Proxy P

May 2019

Proxy P monthly market review

Markets in general

Global markets turned sour in May after trade talks between US and China broke down. The correction was severe and wiped out all the gains made in March and April. It all started with a tweet from President Trump where he announced tariff hikes from 10% to 25% on Chinese goods worth 200 billion dollars. On top of that he threatened with additional tariff hikes from 0% to 25% on goods worth 300 billion dollars. The news came as a surprise because negotiations between the two countries had been going on for a long time and the market was expecting a deal sooner rather than later. The initial reaction wasn´t that bad, because the move was considered as pure tactics from the US. But when it became clear that the Chinese had rejected major parts of the agreement, the market realized that a trade deal wasn´t on the table at all. The trade conflict even escalated with Chinese counter tariffs on US goods worth 60 billion dollars, blacklisting of Huawei and Chinese exports of rare earth metals. The U-turn spooked the market, and as a result sentiment indicators like flash PMIs came out very weak. Weak PMIs means weak future growth, which potentially can result in too high earnings expectations. We acknowledge that we are in a binary situation, but as long as the trade negotiations don´t turn more optimistic the market will have a hard time resuming the positive trend again.

Renewable sector

The renewable energy sector wasn´t unaffected by the weak market in May, but considering the year to date outperformance and the somewhat high sector beta it was a positive surprise to see how it outperformed markets in general. One should be careful analyzing such a short period, but perhaps the great interest and outlook for the sector might be paying off.

The future of EV´s depends on battery prices. Only in the last 12 months, prices for lithium-ion batteries have fallen 35% to 187 dollar per MWh according to BNEF. Today they expect EV´s and CV´s to reach, on average, the same price in 2022. In 2017 the prognosis said 2026. They also see the same pattern within Solar PV and off-shore wind. Different analysts have different estimates but they have had one thing in common. Their cost analysis for renewable and green tech has been far too pessimistic for many years. The question about batteries is not only about price, it is also about technology and the next generation of batteries. Both Toyota and VW group announced that they will have solid state batteries in commercial production by 2025. This would be a total game changer. Grid batteries will, together with hydrogen production, also be an important part of electrification and decarbonization. McKinsey&Co expect growth will take off somewhat after 2025. An important part of the commercialization of grid batteries will be recycling of old EV batteries. In the meantime we are excited by the recent announcement of the brand new Volkswagen ID.3, the first all-electric car with a decent range, 330-550 km, and a price below EUR 40,000 by the largest car manufacturer in the world.

Oil and Natural Gas sector

The oil and gas sector had a very weak development in May, somewhat underperforming markets in general. The weak development can be related to the price of oil, which fell from 73/64 to 64/54 dollar per barrel (Brent/Crude). The main reason was, as mentioned above, the trade conflict between US and China. The market is worried that the conflict will result in declining trade between the two countries, eventually rolling over in slower industrial production and global growth, an environment that most certainly would be negative for oil demand. The weakness is in other words based on sentiment and expectations. Reality is very different. We observe a very strong demand for oil in combination with a fairly constrained supply. Inventories are, from a seasonal adjusted point of view, not building. OPEC plus Russia will convene in June which will set the production agenda for the rest of the year. Given current turmoil in the market, they will probably be quite incentivized to keep inventories tight. Would overall sentiment also mean-revert into a more balanced view of world growth, it could have a dramatically positive impact on the price of oil.