States that this world runs on oil and they are a lot more important to global energy supplies than Iran.

And we're sure that Mr. Obama's *"Iranian Nuke Deal"* did not sit well with the Kingdom.

Fact: Oil is critical to the global economy, so the industry will survive.

This world runs on oil. And the OPEC nations, which produce approximately 40% of the world's supply, cannot meet future demand on their own.

The fallout from an extended period of low oil & gas prices has created tremendous investment opportunities for investors that do their homework.

During times of distress, even high-quality companies become oversold.

Finding the survivors is hard work, but that's where market beating results are going to come from, and that is why we continue to work hard to find them.

The Oil Market is Cyclical

Michael Economides, an expert on the international petroleum markets and author of "The Colors of Oil", once said that it was much easier to forecast oil prices over the long-term than to forecast what they will be a few months from now.

Michael died late in 2013, but if he were alive today, we're sure he would get a kick out of predictions by some analysts that we will never see oil selling for more than $100/bbl again.

Many of these same analysts were saying we'd never see oil under $100/bbl less than three years ago.

While we don't necessarily see oil at $100/bbl very soon, NEVER is a long time.

What we do know is that oil under $50/bbl is unsustainable.

Oil price cycles normally last two years

In the short-term, both oil supply and demand are essentially fixed. Here's what we mean…

In terms of demand, the number of cars and trucks on the road, the number of airplanes in the sky, and the number of homes heated by oil don't change materially from month-to-month. Consumers may do a bit more traveling when fuel prices are lower, but not enough to make a big impact on demand in the short-term.

Likewise, the output capacity of all the world's producing oilfields is more or less fixed within a short time frame. Even Saudi Arabia cannot increase production on a moment's notice by turning a few valves.

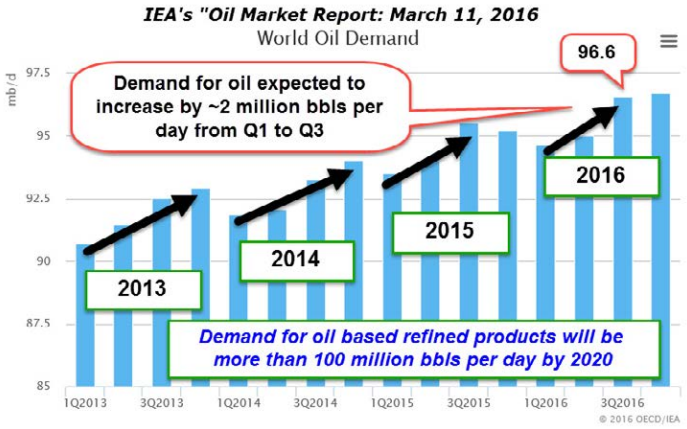
Even though the world consumes an enormous amount of hydrocarbon-based liquid fuels (currently over 95 million barrels per day), a relatively small increase in supply (less than 2%) had a dramatic impact on the price of oil.

On the flip side of this equation, a relatively small *decline* in supply can also have a dramatic impact on price.

Add the fact that the **International Energy Agency (IEA)** is forecasting a 2.0 million barrel per day increase in demand over the next few months, and our forecast of higher oil prices by the end of this year has a high probability of being the outcome.

Also, few people realize that demand for oil is seasonal. As you can see in the chart below, each year there is a spike in demand for hydrocarbon based fuels in the summer months.

This increase in demand is the primary reason that we believe the global oil markets will be back in balance within six months. Oil traders know this, and they have already begun to bid up the price of WTI futures contracts.



Price does impact supply

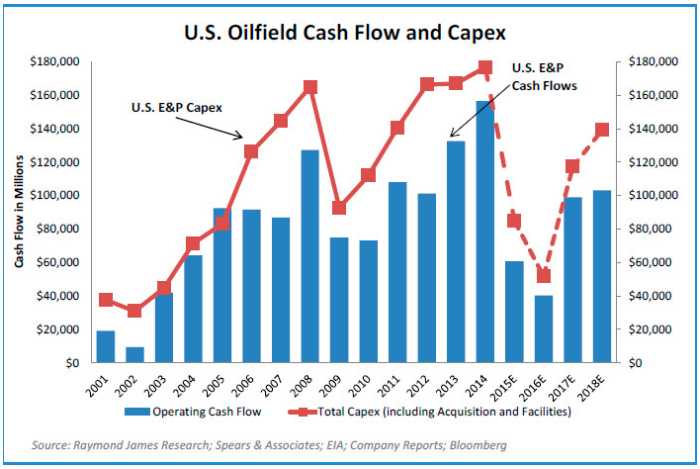
Over time, the global oil market is elastic. When the price of oil falls, the upstream companies (the producers) take actions that reduce oil supply.

Due to the multi-year development and depletion lifecycles of most major oil projects, there is a fairly slow supply-side feedback loop in response to changes in oil prices. However, this is an extremely capital intensive business, and capital is quickly taken away from resource development projects that no longer make economic sense.

Upstream budgets have been slashed to the bone, and this will have an impact on supply, which will not be quickly remedied. The active drilling rig count in the United States is down more than 70% since mid-2014, and it appears to be headed to an all-time record low.

North American oil production overall is now on a steady decline, and we expect the rate of decline to accelerate throughout the summer.

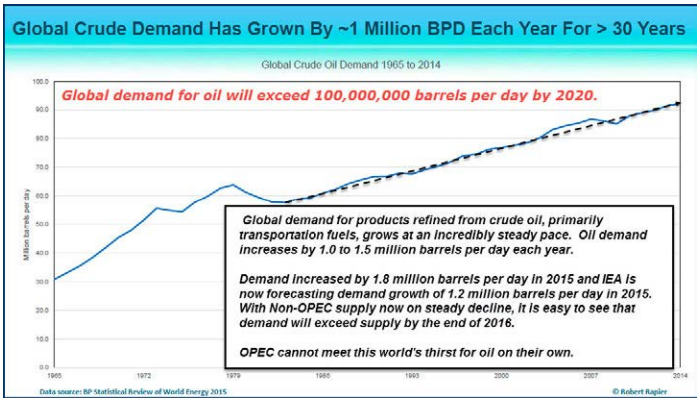
But at the same time, *demand* for oil is increasing…



The slow response on the supply side is why oil price cycles, including this one, always overshoot the mark.

When supply & demand come back into balance, the upstream companies cannot shift gears fast enough to regain supply growth. Demand growth, on the other hand, is "relentless".

And as demand zooms past supply, we will need dramatically higher oil prices to attract capital again.



It's important to bear in mind that oil is unique as an asset because it's a **depleting** resource consumed in enormous volumes. Each and every day, this world uses about 95 million barrels of oil, and without the constant renewal of that supply through ongoing investment of new capital in upstream drilling and development, global oil supply-capacity naturally shrinks.

Across the entire global oil industry, we have to keep investing hundreds of billions of dollars annually just to maintain the output status quo.

The seeds of the next oil shortage have already taken root.

You've probably heard the argument that the U.S. shale industry has altered the global oil market because our upstream companies are nimbler and can ramp up supply much faster than in the past.

But analysts who say this seem to ignore several very important facts…

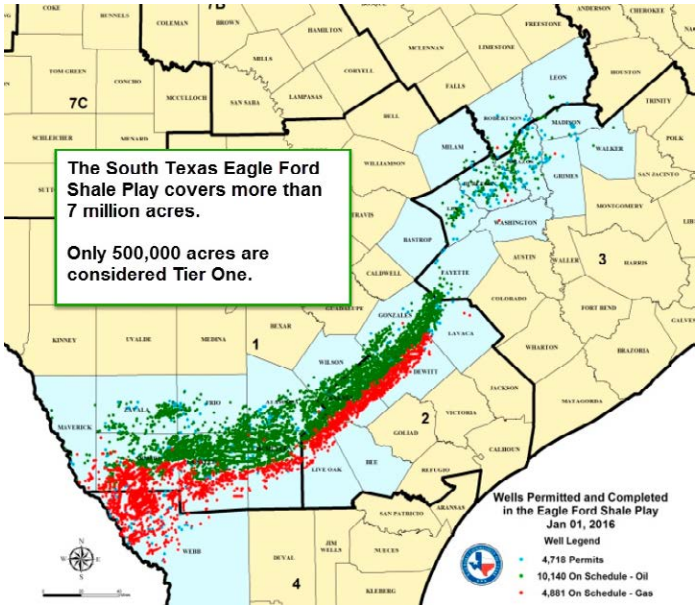
1. U.S. shale plays only produce 4 million barrels per day of oil. That is approximately 5% of the world's crude oil supply. Expecting this small piece of the supply side pie to keep up with global demand growth is unrealistic.

2. Horizontal wells in the shale plays (both oil & gas) have steep decline curves. The high growth rates in the early stages of the Bakken, Eagle Ford and Permian Basin oil plays cannot be maintained when tens of thousands of wells are on decline.

3. Like every oilfield ever discovered, when the Tier One leasehold is drilled out, it will be impossible to keep production from falling. For example, there are now more than 15,000 Eagle Ford shale wells, and they are all on decline. There are less than 100 drilling rigs working in the Eagle Ford today, and they will not come close to drilling enough wells to offset declining production from the wells completed prior to this year.

4. The U.S. oilfield services industry has been devastated by the oil price collapse. If oil went to $100/bbl next week, it could easily take over a year to ramp back up the level of activity in the shale plays needed just to stabilize production.

5. The most optimistic forecast we've seen for U.S. shale oil production is 10 million barrels per day. While it's doubtful to ever come close to that level, we can always hope, because this world will need every drop.



OPEC Cannot Meet Global Demand

There are only three countries (Saudi Arabia, Russia and the United States) that produce enough oil to impact the world's oil price.

Saudi Arabia is also the "Commander-in-Chief" of OPEC, so they have the most power. All Saudi Arabia has to do is announce that they are going to reduce production by 10% and the price of oil would zoom up and probably not stop until it approached $80/bbl.

So why don't they do it?

Our take is that they are tired of leading a group of rogue nations that expect them to do all the work of balancing the global market. Add the fact that half the countries in OPEC are "basket cases" and breeding grounds for (or directly support) terrorist groups, and it is easy to see why the Saudis couldn't care less that their OPEC "brothers" are going bankrupt.

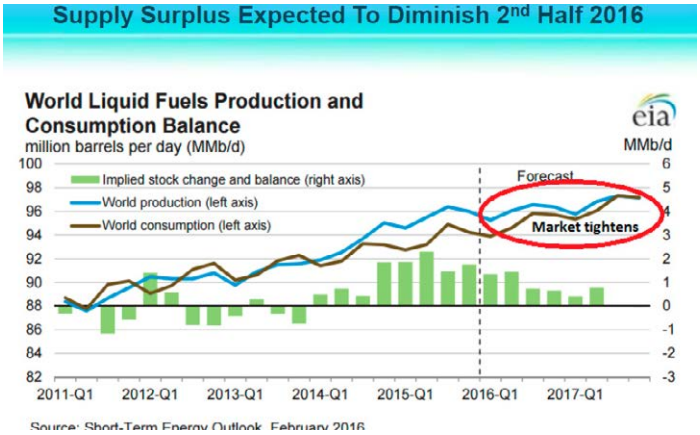
OPEC produces about 40% of the world's oil. Although they probably can add 4-5 million more barrels per day of production by 2020 (assuming they are not consumed by war), they are not expected to go much past that amount.

Every oilfield ever discovered eventually goes on decline, and that includes all of those big oilfields in the Middle East.

All of the big oilfields in Saudi Arabia are under pressure maintenance programs. If the Saudis "pull" too hard on the producing wells, they risk damaging the fields. They will NEVER do that, so when someone tells you that Saudi Arabia can add millions of barrels of oil to the market quickly, just say "hogwash."

Saudi Arabia, Russia and several other significant oil exporting countries are set to meet in the Qatari city of Doha shortly to work out the details of a production cut. It would be nice if they announced a deal that boosts oil prices, but we don't expect it to happen.

Supply & demand will balance no matter what this cast of characters does. It will just take a few months longer.



Conclusion:

We're going out on a limb and declaring that we have seen the low point of this oil price cycle.

As of the date of this report, West Texas Intermediate (WTI) is trading in the low $40's per barrel.

Our forecast is that WTI will move over $50/bbl by early June (the start of the summer spike in demand). With Non-OPEC supply falling rapidly by the 3rd quarter, WTI could move over $60/bbl and may test $70/bbl by the end of this summer.

One last thing: When the global market is over-supplied, unplanned supply outages like those that seem to occur on a regular basis in places like Iraq, Libya, Nigeria and Venezuela have very little impact on the price of oil.

As supply & demand come back into balance, supply disruptions can have a significant impact on the speculators who control the price of oil.

Our Top Picks for 2016 – the "Elite Eight" – all have strong balance sheets, solid production and lots of running room in major North American basins for future growth.

- Cimarex Energy (XEC)
- Concho Resources (CXO)
- Continental Resources (CLR)
- Devon Energy (DVN)
- EOG Resources (EOG)
- Newfield Exploration (NFX)
- Pioneer Natural Resources (PXD)
- Range Resources (RRC)

While we encourage you to do your own research before jumping in, these companies are in a great position to profit and return shareholder value if our predictions come to pass.

In future quarterly updates, we will bring you other companies poised for growth, depending on our overall outlook.

Natural Gas

The natural gas market is much different than the oil market.

Natural gas and, to a lesser extent, natural gas liquids ("NGLs") trade on regional markets.

The United States is the world's largest consumer of natural gas (approximately 80 billion cubic feet per day), but the U.S. market is over-supplied and is likely to stay that way for at least the remainder of this year.

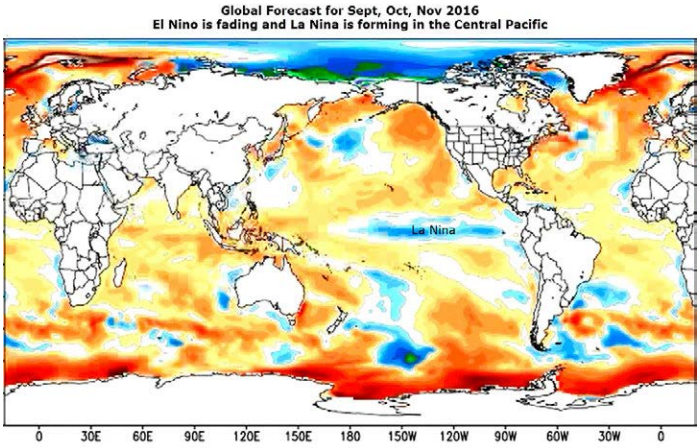
We are expecting U.S. natural gas to stay in the $1.80 to $2.20 range at least until the start of the next winter heating season.

Natural gas demand was down this past winter because we had a *Super El Nino* in the Pacific Ocean – El Nino winters being warmer than normal in North America. However, they do tend to last longer, often extending winter weather into early May. It is just too late to impact the price of natural gas this year.

Longer term, the Pacific Ocean is now moving from El Nino to La Nina. That means we should not have a repeat of the recent warm winter.

Recently, we've seen forecasts of a warmer than normal summer for the eastern half of the U.S., which could increase demand from gas-fired power plants. This is really the only hope for gas prices this year.

La Nina can also cause more hurricanes to enter the Gulf of Mexico, an area that still accounts for about 10% of our natural gas supply.



U.S. natural gas supply is falling now by about 0.5 Bcf per day month-after-month, thanks to a big decline in well completions.

Demand is expected to increase approximately 3.0 Bcf per day in 2016 (see chart below).

Assuming a normal winter, the U.S. gas market should be 4-6 Bcf per day tighter by Christmas, and natural gas prices should drift back up to $3.00/mmbtu.

LONG TERM US NATURAL GAS DEMAND ROADMAP (BCF/D)

	2016	2017	2018	2019	2020	Cumulative 2015-2020
LNG Exports						
Sabine Pass	1.2	1.2		0.7		3.1
Freeport			0.5	1.0		1.5
Cove Point			0.8			0.8
Cameron			1.2	0.6		1.8
Corpus Christi				0.8	0.8	1.6
LNG Sub-Total	***1.2***	***1.6***	***2.6***	***3.1***	***0.8***	***8.9***
Mexico/Canada Exports						
Mexico Net Exports	0.5	0.3	0.3	0.3	0.4	1.8
Canada net Exports	0.1	0.1	0.1	0.1	0.1	0.5
Mexico/Canada Sub-Total	***0.6***	***0.4***	***0.4***	***0.4***	***0.5***	***2.3***
Power Generation						
Coal Plant Retirements	0.4	0.3	0.1	0.0	0.3	1.1
Nuclear Retirements	-	-	01.1	0.1	0.2	0.4
Incremental Electricity Demand	0.1	0.1	0.1	2.0	2.0	4.3
Power Generation Sub-Total	***0.5***	***0.4***	***0.4***	***0.3***	***0.7***	***2.3***
Industrial						
Methanol	0.3	0	0	0	0	0.4
Ethylene	0	0.4	0.1	-	0.1	0.6
Ammonia	0.5	0.1	0.2	0.1	0.1	1.0
Industrial Sub-Total	***0.8***	***0.4***	***0.3***	***0.1***	***0.2***	***2.0***
Transportation						
New Fueling Opportunities	-	-	0.1	0.1	0.1	0.3
Transportation Sub-Total	-	-	***0.1***	***0.1***	***0.1***	***0.3***
	2016	**2017**	**2018**	**2019**	**2020**	**2020**
Total	**3.1**	**2.5**	**3.7**	**4.0**	**2.2**	**15.8**

Research report dated 04/08/2016

SIMMONS & COMPANY

NGL prices also appear to have hit bottom.

There are several large industrial projects coming on-line this summer that should increase demand for NGLs.

Exports are also increasing, with the United States being the Saudi Arabia of NGLs.

Final Thoughts

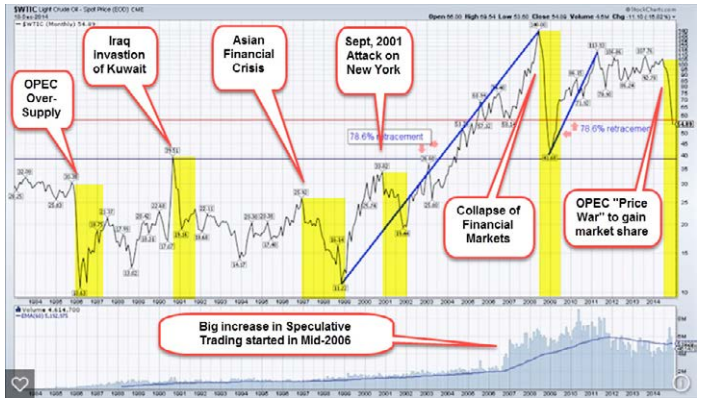
When making predictions about the future, naturally, the first thing we do is look to the past.

As we said at the start of this outlook, over the past several decades there have been six major oil price cycles.

The only one that lasted more than two years started in 1986 when oil dropped below $10/bbl and stayed below $20/bbl for almost five years. That one was different, because OPEC had more than 13 million barrels per day of excess production capacity.

It ended when Iraq invaded Kuwait and we had the first Gulf War. Oil spiked to $40/bbl, but it did not stay there for long.

After the war, oil prices flopped around in the $15 to $25 range until late 1999. Then the global oil markets began to tighten, there was a lot of talk about "Peak Oil" and the price of oil zoomed past $50/bbl in 2005 and peaked at $147/bbl in early 2008.



The Cheap Oil is running out fast

Just for the record, conventional oil production did peak in 2005, just as King Hubbert predicted it would.

We still have abundant and affordable energy today thanks to our brilliant petroleum engineers, who figured out how to drill wells horizontally.

Other scientists at the oilfield services firms figured out that fracking with millions of pounds of proppant could unlock the reserves trapped in the shale. And whatever your feelings on fracking might be, believe us, life on this planet would be a lot harder for us poor humans if not for a steady supply of oil & gas.

Thanks to a bunch of very greedy and stupid Wall Street bankers, with the aid of our even dumber elected officials in Washington, we had a financial market collapse in 2008 that almost took down the global economy.

You all need to watch the movie **The Big Short.** If half of what's in that movie is accurate, a lot of bankers and politicians should be in prison.

From $147/bbl in May, 2008, West Texas Intermediate (WTI) dropped to $38/bbl by January, 2009. By the 3rd quarter of 2009, WTI had rebounded to $70/bbl and proceeded to march up to $100/bbl where it flopped around for over four years. Profits were quite good for energy sector investors.

The U.S. shale revolution increased America's oil production by four million barrels per day. Our production had been on steady decline since the North Slope of Alaska went on decline in the 1980's.

Total U.S. oil production reached 9.7 million barrels per day in May, 2015 and it is now back on steady decline. We see U.S. oil production falling below 8.0 million barrels per day before this cycle is over.

The United States consumes about 20 million barrels per day of hydrocarbon-based liquid fuels, most of which are refined from crude oil.

All of the talk about energy independence has faded away. We are back on the path of depending on nations that hate us for oil supply and watching our trade deficit grow.

Our oil & gas industry will adapt and survive. Investors who pick up the shares of the best companies at today's depressed prices should be richly rewarded as the price of oil rebounds.

Just remember, they call them cycles for a reason.