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ConnText Podcast

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TRANSCRIPT

Energy Markets Outlook with Marcus McGregor, Managing Director and Head of Commodities (Energy and Basics) Research Team

Conning ConnText is a quarterly podcast that features our firm's view of capital markets, trends and investment strategies for the insurance industry, hosted by Rich Sega, Conning's Global Chief Investment Strategist.

[OPENING MUSIC]

SEGMENT 1 – OPENING

[Rich Sega (RS)]

Hi all, Happy New Year! Your podcast host Rich Sega here, wishing you all the best for 2025. We'll start our series this year with a special report focused on the all-important energy sector. Joining in our Hartford Connecticut office today is Marcus McGregor, Managing Director, Corporate Research, and Head of our Commodities research team, which includes many building blocks of the economy like basic materials, and of course, energy. Welcome to the Conning ConnText first quarter podcast for 2025.

SEGMENT 2 – ENERGY MARKETS OVERVIEW

[RS] (0:46)

We can expect many changes over the coming several months of 2025 across a broad range of policy areas; the incoming administration has challenges in many directions. Trump campaigned largely on trade and the border crisis, but also vying for attention are domestic terrorist threats, multiple wars and flashpoints in Europe, Asia, and the Middle East, and a $36 trillion dollar national debt.

The Trump transition team has reportedly prepared more than 100 draft executive orders for the new president to sign on his first day. They'll deal with trade, the border, taxes and regulation, but possibly none more dramatic than energy, the lifeblood of a modern industrial and consumer economy. Incoming Energy secretary nominee Chris Wright, CEO of hydraulic fracker Liberty Energy, is the first such candidate to head that department with extensive industry experience. He has been open to a broad range of energy solutions beyond his specific company's focus, including renewables and nuclear, which is very good news for an energy-hungry world.

So Marcus, let's start with the broad market view. What do you and the team see as the fundamental outlook for the U.S. and global energy sector?

Marcus McGregor [MM] (1:56)

That's a great question, Rich. The team and I - this is perfect timing - we recently put out our price deck assumptions for WTI, which is West Texas Intermediate, and also for domestic prices for natural gas. So for WTI, we expect prices to average between $60 to $90 a barrel in 2025, and on the natural gas side we expect prices to range between $2 to $4 per BTU.

The demand expectations for this year are a little soft, depending on what agency you talk to. I think it's impacting oil prices today with some expecting demand to be a little bit stronger in 2025 versus the assumptions of it being pretty weak. Also on the nat (natural) gas side, the prospects of increased LNG exports, also data-center demand driven by AI, is expected to be a positive for the gas outlook for prices.

Based on these prices, Rich, we expect the companies that we follow, the companies that are in client portfolios, to perform pretty well in this environment.

[RS]

Marcus, what are the big risks to that outlook and the major factors that might lead to those risks?

[MM]

Some of the things that our team are looking at when it comes to risks this year include trade policies with Canada and Mexico, also sanctions against Russia and Tehran. Those could affect prices really to the upside this year. Given that we have a well-supplied market, we see limited upside risk and more downside risk. However, things can change; this is a very volatile sector. But those are some of the items that we're looking at this year when it comes to key risks, when it comes to the commodity price outlook that we have.

[RS] (3:49)

So let's delve into the details a bit. As you say, on the face of it, given the slowdown in global demand and the mindset of the incoming administration, supplies seem more than adequate and many folks fear that a weak economy or a geopolitical event could cause a collapse in prices. But as you say, many things can change direction quickly. You mentioned sanctions in particular; are they the biggest threat to a price spike?

[MM]

Yes, at the moment, and any revisions to demand. What we're seeing currently today has been a lot of buying by the Chinese and Indian refineries just ahead of potential sanctions. So countries are preparing themselves for an uptick in prices in the near term, with the new Trump administration. So a lot of countries, again like China and India, have been buying, which is why you've seen prices for WTI and Brent, which is also a benchmark crude, spike in recent days.

[RS]

What's the practical effect of the recent news we heard about Biden's ban on new leases that block drilling for oil in more than 625 million acres of US coastal waters? Sounds like a big number, but what's the real impact?

[MM]

Yeah, it's very minor. We did a white paper about 10 years ago on the shale revolution here in United States, where fracking and onshore drilling became like the "big thing." What happened in that process is that it became very cheap to drill onshore versus offshore. So you have places like the Permian Basin, which is producing almost five million barrels a day - nearly half of all U.S. production - as a primary source of hydrocarbons for the U.S. So the ban on offshore drilling is really seen, in short term, as really not a major item again to volumes here in the US, to overall prices, and just to the overall economy here in terms of how we look at energy and think about energy production here in the United States. However, longer term, it does limit our abilities to get additional resources. So if there were ever issues with fracking, or energy demand were to increase quite a bit, having that ban on offshore fracking could be an issue. And I think the industry is actually pushing for that ban to be lifted.

[RS] (6:11)

I've read recently, Marcus, that given the current trends in the dollar and Federal Reserve policy, drilling in the Permian is profitable if oil prices stay above the low $40s per barrel, well below our $60-$90 probable range. Do fracking and shale oil make the difference here and also make the offshore drilling ban less impactful?

[MM]

Yeah, absolutely. If we put a number to it, if we think about places like the Permian Basin and shale and onshore drilling, breakevens are about 40 bucks per barrel, so it's very cost effective to drill onshore. When you start thinking about offshore - the major platforms, deep water, the technology involved, the long lead times in terms of establishing platforms - costs can be between 50 to 60 bucks a barrel, so it's very uneconomic to really go offshore if you don't have higher oil prices.

And also too, I'll add to that Rich, another point, faster production times. So it's easy onshore and fracking to get volumes out and extracted versus offshore drilling.

[Music break]

[RS] (7:23)

So here's a question that I know you're personally very interested in: the rapid expansion of US LNG exports influencing global energy supply chains. What challenges does growth in AI-driven data center demand pose to the domestic energy infrastructure, along with exporting some energy resources, particularly in terms of grid reliability, distribution, all those things that are interrelated?

[MM]

Absolutely. So I know one of your favorite places, Virginia, has been benefiting from the AI increase in demand, right? Virginia has been one of those states where you've seen an increase in capacity in data centers locally. So we think Virginia will continue to lead the way. But in terms of putting pressure on the infrastructure, we see that as limited. If you think about demand for nat gas, it's expected to grow probably somewhere between 2% and 3% through the end of 2030. I think on the power consumption side, about 2 ½% annual growth is expected up until 2030. Very minor on the edges there, but there will be some places like Virginia, where activity is definitely going to pick up when it comes to AI demand.

[RS]

The International Energy Agency, the IEA, they keep predicting a decline in global coal use, but thanks to soaring energy demand in China and India, coal consumption will hit another new high this year, almost nine billion tons. What's the current state of the US coal industry?

[MM]

Slow death. It's kind of how I would characterize it. I mean part of the issues that coal is having is nat gas, right? We just talked about shale and how low gas prices are. It's very competitive with coal. Capacity is gradually decreasing in the United States, and with exports the strength of the US dollar becomes an issue. So it becomes better for places like China and India, which are driving global consumption of coal, to buy their resources elsewhere. We primarily ship most of our coal, met (metallurgical) coal as well, to India. And again, with the strength of the US dollar shrinking profit margins, the outlook is just continuing to decline here in the United States.

[RS] (9:43)

Marcus, last question: What's good for energy consumers, prosperity and the economy may not be so good for energy investors as prices fall. What are the sector's investment opportunities for our clients in the coming year?

[MM]

I would first say this to clients and investors in energy in general: the sector itself has become increasingly cost conscious over the past several years. Companies have been driving out costs in the industry. And a lot of companies are now profitable at 30 to 40 bucks a barrel and that's well below, Rich, as you mentioned, our price target range of $60 to $90 for WTI. And even on the emerging market (EM) side, when we think about investments in oil and gas, we look to countries like Saudi Arabia and the Middle East where costs are much, much lower for investors who do have an appetite for EM.

Looking ahead, based on slow growth, prices that are moving sideways, we think that companies will continue to focus on M&A activity. So where are the opportunities in all of that?

We are always reminding investors to focus first on quality within energy and prioritizing credits that are rated mid-BBB or higher. Sectors that we like in this environment include integrated, which are your large companies like Exxon Mobil and Chevron, as we believe they will be able to weather the volatility, and also midstream, which will take advantage of volumes within the energy space.

Again, those that would be mid-BBB and higher, integrated and midstream, but lastly, also a little touch on nat gas versus oil. We think that the nat gas theme this year will be the prevailing theme for most investors, focusing again on expectations of increased US LNG exports this year and also the demand that we'll see from AI-driven data center growth.

So again, focusing more on companies that are touching on natural gas, higher-quality names and also the sector sub-industries that we like, both integrated and midstream, for 2025.

[RS]

Thanks my friend. Always a pleasure to hear your insights.

[MM]

Always a pleasure, Rich. Thank you.

SEGMENT 3 – CLOSE

[RS] (12:13)

And thanks to all for listening today. I hope our discussion helped to frame the risks and opportunities that we see in this most crucial component of our economy. While we focused on energy, fossil fuels represent more than just heating bills and gas pump prices: they contribute inputs to a broad swath of industries like fertilizers, pesticides, packaging, chemicals and pharmaceuticals too.

For Conning's broader views of what we expect to see in markets in 2025, please visit our website – Conning.com – for our 2025 Market Outlook webinar. Cindy Beaulieu, chief investment officer for Conning's North American business, and our investment experts will discuss key investment themes for the new year.

We always welcome your feedback and questions. You can get messages to us through your relationship manager, your portfolio manager, or send them directly to us at ConnText@Conning.com (that's ConnText w/ 2 Ns).

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