GUINNESS
ASSET MANAGEMENT

Initial thoughts from April 2020 OPEC+ deal

OPEC+ agreed a 9.7m b/day cut to production in an effort to defend oil prices against current demand weakness. The actual production cuts are likely to be smaller than the headlines imply; in reality, they will be too little too late to defend the physical oil market in the near term, as global oil inventory levels max out. However, looking beyond that, the agreement gives us confidence that OPEC is looking to defend longer term oil prices, and that a journey to rebalancing has begun.

What has been announced?

OPEC+ have confirmed a deal to cut their production by 9.7m b/day, relative to their 'baseline' production level of October 2018. The production cuts are to be shared evenly across all participating members (excluding Mexico) and represent a 23% cut to the baseline production level. They will extend until April 2022, gradually stepping down in size over the period. Beyond the OPEC+ announcement, there are some 'soft' indications of production declines and cuts from G20 countries, including 3.7m b/day from the United States and Canada, and potentially additional cuts from Norway (still to be announced). The OPEC+ meeting started (and was due to be completed) on Thursday 9th April, but negotiations continued throughout the weekend, resulting in the announcement of the complex deal late on Sunday 12th April.

We summarise below the proposed cuts by country and the new production levels relative to February 2020 production levels:

OPEC+ announced production targets and comparison versus current production

	Oct-18	Feb-20	May 2020 - June 2020			
	Baseline Production	Current Production	Announced Production Cut	As a % of Baseline	New Production Target	Actual Proposed Cut
Algeria	1,057	1,010	241	23%	816	194
Angola	1,528	1,380	348	23%	1,180	200
Congo	325	300	74	23%	251	49
Eq Guinea	127	120	29	23%	98	22
Gabon	187	180	43	23%	144	36
Iraq	4,653	4,590	1,061	23%	3,592	998
Kuwait	2,809	2,670	641	23%	2,168	502
Nigeria	1,829	1,680	417	23%	1,412	268
Saudi Arabia	11,000	9,650	2,508	23%	8,492	1,158
UAE	3,168	3,210	722	23%	2,446	764
Total OPEC-10	**26,683**	**24,790**	**6,084**	**23%**	**20,599**	**4,191**
Azerbaijan	718	666	164	23%	554	112
Bahrain	205	201	47	23%	158	43
Brunei	102	119	23	23%	79	40
Kazakhstan	1,709	1,699	390	23%	1,319	380
Malaysia	595	531	136	23%	459	72
Mexico	1,753	1,715	100	6%	1,653	62
Oman	883	821	201	23%	682	139
Russia	11,000	10,382	2,508	23%	8,492	1,890
Sudan	75	71	17	23%	58	13
South Sudan	130	136	30	23%	100	36
Total non-OPEC	**17,170**	**16,341**	**3,616**	**21%**	**13,554**	**2,787**
Total OPEC+	**43,853**	**41,131**	**9,700**	**22%**	**34,153**	**6,978**

Source: Bloomberg, DNB, IEA and Guinness estimates

The announced cuts of 9.7m b/day are relative to a baseline production level from October 2018, when both Russia and Saudi Arabi were producing 11m b/day. Current production (February 2020) was already 2.7m b/day lower than the

October 2018 baseline level, implying that the 9.7m b/day of announced cuts is actually only a cut of 7m b/day relative to current production. This calculation assumes full compliance from all members (which is an unlikely outcome in our opinion) and, if we saw 80% compliance, the actual cut from current production would be only around 5m b/day.

Our view on the actual production cuts from this agreement contrast sharply with some press headlines that refer to the agreement delivering up to 20m b/day of production cuts. We do not view the 'soft' cuts and declines from the US and Canada, nor purchases of crude oil for strategic petroleum reserves as being 'voluntary' actions to support prices, and therefore exclude them from the table above.

What does it really mean?

As ever, the devil is in the detail, and in the ultimate delivery (in terms of compliance and duration) of the proposed cuts. In terms of **positives**, we view the fact that an agreement has been reached as a significant positive and a clear reversal to the price war that started after the OPEC meeting on Thursday 5th March 2020. We note that this has been a more complex agreement than anything that OPEC has delivered historically in terms of the number of countries involved. The duration of the agreement is also impressive; OPEC+ have agreed to a headline cut of 9.7m b/day for two months, then 7.7m b/day for six months, and a further 5.7m b/day for sixteen months. This is longer and larger in duration than most had been expecting and gives us confidence that the organisation has a strong desire to support prices through a potentially extended period of demand loss. It will lessen the inventory overhang for the second half of 2020 and 2021, and will certainly help to accelerate the pace of oil market rebalancing.

In terms of **negatives**, the production cuts are very likely to be too little and too late to stop global oil inventory levels being breached, and to stop spot oil prices staying under sustained pressure in the short term. We have some sympathy with OPEC here because, in truth, there is very little that they could have done to prevent oversupply in the face of global oil demand declines of 25m b/day. Separately, the negotiation dragged on over the weekend and, in order to get the deal done, Saudi appears to have accepted a lower production cut from Mexico (a 6% reduction rather than a 23% reduction). Whilst not big in absolute terms (0.3m b/day), we see heightened risk over the deal's compliance as a result of this concession.

Implications of OPEC's actions for oil prices and equities

The new agreement is effective from the start of May, so it will take some time before we see the compliance and implications of this agreement. The forthcoming few weeks will be volatile whilst demand remains weak and the production cuts feed through into the physical oil market.

Looking beyond the next couple of months, however, the deal shows that OPEC will do whatever it can to avoid a disorderly market. While it reduces the risk that oil stays at or below $30/bl for a sustained period, it does not guarantee a trajectory towards substantially higher prices. It is important to remember that this production is only being withheld from the market and that it will come back at some stage. Only once this has happened can OPEC start focusing on moving oil prices back towards higher levels.

Ultimately, this will require broader non-OPEC oil supply (especially US shale oil) to suffer structural production impairment. We see a reasonable likelihood that this happens, with some higher cost, mature non-OPEC production being temporarily shut in and never restarting again (this could be as much as 5m b/day of production). In addition, substantially curtailed investment levels will mean that some non-OPEC production will suffer structural long-term declines in production from here on out. This would allow OPEC to return its withheld production in a controlled manner, regaining control of the market, and managing the oil price back to the levels that its economies require.

In terms of energy equities, the MSCI World Energy Index is now down around 40% year to date (USD), having been down 58% on 18th March. We believe our portfolio now discounts a Brent oil price in the low $40s/bl, and WTI price of

around $40/bl (this compares to the current long-term Brent oil price of around $50/bl). If the equity markets price in a $50/bl long term oil price into energy equities then we believe they offer around 50% upside.

Why the Guinness Global Energy Fund?

Best Fund over 10 years
Equity Sector - Energy

Best Commodity Fund

The Guinness Global Energy strategy started in November 1998 and has been consistently run and managed by Tim Guinness and the wider team ever since. The portfolio is constructed on a "best ideas" basis in a concentrated manner comprising 30 equally weighted positions of 3.3% each. Our equally weighted approach is a 'Guinness House style' and it provides us with a structural sell discipline, a regular 'top slicing' premium and it keeps life simple so that we can focus our efforts on picking the best energy stocks. Our investment process is based on regular, detailed, and disciplined macro analysis (to achieve the best possible understanding of the drivers of energy markets) and intelligent regular screening of all energy equities.

We initially screen for good quality companies that display attractive valuation with positive earnings momentum and then perform detailed due diligence on this group to select our preferred portfolio holdings. Our bias is towards value with cash returns as a preferred valuation methodology. We believe that our approach has been a key factor behind the long–term outperformance of the Guinness energy strategy versus the MSCI World Energy Index and our strong performance relative to our peer group of competitor energy funds. We think our competitive edge lies in the following attributes:

Consistency of investment philosophy & process	Strategy developed in 1998, applied by the team for 19 years
Equally weighted portfolio	Limits risk, gives concentration, and keeps life simple
Top-down analysis	Shaping the portfolio towards different energy sectors
Value bias	Picking good quality stocks when valuation is attractive and allowing each idea to work
Team	Three managers with varied backgrounds and skills
Length of track record	According to Towers Watson, "To be statistically significant, a performance record should be intact for nearly 15 years."

Guinness Global Energy portfolio

Single sector	Companies producing or distributing energy
High conviction	Equally weighted, concentrated portfolio (30 positions)
Low turnover	Buy and hold rather than trading philosophy
Unconstrained	No reference to index
Global	Diversified globally
Investment type	Listed equities (long-only)

**The value of an investment and the income from it can fall as well as rise as a result of market and currency movement; you may not get back the amount originally invested. Past performance is not a guide to future performance.*

Note: Simulated (composite) past performance prior to 31 March 2008, the launch date of this Fund. The Guinness Global Energy investment team has been running global energy funds in accordance with the same methodology continuously since 1998. These returns are calculated using a composite of the Investec GSF Global Energy Fund class A from 31 December 1998 to 29 February 2008 (managed by the Guinness team until this date); the Guinness Atkinson Global Energy Fund (sister US mutual fund) from 1 March 2008 to 31 March 2008 (launch date of this Fund), the Guinness Global Energy Fund class A (1.49% OCF) from launch to 02.09.08, and the Fund's E class (1.24% OCF) thereafter. *Source: Financial Express, bid to bid basis, total return.*

Guinness Asset Management

Guinness Asset Management provides a range of long-only actively managed funds to individual and institutional investors. Founded in 2003, Guinness is independent and is wholly owned by its employees. We have a variety of specialisms in global sector funds, Asian regional and country funds and global growth and global dividend funds. The Guinness equity funds are in a Dublin OEIC and sit alongside a range of similar SEC-registered funds offered to US investors by our US sister company, Guinness Atkinson Asset Management Inc. Having raised around $3bn in these vehicles, primarily from Family Offices, Private Banks and Wealth Managers, Guinness is now pursuing a new era of growth by presenting its capabilities to Pension Funds and other Institutional Investors.

We believe in: in-house research; intelligent screening for prioritisation of research; well-designed investment processes; concentrated, high conviction portfolios; low turnover; and the avoidance of benchmark constraints. Our in-house global economic and industry research allows us to take an independent view and not be led by the market. Our size and specialist nature also means we have the ability to act quickly and efficiently to any market movements. At heart Guinness Asset Management is a value, or growth at reasonable value, investor. We combine strategic sector-selection with a fundamental screening process to identify specific value-driven stock opportunities.

Please find further details at www.guinnessfunds.com

Guinness Global Energy team

Tim Guinness

Tim founded Guinness Asset Management in 2003 when he left Investec, who then appointed his new company as the outsourced manager of the Investec Global Energy Fund.

Tim has over 37 years investment experience. He founded Guinness Flight Global Asset Management Ltd in 1987 and was joint CEO from 1987 to 1999 and a portfolio manager of the Global Equity Fund. After Investec acquired Guinness Flight in 1998, he was Chairman of the company during the transition into Investec, as well as lead manager of the Investec Global Energy Fund. Tim read engineering at Cambridge University and, upon graduation in 1968, completed a Master's Degree in Management Science at the Sloan School M.I.T. in the US.

Will Riley, CA

Will joined Guinness Asset Management in May 2007. Previously Will worked for six years for PricewaterhouseCoopers, first in the London Middle Market Assurance Team, then as a valuation specialist in the Valuation & Strategy division. Will qualified as a Chartered Accountant in 2003 and graduated from the University of Cambridge with a Master's Degree in Geography.

Jonathan Waghorn

Jonathan Waghorn has 23 years' experience in the energy sector. He was a Shell drilling engineer in the Dutch North Sea and worked as an energy consultant with Wood Mackenzie before becoming co-head of Goldman Sachs energy equity research in 2000. He joined Investec Global Energy in 2008 where he helped grow the energy franchise at Investec to a peak of nearly $3.5bn in 2011. Jonathan joined Guinness Asset Management in 2013.

Guinness Global Energy Fund is an equity fund. Investors should be willing and able to assume the risks of equity investing. The Fund invests only in companies involved in the energy sector; it is therefore susceptible to the performance of that one sector, and can be volatile. Details on the risk factors are included in the Fund's documentation, available on our website.

The value of an investment and the income from it can fall as well as rise as a result of market and currency movement; you may not get back the amount originally invested. Past performance is not a guide to future performance.

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- the Manager: Link Fund Administrators (Ireland) Ltd, 2 Grand Canal Square, Grand Canal Harbour, Dublin 2, Ireland; or,
- the Promoter and Investment Manager: Guinness Asset Management Ltd, 18 Smith Square, London SW1P 3HZ.

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