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From the Desk of Laszlo

Winter 2015

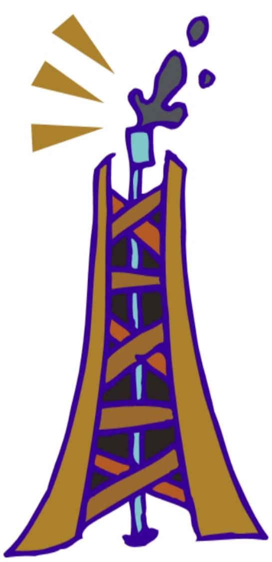
Boom - Bust of Oil

Happy New Year everyone. Looking back, it was a busy year. With all the talk about oil prices, people need to understand that 2014 was actually a positive year. In my last newsletter, I talked about the need for a correction. We did have a small one in early fall, and since then, things recovered. However, a correction of 10% is a healthy thing for markets but more importantly, it allows managed money to take advantage of opportunities of investments mispriced in the market.

The biggest mispriced investment is oil. At present, companies and countries that produce oil are producing at a record pace. What has been ironic is that cars, planes, ships and trains in the last number of years have become more fuel efficient. In the US, still the biggest oil user in the world, the demand for fuel has been dropping at about 2% per year over the last five years. Even as their economy picks up, the efficiency has also gone up so the efficiency has been greatly hidden. New generation planes actually use 30% less fuel. Cars in the next 20 years are mandated to double their fuel economy.

Efficiency is only part of the equation. The other part is China and Europe. China is transitioning from a developing economy to a developed economy. What is the difference? The difference is China was growing at 10% or more a year for the last 30 years as it built cities, roads, transportation, and infrastructure. This growth and change was unheard of in modern times. But as their economy grows, it then changes to a mature economy that only grows at 2 to 3%. This reduces fuel consumed to build buildings, roads, bridges as now, people start to buy cars and the economy shifts to a consumer type economy which requires less fuel. Lastly, Europe, as I discussed in previous newsletters, is still slow and the demand for fuel is down as well.

So now you have producers producing record amounts of oil at the same time demand for oil is falling. This simple equation means oil will go down. While this is not good news for producers, it is actually good news for consumer nations and those that manufacture products as their costs drop. Transport companies such as trains, trucking and planes cost less to produce and run. Products that use oil in their manufacture such as medicines, clothing, fertilizers, manufactured goods, etc. will all cost less to produce and those companies will benefit. Just watching the market lately, the only part that has been falling is the oil companies and those that directly service them.



So what has been great news for one side of the economy is hard hitting on the other. Herein lies the opportunity then to take advantage of companies that produce oil. If one is looking for a beaten down asset class, this might be a time to take a serious look at it. It is finally on sale and if your time horizon is over 5 years, you can do well.

Some warning to those that rely on oil income, such as Alberta; boom/bust cycles have always been there and this one is no exception. A lot of people had placed their money in real estate because of the gains in the last 10 years there. What could go wrong in Alberta? Well, when you have 10 to 30 thousand people move here every month, they have to live somewhere. What happens when that same number of people leave and go back east where the cost of living is lower? The liquidity, or the ability to sell real estate in that market dries up very fast. However, this too shall pass, only time will tell.

Factoids and Deadlines

RRSP Deadline for 2014 Tax year is March 1, 2015
RESP Last available contribution for which 20% grants are added are in the year your child turns 17.
TFSA Limit is now $36,500
RRSP to RRIF conversion must be made in the calendar year you turn 71.

Written by Laszlo Szojka