CINDY BOURY FCSI®, CIM®, FMA
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CINDY BOURY PRIVATE WEALTH MANAGEMENT

IN THE KNOW: FINDING VALUE & TAX REFORM

The question we probably get asked more often than any other is ***"how can I feel comfortable investing when the stock markets are near all-time highs"?*** Our answer is that there are always companies that make sense to buy because there are always asset classes, industry sectors or regions of the world that are temporarily out of favour. Many people talk about "buying low and selling high" but it can be difficult to buy a stock that the media is negative toward or to add more money to an investment we already own after it has declined in value. Fortunately, we've seen this movie before and our disciplined approach of buying high quality, fundamentally sound companies even when their share prices have fallen is simply the "buying low".

We believe that the Canadian energy producers and pipelines represent just such an opportunity and we welcome the decline in the share prices of some of our favourite companies like Enbridge, ARC Resources and Peyto Exploration. So why are we positive about Canadian energy producers? It starts with our expectations for oil and gas prices going forward. Raymond James is calling for oil prices to climb as high as $70 per barrel in 2017 before moderating back to $65 next year. They are calling for U.S. natural gas to move from $2.41 in 2016 to $3.25 this year and $3.50 in 2018. It's because of supply/demand.

Supply is being driven down by lower capital investment and production cut backs by many producers. Capital expenditures on oil and gas exploration and production are down roughly 44% since the end of 2014 and we've seen estimates that the cumulative total has fallen by over **$500 billion!** There is a natural delay in the supply response, but if history is any guide, it is inevitable that supply will decline and prices will rise. One can't bring a deep water south Atlantic oilfield or remote Siberian gas field into production quickly. Meanwhile on the demand side, the appetite for personal vehicles in the emerging markets continues to move higher and North Americans are buying SUVs and pickup trucks in large numbers. If we see the strong summer travel season that many analysts are expecting, demand will increase. If we're correct about strong economic growth worldwide that will also feed higher demand for all types of energy.

Those who are negative on energy investments right now point to the high level of oil inventory in the U.S. but we think they may be missing some important information as to the reasons why this situation exists and the global inventory situation. US inventories are up due to regular seasonal refinery shut downs and maintenance. Meanwhile, there is growing evidence that oil inventories in the other 75% of the world are down. The respected energy analytical firm Vortexa reported on April 6 that crude oil in tankers is down 17% worldwide since January 1. OPEC cuts are working and the cartel has extended existing reductions in supply. Saudi Arabia particularly has a strong incentive to limit supply. Remember from our September 2016 newsletter "we also know that with the upcoming privatization of Saudi Aramco, the world's swing producer is desperate to see a higher oil price".

Turning to natural gas, we see that inventories are still quite high. They are 17% below last year levels in the US (April 6) and 6.5% lower in Canada (March 23). If we continue to see growing demand for electricity due to economic growth and in the absence of an extraordinarily cool summer followed by a warm winter, we expect to see the natural gas markets continue to get better for producers. Some commentators have expressed concern that a resurgent coal industry may hurt the demand for natural gas by electrical utilities but we don't believe that's likely. Since 2006 we've seen natural gas as a percentage of power generating fuel increase from roughly 20% to 37% while coal has gone from 50% to 32%. As much as the current US administration may want to see a rejuvenated coal industry, the truth is that it is much less attractive for utilities to burn coal than to use natural gas. It's just economics and that isn't going to change. Another big positive for natural gas producers going forward is the large capacity of liquefied natural gas export facilities that the Americans have built and are building. There is a huge potential export market for all North American gas producers.

So why have the shares of Canadian oil and gas companies been so weak if the outlook is so positive? We think it may come down to worries about the effects of a rumoured border adjustment tax (BAT) on Canadian producers. We don't believe in a BAT, especially in energy, and are generally sceptical about tax reform in the U.S. If we can learn anything from the attempted healthcare reform debacle, it is that it's very difficult to make radical change in Washington, D.C.

Tax reform in the United States is enormously complex and vested interests make it highly unlikely anything will happen quickly or comprehensively. To get a sense of the size of the problem, consider that the U.S. tax code is over 9,000 pages or 4,000,000 words long! Every year there are more than 400 additions to the tax code and in the last 15 years there have been over 4,500 changes. Many of those additions or changes represent a political or business interest with advocates in one of the branches of government. The other problem with a BAT is that it would likely put upward pressure on the U.S. dollar which is the opposite of what the country needs to stimulate exports. The U.S. will already have to deal with upward pressure on the dollar as they raise interest rates, so a BAT would just add fuel to the fire. Finally, Canada is the number one export destination for many individual states and is generally viewed as a fair trading partner.

Granted, there are things that could derail our scenario and we will continue to monitor for signs of OPEC cheating, rapid increases in US production or a looming recession. So far, none of those issues are a concern. So we think that the recent downward slide in the prices of oil and gas company shares is unwarranted and we are pleased to buy well-managed, high-quality, dividend paying stocks at lower prices in a market that is trading near all-time high levels.

As always, we welcome the opportunity to have a conversation with you on this or any other financial topic. Please feel free to ask!

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