

Market Commentary

Second Quarter 2018



Sentry Energy Fund

Energy market performance during the quarter was robust. This is not a surprise as excess oil inventories have been drawn down. Both the S&P 500 Energy Index and the S&P/TSX Energy Index outperformed their broader indexes for the quarter (15% for S&P Energy versus 3% for S&P 500 Index and 16% for S&P/TSX energy versus 6% for the S&P/TSX Composite Index). Sentry Energy Fund was up 11% in the quarter.

The energy market's performance was helped by the rebound of crude oil prices in April and May as supply from Venezuela and several other OPEC countries (Libya, Nigeria, Angola) disappointed. In November 2016, OPEC had agreed to cut production of around 1.3 million barrels per day (b/d). However, due to production issues, the actual cut was closer to 2 million b/d. To offset the production decline, OPEC and Russia agreed to bring back production to reach 100% compliance and help to stabilize prices and inventory.

An increase in production could moderate prices in the near term. However, as OPEC and Russia increase production, spare capacity will decline. Should the sanctions on Iranian oil exports be enforced, spare capacity could be drawn down more significantly. Combined with the limited ability of the U.S. to act as a swing producer given the infrastructure constraints, a case can be made for a more constructive view on oil prices for the next 18 months.

The biggest risk to this constructive outlook comes from the demand side of the equation, given the escalating trade tension and higher commodity price. Trade tension/war has the potential to paralyze investment, slowing global growth, which ultimately rations crude demand.

We are not yet overly concerned that the higher crude oil prices will destroy demand. With the Brent price around \$75 per barrel, this only represents 3% of global GDP, which is still much lower than the 5% level during the 2011-2013 period when the oil price was over \$100 per barrel. During that period, oil demand was still up over 1.1 million b/d annually. Therefore, barring the impacts of a full-scale trade war, we remain constructive on crude oil.

Natural gas inventories are at the low end of the five-year range and prices have been range-bound, reflecting the ample supply of low cost natural gas in North America.

Fund performance was helped by holdings in international (Brent-linked) names such as Hess, Parex Resources, and Noble. Detracting from performance was our underweight in large cap names such as Canadian Natural Resources and Suncor Energy, which were up 17% and 20% respectively for the quarter.

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Given our constructive outlook for oil, combined with reasonable valuations, we continue to overweight the portfolio toward exploration and production oilfield services (as opposed to integrated and refineries). Furthermore, energy management teams continue to promise investors capital discipline and a focus on returns. This should continue to be a catalyst for a sector re-rating.

We expect the infrastructure bottlenecks to be removed, and Permian (Midland) oil prices to realign with international (Brent) as pipeline capacity gets built. In the interim, however, our portfolio additions (ConocoPhillips, Saipem, and Noble Energy) have increased our weighting to Brent-linked crude oil pricing.

Class F Returns (in %) as at June 30, 2018	Year-to-date	1 year	3 year	5 year	Since inception (3/16/2009)
Sentry Energy Fund	3.1	9.1	-6.7	-4.2	5.1

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