



Overview

Winter has come and gone and, with the exception of a cold front currently giving the Eastern and Central U.S. one last taste of cold weather, Spring is upon us; which means energy markets are looking ahead to the summer weather patterns and inventory injections. As has been the case the last few years, focus in the energy sector will remain on weather, production (rig counts), and supply/demand (power plant & industrial). Expect short-term volatility, which will be driven by the unexpected, such as hotter-than-normal temperatures, a hurricane, or falling rig count. Conversely, long-term prices appear to be more stable; however, keep in mind that can change quickly should traders embrace a bullish-sentiment long-term.

Natural Gas

Recent revisions to price forecasts illustrate my point regarding price drivers. Recently, the Energy Information Administration (EIA) released its latest Short-Term Energy Outlook on April 11. Calling for an average price of \$3.10/Dth in 2017 and \$3.45/Dth in 2018 the EIA cited tighter supply/demand balance and exports increasing more than production as the culprit. For reference, we ended this year's injection season 17% below last year's record storage level, however still above the five-year average. There was a greater drawdown of inventories despite the warmer than normal winter, a result of decreasing natural gas production. For several years we have cautioned that producers were facing losses in natural gas production and had it not been for the value in wet shale plays yielding petroleum products, natural gas production levels would be even lower. Barclay's also raised its price forecast to \$3.12/Dth for 2017, citing heavy production maintenance and nuclear outages and a market which is focused on low production levels, increasing demand, and the potential for a hotter than normal summer.

Shifting gears, energy prices, especially natural gas, are driven by cooling demand in the summer. Since power plants rely heavily on natural gas for generation, as temperatures rise so does the price of natural gas. On page 2, you will see the current weather forecast for most of the summer, produced by the National Weather Service (NWS), a division of the National Oceanic and Atmospheric Administration (NOAA). These forecasts are calling for above normal temperatures across the United States from May-September. Additionally the NWS is projecting a greater than 50% chance of the recurrence of El Nino from August-December, which can impact hurricane activity in the Atlantic Basin. Remember, El Nino typically leads to less hurricane activity and the market will factor that expectation into prices. Anything contradictory to the expectation, such as increased hurricane activity, will be bullish.

As I alluded to earlier, expect your natural gas prices in the short-term to be volatile, reacting to changing weather forecasts, storage reports, and even hurricane activity later in the summer. From a technical analysis viewpoint, a trading gap exists around \$3.65/Dth (see chart on page 3) and that will most likely fill this summer. As a refresher, gaps are created when the market settles at a price point and opens at another, never trading in between those two. For example, the market settles at \$3.50 and opens the next day at \$3.40 trading downward. At some point the market will recover and trade between \$3.40-\$3.50. The market has been trending towards the gap at \$3.65 and this will most likely fill soon.

That being said, if you have followed our recommendations, you should have most of your load hedged for 2017 at prices well below current market prices. Last year, the May contract settled at \$1.995/Dth; recently the May 17 contract settled at \$3.142/Dth. Longer-term hedges have also been recommended through 2020, as long-term prices continue to trade at a discount to the near-term. For example, the 2017 strip price is \$3.33/Dth compared to \$3.008/Dth through 2020. If you have not hedged your natural gas requirements or would like to discuss a long-term hedge strategy, please contact us for assistance.

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Crude Oil

Crude has continued to trade in the \$40-\$50 per barrel range, as expected, with a cap somewhere near \$60/bbl, which can be solely contributed to U.S. production and the shale boom. Despite long-term lower prices, the industry had continued to thrive in part because of efficiencies in production, with some basins experiencing 50% gains in efficiency. Also, many in the industry have reigned in spending; no longer can a company spend \$2-\$3 for every \$1 generated as was the norm when prices were \$100/bbl. This change in mentality, along with efficiencies, has allowed the United States to maintain its dominance, and consequently keep prices in check in the petroleum industry....for now.

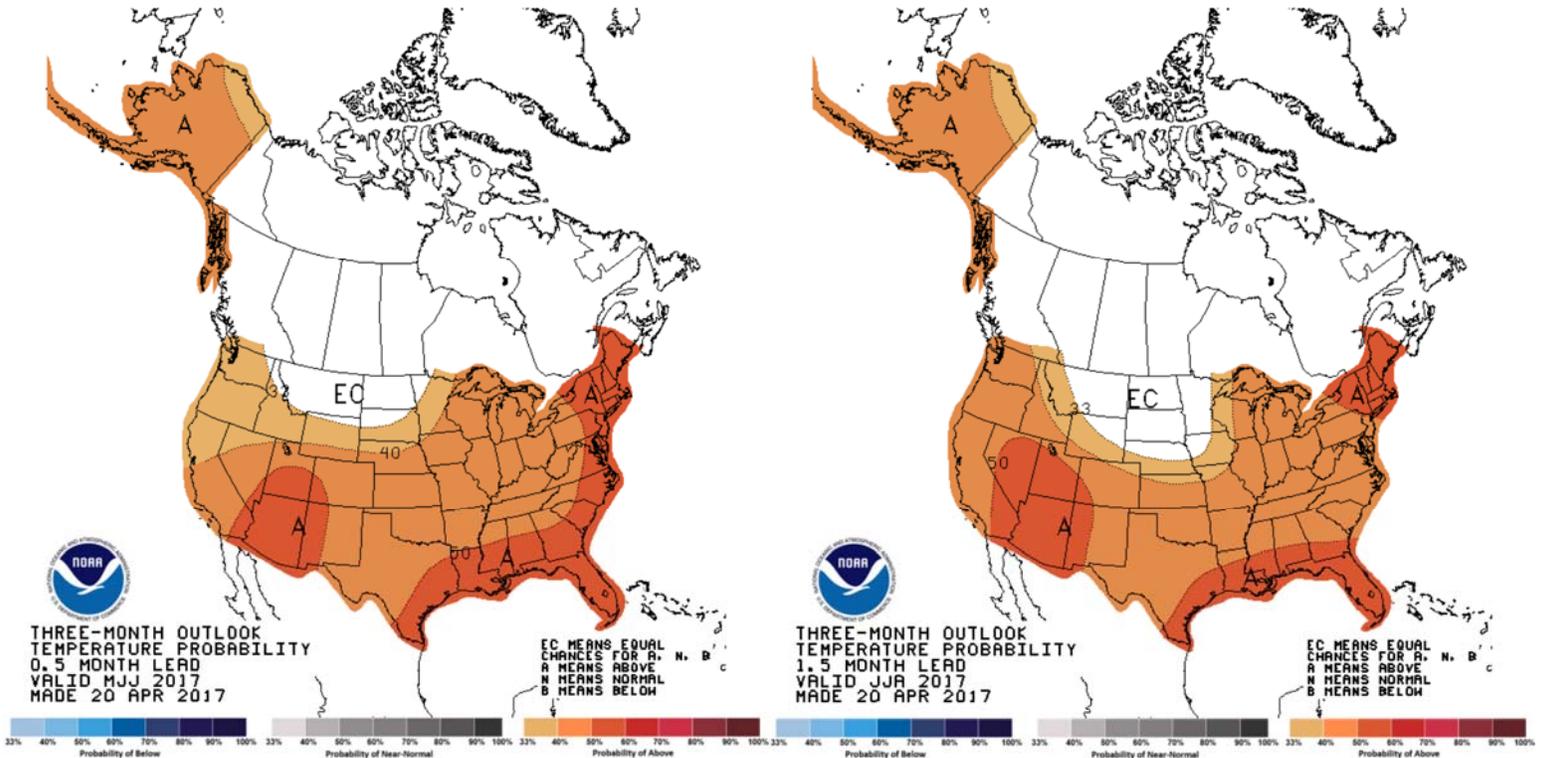
There is a growing concern with the shale boom and production in the industry. Recently, Columbia University's Center on Global Energy Policy released a report which details the potential consequences of rising interest rates to the gas and oil industry. The article can be found here ([Columbia University](http://energy.columbia.edu/sites/default/files/energy/Reserve_Base_Lending_Outlook_For_Shale_Oil_Gas_Finance_May2017.pdf)) however essentially it highlights that almost 50 exploration and production companies are set to outspend their cash flow by approximately \$4 billion this year if crude oil prices average \$55/bbl. Rising interest rates would make borrowing more expensive or impossible for some of these companies, which have relied on this method for continued exploration and drilling. While this could certainly lead to a production decline, the more likely scenario is that the market consolidates, something we advised on last year.

Since 2014, 69 oil and gas producers have gone bankrupt, with over \$34 billion in debt. I anticipate the industry will continue to consolidate; however, with the spending in check and the efficiencies in place, crude should continue to trade in the \$40-60/bbl range through 2017 with a cap somewhere around \$80/bbl should some major dynamic change, such as a war in the Middle East.

Columbia University article address: http://energypolicy.columbia.edu/sites/default/files/energy/Reserve_Base_Lending_Outlook_For_Shale_Oil_Gas_Finance_May2017.pdf

NOAA Temperature Forecast for May-July as of April 20, 2017

NOAA Temperature Forecast for June-August as of April 20, 2017



James Hatch, VP Energy Services

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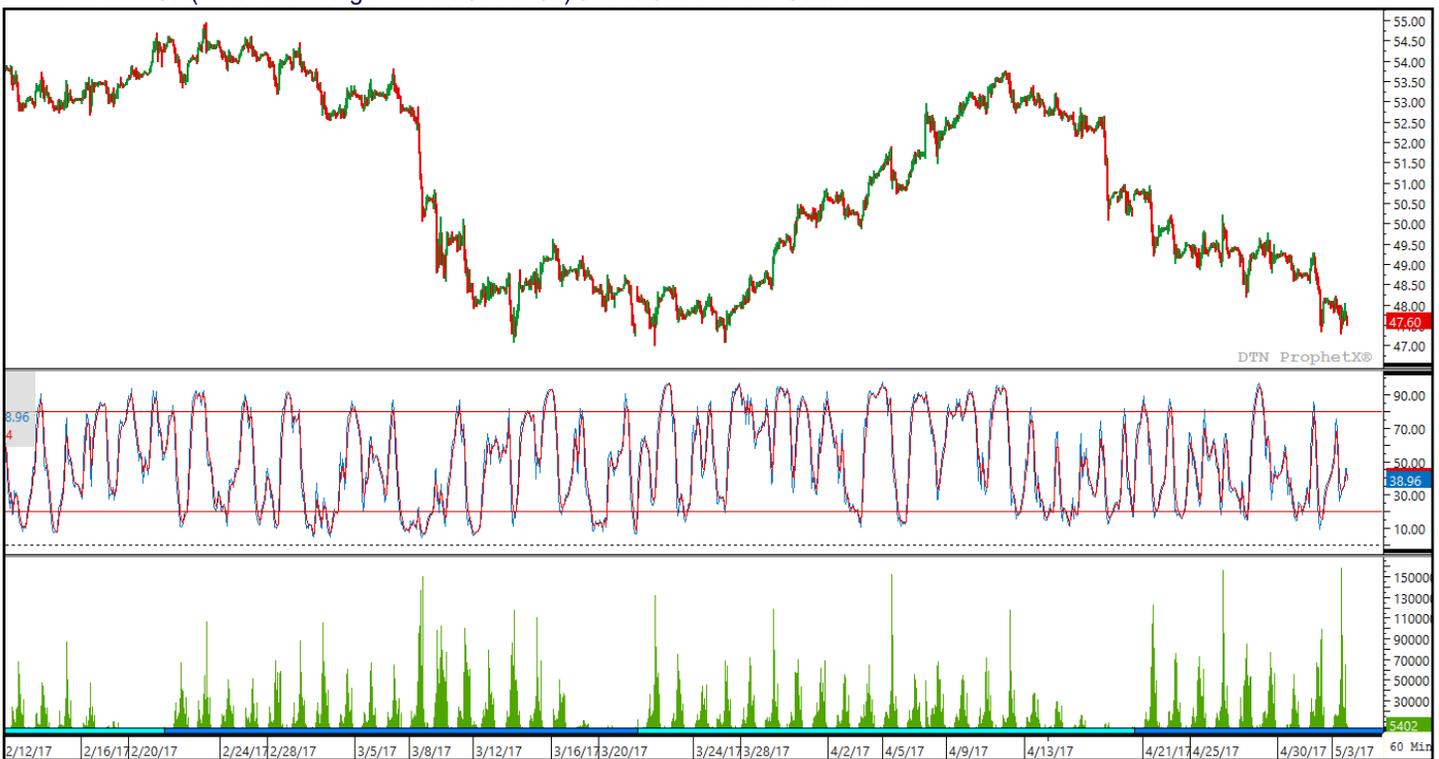
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NYMEX Natural Gas June 2017 Futures Contract Price History



NYMEX WTI CL (West Texas Light Sweet Crude Oil) June 2017 Futures Contract



James Hatch, VP Energy Services

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