



BRENT CRUDE vs WTI

Even the US Energy Department no longer deems America's benchmark oil grade the best guide to global prices. The US Energy Agency has abandoned its domestic West Texas Intermediate (WTI) as its benchmark for oil forecasts as the agency declares that WTI is no longer reflecting accurate oil prices. The new benchmark that the agency has adopted is North Sea Brent crude. As rising production swells the US national stockpiles, WTI prices have been suppressed compared to other crude oil benchmarks, Dubai and Brent crude. Brent and the WTI futures have traded at a difference of more than \$20 since last October and, as we write this, the prices of Brent and WTI are \$116.94 and \$95.95 respectively.

The rising US crude production (see chart), the result of shale oil output as well as supplies from Canada's oil sands, has led to a surplus at Cushing, Oklahoma, depressing the price of WTI.

The increased production overwhelmed the transportation infrastructure needed to move crude from Cushing, where the WTI price is set, to the US Gulf of Mexico. Insufficient pipeline capacity has been the main issue that is causing the inventory increase in Cushing, Oklahoma. The US Energy Information Administration said retail prices for fuels such as petrol and diesel now follow Brent more closely than WTI.

Texas oil production is absolutely dominated by the Permian Basin, located in West Texas. It holds the wells that have the highest-quality oil – light, sweet, and easy to refine. Texas has increased production in the past few years. However, much of the recent production increase is coming from unconventional fields, like the Spraberry field.

In efforts to accommodate the production increase in Cushing, Enbridge and Enterprise, teamed up to expand the 500-mile Seaway pipeline. The pipeline which runs from Cushing to Freeport, Texas, was restarted after a brief closure to increase its capacity to 400,000 barrel a day from 150,000 barrels. In mid

January, the price difference between WTI and Brent crude narrowed to its tightest margin in four months, \$16.10, on expectations that the expanded pipeline carrying oil to the Gulf coast would help ease the surplus at an important US delivery hub. Enbridge and Enterprise, a 50/50 venture, were responsible for pump station additions and modifications which led to the increase in capacity.

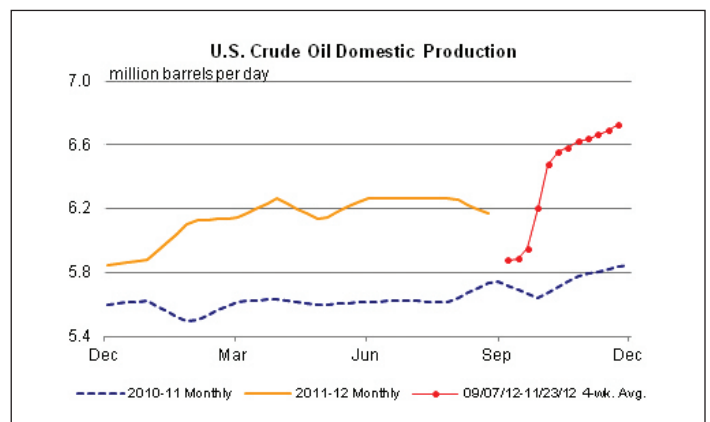
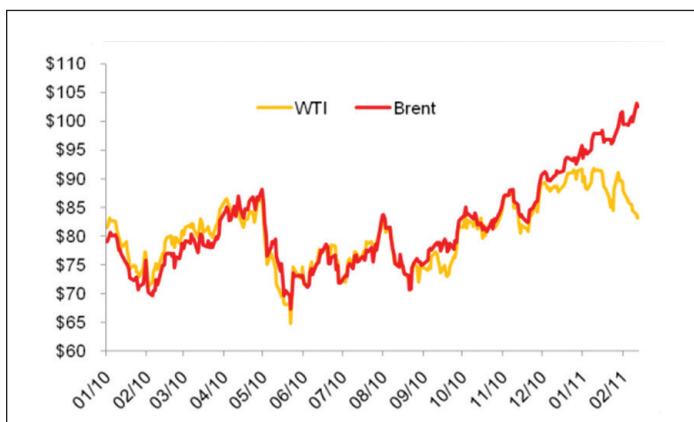
One of the first signs the global market was switching out of WTI was when Saudi Arabia and Kuwait, back in 2009, opted for the heavier Argus Sour Crude Index (ASCI). One year later, Iraq switched to ASCI from WTI as well.

Having said all that, the fate of WTI was probably sealed years ago when the US government's decontrol of oil prices changed the trading mechanics of crude oil. Also, the rise of Texas Tea, in early 1980s, led to the commoditization of WTI. At that time, the US domestic production was flowing at a rate of 8.6 million barrels per day, with approximately 30% of that oil coming from Texas. This oil was some of the highest-quality crude that US refiners could get their hands on. So why has the global oil price benchmark switch from WTI to Brent?

Simply put, the preference for Brent crude today stems from the fact that it may be a better indicator of global oil prices. Brent essentially draws its oil from more than a dozen oil fields located in the North Sea. It's also still considered a sweet crude, despite having a higher sulfur content than WTI. Although most Brent is destined for European markets, it's already used as a price benchmark for other grades.

Brent represents the Northwest Europe sweet market, but it's directly linked to a larger market. All West African and Mediterranean crude, and now Southeast Asia and US crudes are using Brent as their benchmark prices.

For years, the price differential between the two has only been



a few dollars. From time to time, a shortage could push the price spread wider. The drastic price divergence started in 2010 and has been around \$20 since.

As previously stated, the problem for WTI has been the flood of oil flowing into Cushing from areas like North Dakota and Canada. A production boom took place recently in North Dakota, and Canada's imports have risen to record levels over the last few years. In 2011, Canada, as a whole, exported 2.23 million bbl/day of crude oil to the US, or about 25% of the US total crude oil imports. And North Dakota had 214 oil-focused rigs in May of 2012. All these factors have contributed to Brent becoming the new global benchmark.

So what does all of this mean for WTI? Brent and the WTI futures have traded at a difference of more than \$20 since last October. In November, the WTI-Brent spread widened to as much as \$26.03 a barrel as WTI suffered from an oversupply, while geopolitical tensions supported Brent, the global benchmark. However, Brent also faces problems such as declining production in the North Sea, which pushes up the prices. The Middle East unrest also contributes to a price hike. As you can see, there are many variables to consider when trying to explain these price

fluctuations. This will be a much talked about subject for 2013, so stay tuned for more on this. ■

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