Trustnet
Powered by FE fundinfo
hanetf Thematic ETFs
Fund name, SEDOL, ISIN or Citicode
News & Research Funds Investment Trusts ETFs Fund Groups My Portfolio Recei

Trustnet / News & research / How portfolios should be positioned for the energy crisis

How portfolios should be positioned for the energy crisis

There will be winners and losers, but one thing is clear, the apathy towards energy from governments and investors should continue to shift more constructively

By Robert Crayfourd,
CQS Natural Resources

The world is in the midst of an energy crisis. This is in part due to Europe losing 40% of its gas supply that came from Russia; however, gas prices were elevated months before the invasion. Undoubtedly losing Russian gas supply has exacerbated the issue, but the core issue is supply or the lack of it.

The energy sector has been constrained by environmental, social and governance (ESG) policies, with banks pulling back from lending to oil and gas companies. Politicians rallied against a common net-zero theme, which further saw regulatory pressure on producers, limiting new licences and generally discouraging new investment.

This has constrained supply and left producers preferring to pay dividends or enact buybacks, rather than invest profits in growth. At the same time, poor Western policy on energy security, a miscalculation on the timeline of the energy transition and a lack of sufficient investment in alternatives has left the world critically short of energy.

This energy crisis is likely to remain an issue through next winter, with an increase in global liquid natural gas (LNG) export capacity by Qatar and the US from 2024 onwards the only real obvious source of material additional gas.

For this winter, Europe can likely muddle through given high levels of stored gas and by paying exorbitant prices for LNG and reducing demand, primarily through the industrial sector. But the situation looks worse next year with the probable loss of Russian flows through next summer, in what is normally the period they use to restock inventories.

Of course, global warming is one of the greatest threats to the world as we know it, but there has arguably been too much focus on reducing the causes rather than providing the solutions. Renewables are part of that solution but will not work on their own.

Global power grids have shown elevated instability when renewable loads get to 20%, whilst the variable nature does not account for periods of low light and low wind and have thus required gas as a balancing factor. The solution will be a complex combination, but the main requirement will be sufficient grid storage.

The energy crisis touches every part of the economy and has been a key driver of inflation, which has fed through to central bank rate hikes. Understanding the cause, duration and solutions will be a key differentiator to performance of people's portfolios. Equally it provides many attractive investment opportunities.

The key themes to play this

Oil – this is now the cheapest form of energy; the complete inverse of normal market conditions. It is trading at a fraction of gas and even cheaper than coal. Oil producers, to a lesser extent than coal, are unpalatable in an ESG driven world. As a result, these names trade at a big discount to the spot price, with even the likes of BP trading at a price-earnings ratio of four times.

Nuclear/ Uranium – The only zero carbon form of energy the whole world could run on given its base load nature. The energy crisis has rekindled support in part due to costs, but also due to the energy security benefits nuclear can provide. The EU included it within their green taxonomy and the West has moved to increase lives at multiple reactors. The growth in reactors remains driven by Asia, predominantly China, where the cookie-cutter build process has left costs at a fraction of what we have achieved in the UK.

Lithium – Lithium is a key component in batteries, with demand set to increase materially from electric vehicle demand growth, but also grid storage to stabilise variable power from renewables such as wind and solar. The miners have all performed very well, given the huge 600% increase in lithium carbonate pricing, but as a result don't actually look that expensive on earnings. The duration of current strong lithium carbonate pricing is key, so whilst demand growth looks likely to remain strong, it may remain elevated for longer than implied in current valuations.

Copper – the key metal in everything electrical. It is currently depressed due to near term recessionary concerns, whilst the miners themselves have fallen 37% in the past six months. There may be further downside from spot pressures if we see a material global slowdown, but if we look four-to-five years out, a lack of new mines coming online and a growth in demand from electrification trends appears likely to tighten fundamentals significantly.

Coal – plants are running flat out, trying to offset gas wherever possible globally. Against this strong demand, Western miners are committed to running down existing coal mines and certainly are not investing in new ones. Despite incredibly strong performance with the likes of Thungela, up 500% in 12 months, it is still set to generate half its market cap in cash this year and is likely to pay out the majority as dividends. Coal remains environmentally unpalatable for most, but socially without it, billions would be plunged into the dark ages.

There will be winners and losers, but one thing is clear, the apathy towards energy from governments and investors should continue to shift more constructively. Ultimately energy security will gain greater focus politically and should see more investment and regulatory support, but for now strong earnings are being channelled back to shareholders through dividends and buybacks.

Robert Crayfourd is portfolio manager of CQS Natural Resources. The views expressed above should not be taken as investment advice.