CREDO WEALTH

Shale Oil; Pretender to the Throne?

Contrary to all expectations, Bonnie Prince Charlie's campaign to win the British throne began exceptionally well, sweeping all before him as he marched south to London. In like fashion, the emergence of shale oil shocked global supply, and seemed poised to depose the current arbiters of the global oil market, OPEC. On the back of this BP, which we continue to hold, has taken a sustained bruising over the last six months. Like the Jacobite Rising of 1745, however, will shale oil become the revolution that wasn't?

Over the last few years roughly 4/5ths of growth in the global oil supply has come from shale-derived oil, a resource predicted to peak in 2018. This all comes down to the economics of oil: an elevated price enables the development of unconventional extraction methods. The US has been a child of fortune, benefitting from the coalescence of existing regional infrastructure with extensive, shale-rich sediments. But it is economics, not military clout, that threatens this nascent revolution.

While Bonnie Prince Charlie lacked broadswords, shale wells lack sustainable oil flows. Unlike a conventional reservoir, which taps a large area, shale is more targeted. As a result, the volume of oil extracted declines rapidly, at 30% per year compared to 6% for a conventional well. The IEA estimates that maintaining production of 1 million barrels per day in the Bakken, a geological formation in North Dakota and one of the largest sources of shale oil in the US, requires drilling 2,500 new wells a year. A large conventional oil field in Iraq needs only 60. On the assumption that the best parts of the best fields are drilled first, we may reasonably suspect that the cycle of overcapacity driven by shale oil may well be short lived.

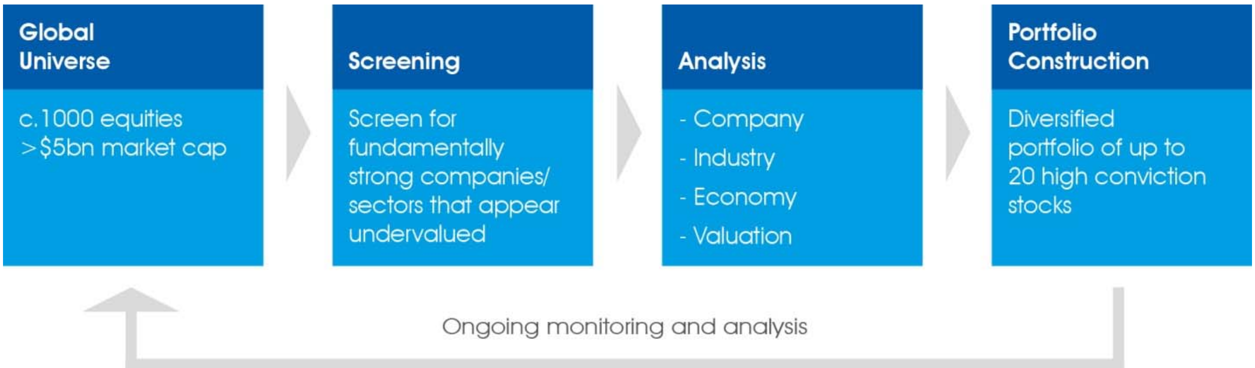
18th Century rebellions are all very well, but we should be cognisant of more recent history. The rise of OPEC and the resultant oil crises throughout the 1970s led to a more than 10-fold increase in inflation adjusted oil prices. Such elevated prices spurred development of higher cost sources of supply, and the discovery of hitherto untapped reserves (in the North Sea, Gulf of Mexico, and Barents Sea, to name a few). Realising their folly in holding back production, OPEC ramped up supply, leading to the precipitous collapse of the oil price in 1986. Despite this, some of these sources remained profitable. However, the same does not hold true today. Shale largely operates on the higher end of the marginal cost curve: when the oil price collapses, profit margins are quickly eroded. Shale's uprising may be routed by a depressed oil price, but it will not be defeated. Oil is a commodity: prices are liable to overshoot in the short term, but in turn lower prices drive demand and curtail supply by the higher cost producers.

Nevertheless, we should not rush to dismiss shale oil. Shale's resilience lies in the flexibility of its capital expenditures: when the oil price is low, operators can simply slow down production and live to drill another day. This leaves the US well placed as a swing producer, tinkering with the taps to moderate the highs and lows of the market. The spigots are open for now, but we remain confident of BP's underlying strength in the face of this new supply. Shale oil may not be a revolution, but it is unlikely to suffer the same fate as the Jacobite cause. We need not prepare for a Culloden.

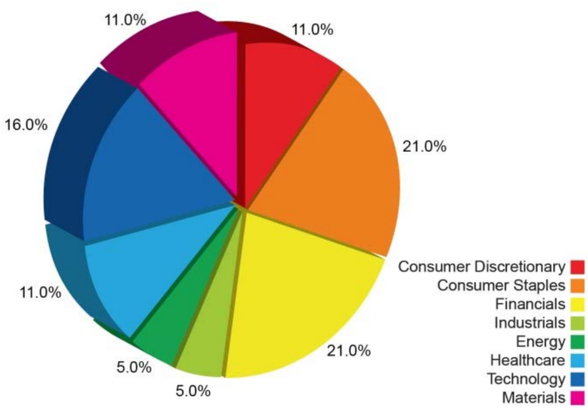
BESTIDEASPORTFOLIO

The Credo Best Ideas Portfolio is a diversified portfolio (not a fund) of global equities which we believe to be well-positioned to outperform the wider equity market over the longer term. The portfolio has a bias towards developed market, large capitalisation stocks. Our aim is to generate sustainable excess returns versus global market indices through careful stock selection.

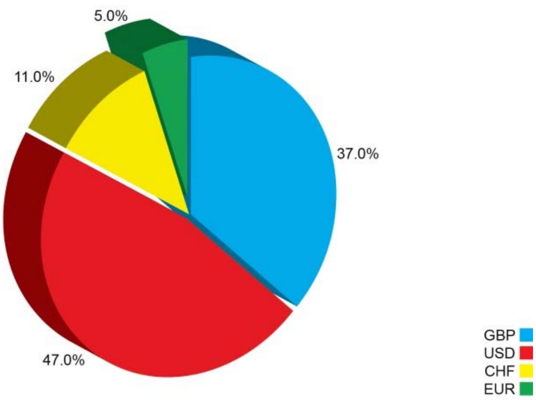
Investment Process



Sector Allocation



Currency Allocation



Performance / Stats[1]

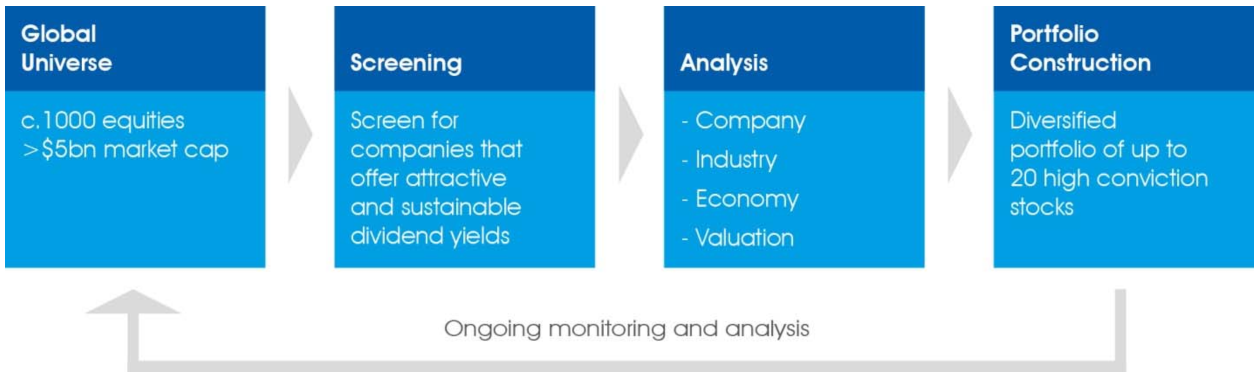
	Trailing 12 Month P/E	12 Month Forward P/E	Dividend Yield	Return Since Inception (14/04/2011)[2]	Annualised Return Since Inception
Best Ideas Portfolio	14.8x	14.3x	2.9%	54.9%	12.8%
MSCI World Index	18.0x	16.6x	2.4%	46.2%	11.1%

(1) Source: Bloomberg pricing as of 28/11/2014 close.
(2) Performance figures are based on a notional portfolio, denominated in pound sterling, designed to track the holdings of the Credo Best Ideas Portfolio. Portfolio incorporates all additions and removals. Portfolio may not be fully invested at a point in time and therefore can hold a portion of assets in cash. Performance is calculated before any fees (which can vary depending on the level of service) but includes gross dividends, not reinvested.

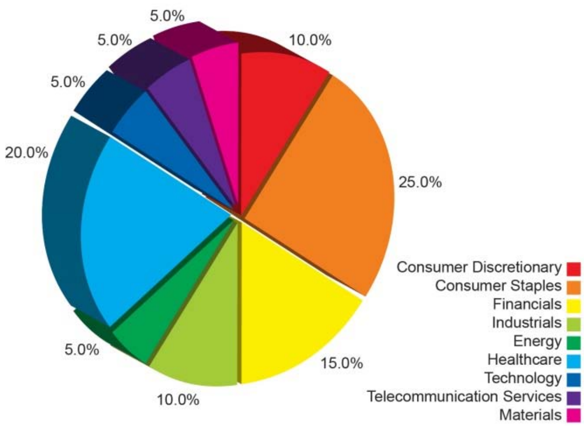
DIVIDEND GROWTH PORTFOLIO

The Credo Dividend Growth Portfolio is a diversified portfolio (not a fund) of global equities that has an objective to provide investors with a sustainable and growing income stream through dividends and share buybacks. We focus on companies that pay attractive dividend yields, with an ability to sustain and grow these over the long term. The portfolio has a bias towards developed market, large capitalisation stocks. Our aim is to generate a total return in excess of the MSCI World.

Investment Process



Sector Allocation



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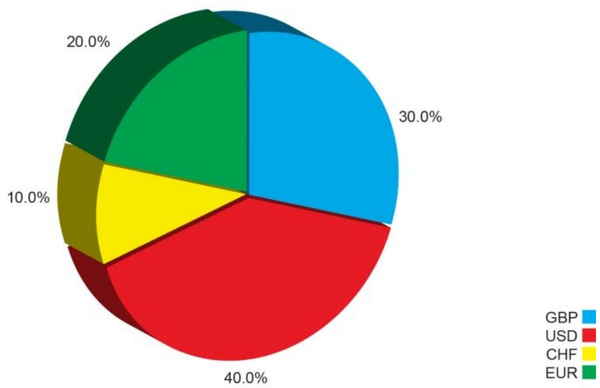

Performance / Stats[1]

	Trailing 12 Month P/E	12 Month Forward P/E	Dividend Yield	Return Since Inception (28/12/2012)[2]	Annualised Return Since Inception
Dividend Growth Portfolio	15.1x	14.3x	3.5%	40.2%	19.2%
MSCI World Index	18.0x	16.6x	2.4%	39.2%	18.8%

(1) Source: Bloomberg pricing as of 28/11/2014 close.
(2) Performance figures are based on a notional portfolio, denominated in pound sterling, designed to track the holdings of the Credo Dividend Growth Portfolio. Portfolio incorporates all additions and removals. Portfolio may not be fully invested at a point in time and therefore can hold a portion of assets in cash. Performance is calculated before any fees (which can vary depending on the level of service) but includes gross dividends, not reinvested.

How to Invest

If you wish to make an investment in the Best Ideas Portfolio or Dividend Growth Portfolio please contact one of our Relationship Managers.

Important Notice

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Performance figures are based on notional portfolios, denominated in pound sterling, designed to track the holdings of the Credo Best Ideas and Dividend Growth Portfolios. The portfolios incorporate all additions and removals and may not be fully invested at a point in time and therefore, can hold a portion of assets in cash. Performance is calculated before any fees (which can vary depending on the level of service) but includes gross dividends, not reinvested.

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