SANNING CAPITAL
EFFICIENCY FUND

2015 April– Time to get into Oil? (Part 2)

In the last (April) issue of our Factsheet we debated possible oil price developments. We expressed our bullish view on “black gold” in a situation where WTI wandered around mid-forties a barrel trading near its 6-year lows. Our argument was both simple and fundamental: we expected some of the most expensive supply to fall off, be it in US or elsewhere and we argued some signs of this happening could already be observed in the US.

A month later WTI costs 59.49 USD/bbl (as of 4th May 2015). Even though we are glad the price went up in line with our view, we are aware of the fact the recent run up of more than 20% in a single month was accelerated by some random factors, namely war in Yemen and USD weakness. We are also aware that many risks remain, e.g.:

1. With US production growing further (and let’s keep in mind US production is likely to replace Saudis as a swing producer), inventories keep mounting helped by “contango” arbitrageurs buying cheaper spot, selling pricier forward. The new data showed the inventory build is slowing, but the risk of oil flood if we run out of storage stays.
2. Big question is what OPEC does. Saudis have signaled many times they are not willing to cut the production in order to stem the price. King Salman’s appointment of new throne ascendant last week is unlikely to impact the overall course of Saudi policy. SA remains unpredictable player and makes any oil-related investment suffer a great deal of political risk.
3. The so called “fracklog”, a substantial amount of drilled shale oil wells in US waiting for development, could kick in immediately if price increases, thus muting what would in the absence of shale oil be a rapid surge in price known from previous cycles. Estimates of the fracklog amount range 300 000 - 800 000 bbl/day. This only illustrates new role of US as a swing producer that changes mechanics of global oil supply and could prevent rapid swings in oil price up.
4. Iran’s deal could bring on new supply, yet unlikely this year. The underinvested local infrastructure will require some good hand treatment first.

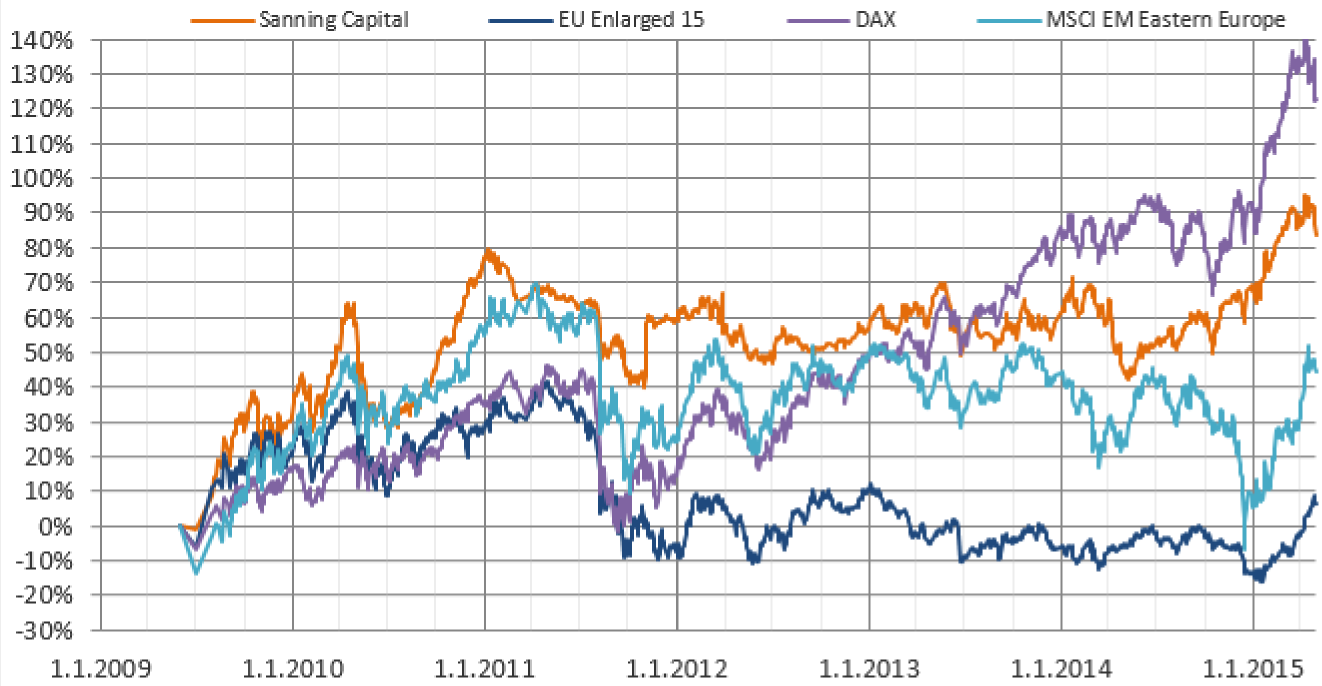
The economy of most of US shale oil formations seems to be profitable with price below 80 USD/bbl. If the most expensive global supply gets wiped out, swift US producers will retake their place up till 80 USD/bbl, effectively capping the oil price.

Our conclusion is that while we certainly thought price in low forties could justify discussion about buying into oil, after April 20% rally the story looks less appealing. There might be further 30% upside in the market, but the time horizon of supply-demand regaining balance is big unknown. For how long can costly producers keep bleeding? How much capex will exactly be eliminated?

Bearing in mind the inherent riskiness of oil and some of the pointed out issues, we don’t consider the risk/reward profile of oil equity that attractive at the moment.

This month we lost **-3.2%** from our NAV. Our benchmarks: **S&P 500** (0.0%), **NASDAQ** (-0.1%), **DAX** (-5.2%), **EU Enlarged** (+8.9%) and **MSCI EM Eastern Europe** (+10.9%).

Fund vs. Indices



Fund Manager

Jan Pravda

Launch Date

2.6.09

Location

Prague

Fund Currency

EUR

Share Price

€ 1 835.04

Performance Fee

20 % HWM

Management Fee

2% p.a.

Cumulative Performance

Period	Sanning[1]	EU Enlarged[2]	MSCI EM EU[2]	DAX	S&P 500	Nasdaq
1 month	-3.2%	8.9%	10.7%	-5.2%	0.0%	-0.1%
3 months	6.0%	20.0%	30.3%	7.1%	4.5%	6.6%
12 months	25.9%	12.9%	15.7%	19.5%	11.0%	20.4%
3 years	17.0%	3.7%	2.4%	69.4%	49.2%	62.2%
5 years	16.2%	-19.6%	1.3%	86.7%	75.7%	100.8%
Since inception (2.6.2009)	**83.5%**	6.5%	44.3%	122.7%	120.7%	169.0%

Further Characteristics

Beta relative to:		Volatility [3]	**18.3%**
EU Enlarged 15	**0.29**	Alpha (vs EU15)	**0.11**
DAX	**0.22**	Sharpe ratio	**0.59**

(1) Net off management fees, gross off performance fees

(2) These two indeces presented only to illustrate performance in 2009-2014, when focused on Central Eastern Europe

(3) Annualized standard deviation since inception

SANNING CAPITAL LIMITED is an opportunity fund based on fundamental research focused on investments into publicly traded companies providing global improvements of eifficiency and/or reduction of consumption of energy, capital and time. It is funded by the managers' own capital and several private investors.

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