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MEMORANDUM

TO: All Clients
FROM: Meketa Investment Group
DATE: April 21, 2020
RE: COVID-19 Update: Negative Oil Price

Yesterday saw an unprecedented drop in the West Texas Intermediate ("WTI") oil price amid fears of available storage in the United States. Prices for WTI oil opened at $18 per barrel and crossed into negative territory for the first time in history reaching as low as -$36 per barrel. This is a decline of over 300% and basically means that producers have to pay in order to offload their oil supply for front-month May 2020 delivery. The initial decline in oil prices starting seven weeks ago was the result of demand destruction from the COVID-19 crisis and surplus supply from Organization of the Petroleum Exporting Countries ("OPEC") and Russia (collectively "OPEC+") production increases. In response to cratering demand and over supply, OPEC+ agreed to a historic cut of almost 10 million barrels of oil equivalent per day. These cuts have done little to curtail the decreasing available storage as supply continues to out produce demand.

The third factor in determining oil prices is market sentiment toward oil futures contracts that are settled with the physical delivery of oil. Yesterday's decline is coming as May 2020 futures contacts are set to expire today, and buyers do not want to take delivery of the oil due to lack of demand and storage. This resulted in oil traders selling today's futures to avoid taking physical delivery and sending the May contacts into negative territory. As a result, producers had to pay counterparties to take delivery of May oil production. Oil needs to be delivered to Cushing, Oklahoma where approximately 91 million barrels of storage capacity is housed and where official transfer of title accompanying the actual physical movement of oil occurs. With growing concern of Cushing reaching capacity, there is an unwillingness of buyers to take delivery. Referencing Brent prices, the international pricing benchmark in the North Sea, prices are $27 per barrel where storage capacity is still available.

Going forward, we are likely to see additional declines in US production with oil-producing wells being shut-in, which means the well spigot is close, production is ceased, and hydrocarbons are left in the ground. This is active intervention, in addition to the natural declines from well production, which is exponential for shale production. If shut-ins occur, there will be further volume and supply decreases.

The market is currently in contango, as oil contracts for future delivery are more expensive than the current spot (or May 2020 contracts expiring on Tuesday, April 21, 2020). June oil contracts are significantly higher in the $20s, showing that the market still expects demand to eventually return and oil in storage consumed. What month that happens is unknown, and a month from now buyers may be mass exiting the June contacts.

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