Perspectives

SEPT 2019

Attack on Saudi Oil and Market Implications

Ben Mohr, CFA
Director of Fixed Income

Over the weekend, half of Saudi Arabia's oil production stopped due to a drone attack on the country's major Saudi Aramco oil infrastructure which includes processing centers and oil fields. While a Yemeni militant group — the Houthi rebels — claimed responsibility for the attack, U.S. intelligence suspects Iran as the culprit. The loss on a per-barrel basis from this attack is more debilitating than that from Iraq's invasion into Kuwait in the 1990s. However, Trump appears to want to avoid a conflict with Iran.

The price of oil soared given this reduced worldwide supply. The WTI (West Texas Intermediate) Crude price — the bellwether price of a barrel of oil in the U.S. — rose from $55 on Saturday to $60 on Sunday to just above $63 on Monday and had leveled off to just below $60 as of the time of this writing mid-day Tuesday, showing that the markets have gained some comfort with the post-attack developments. The S&P 500 fell by as much as 0.6% on Monday and rebounded slightly by 0.2%, also as of mid-day Tuesday. U.S. Treasury bond prices rallied slightly, thereby depressing yields as the 10-year yield fell 6 basis points from 1.90% to 1.83% on Monday.

The world produces an estimated 101 million barrels per day of oil. However, the attack has reduced this capacity by about 5 million barrels per day. The critical issue is that there does not appear to be enough spare capacity to offset this lost production, as OPEC (the Organization of Petroleum Exporting Countries) — not including Iran — has only an estimated 1 million barrels per day of spare capacity.

Preliminary assessments indicate that it could be several months before the facilities resume full production, though Saudi sources are confident that the lost production will be back online in as little as two to three weeks. Given this uncertainty, if the damage is debilitating enough such that the shutdown is drawn out, it may push oil prices continuously higher and the various countries of the world would need to dip into their Strategic Petroleum Reserves (SPR's). Trump on Sunday approved withdrawing from the U.S.'s SPR, estimated at 650 million barrels, while China's SPR is estimated at 500 million barrels.

This development may potentially result in a tailwind for U.S. exploration and production, midstream, and refining companies, as the reduced OPEC supply may lead to greater demand for U.S. oil which, in conjunction with the rise in oil prices, may boost U.S. energy issuer stock and bond prices. With energy issuers comprising roughly 15% of the U.S. high yield bond market, the Barclays U.S. corporate high yield index spreads tightened in from 361bp to 356bp on Monday. Nonetheless, the temerity and unprecedented nature of the attack as well as the resulting growing geopolitical uncertainties may weigh on broader global financial asset prices for the short term, but is not expected to have a meaningful long-term impact on the economy and financial markets.

PREPARED BY MARQUETTE ASSOCIATES

180 North LaSalle St, Ste 3500, Chicago, Illinois 60601
CHICAGO BALTIMORE MILWAUKEE PHILADELPHIA ST. LOUIS

PHONE 312-527-5500
WEB MarquetteAssociates.com

About Marquette Associates

Marquette Associates is an independent investment consulting firm that guides institutional investment programs with a focused client service approach and careful research. Marquette has served a single mission since 1986 – enable institutions to become more effective investment stewards. Marquette is a completely independent and 100% employee-owned consultancy founded with the sole purpose of advising institutions.

For more information, please visit MarquetteAssociates.com.