JAG CAPITAL MANAGEMENT LLC

TWO MINUTE DRILL
November 30, 2017

Timely Insights from JAG's Research Team

Total reading time = 2 minutes

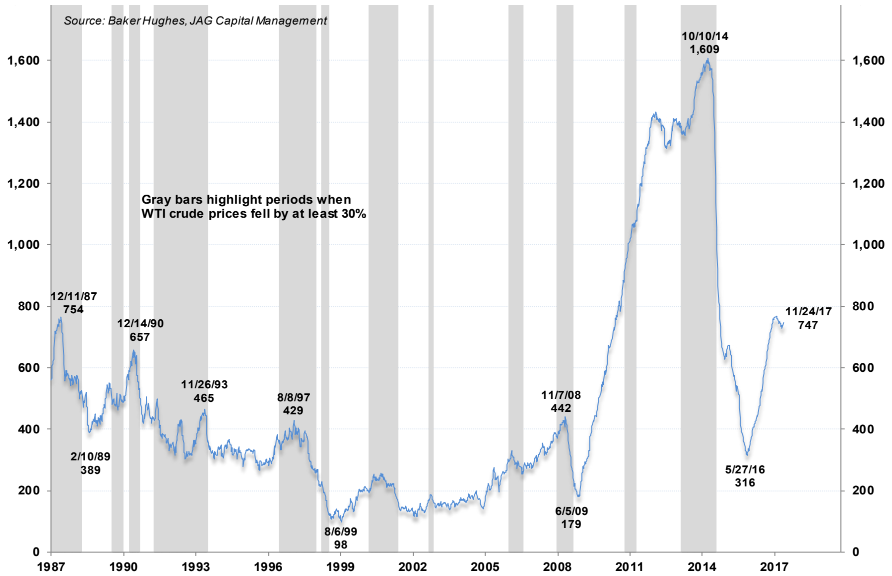
WTI Price

After peaking at over $107/barrel during the summer of 2014, West Texas Intermediate crude crashed to $26.21 in February 2016. Since then, however, oil prices have firmed, rising to near $60/barrel recently. Given the fact that crude oil prices are the major driver of revenue and profits for companies engaged in oil exploration and drilling, could the rally in oil prices be a sign of hope for Energy sector bulls?

U.S. Field Production of Crude Oil

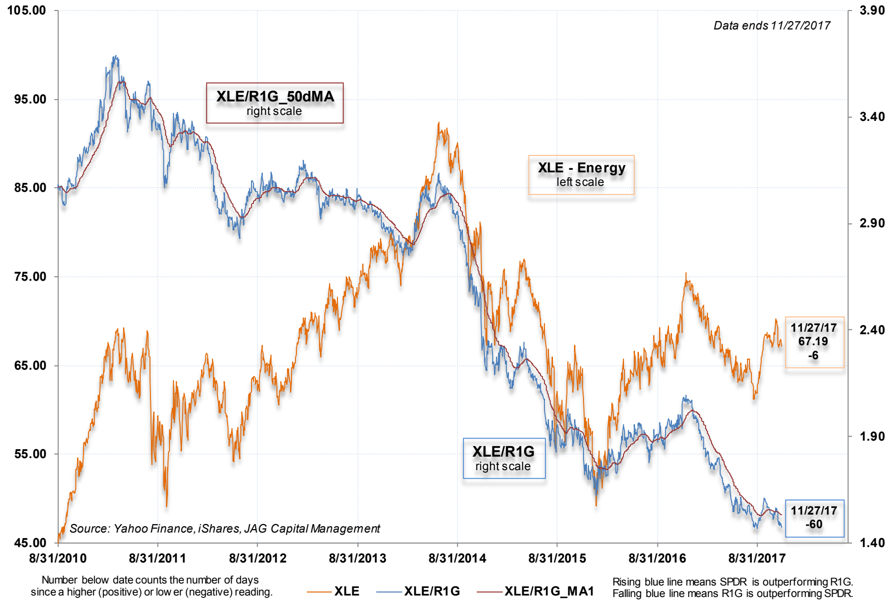
The amazing advancement of U.S. shale fracking technology has been under-covered by the business media. U.S. field production of crude oil is within a whisker of setting an all-time record, despite the fact that crude prices remain almost 40% below their highs. This is possible only because of a revolution in the efficiency of fracking. Quite simply, U.S. oil producers can extract more oil at a lower cost than ever before. This compels them to economically produce more oil at lower price points than was possible even five years ago. And as oil prices rise, they open the spigots even further. Given the fact that the U.S. is now the world's "swing producer" of oil, domestic producers risk over-supplying the global market, which could keep a cap on the commodity's price.

Baker Hughes U.S. Oil Rig Count



According to Baker Hughes, the U.S. oil rig count has fallen by more than 50% since the fall of 2014. But as we saw on the previous chart, U.S. oil production is close to setting an all-time record. We think this not only demonstrates the gigantic improvements in fracking efficiency, it also has some implications for energy stocks. Lower rig counts imply less need for the equipment, consumables, and materials that are used to build and operate rigs. This makes it difficult for oil service companies to grow revenue and earnings. Also, we think fracking technology will continue to improve, which probably limits the upside for crude oil prices in the future. Given these fundamental headwinds, we remain on the sidelines as we approach 2018.

XLE vs. XLE / Russell 1000 Growth (R1G) with Moving Average



As measured by the XLE (Energy Sector SPDR ETF), Energy sector stocks began underperforming the Russell 1000 Growth Index way back in 2011. The downtrend in relative performance steepened to a sharper slide in late 2014 as crude oil prices crashed from $100/barrel to below $30/barrel in 2016. After such a long – and deep - bear market, some investors are projecting that 2018 will be a turnaround year for oil stocks. We are not convinced.

Disclosures

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JAG
CAPITAL MANAGEMENT LLC

9841 Clayton Road | St. Louis, MO 63124
800.966.4596 **www.jagcapm.com**
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