Weekly Markets Commentary

Sept. 16, 2019

David Joy
Chief Market Strategist,
Ameriprise Financial

"The good news for the U.S. is that domestic oil production has surged in recent years. As a result, there should be no interruption in the domestic supply, although the price will likely be higher for an indeterminate period."

Investors Respond to Strikes on the Saudi Arabia Oil Facilities

The weekend attack on Saudi oil facilities quickly deflected attention away from what had been a building renewal of risk appetites among global investors. In early Monday trading, Brent crude futures were trading higher by $5.21, or 8.6 percent, to $65.48 a barrel. West Texas Intermediate was trading at $59.46 a barrel, higher by $4.59. Both benchmarks had traded even higher at the opening.

With longer-term memories mindful of the potential global economic impact of sharply higher oil prices, the focus following the attack quickly shifted to the extent and duration of the lost production. It is estimated that 5.7 million barrels of daily oil production, or roughly 5 percent of global consumption, has been disrupted. Some of that lost production can be replaced relatively quickly with the restart of excess capacity, but full restoration of the kingdom's output is likely to take weeks. And some of that interrupted production could be replaced by existing storage inventories. In the U.S., President Trump moved to tap the strategic petroleum reserve if needed to stabilize markets.

Stocks in Saudi Arabia fell by 3 percent when trading opened following the attack, but subsequently recovered much of that lost ground. Japanese markets are closed on Monday, but elsewhere in Asia stocks prices were mixed, but showed little evidence of disorderly trading. In Europe, prices are down across the board, with the Stoxx 600 index down by less than 0.5 percent. Oil producers in Norway and Russia are notably higher. Equity futures in the U.S. are indicating a down opening of approximately 0.4 percent. Safe-haven assets are trading higher as expected. The yield on the ten-year U.S. Treasury note is lower by six basis points at 1.83 percent, and gold is higher by $14.63 to $1,503.00 an ounce (a basis point is 1/100th of a percent). The Japanese yen and Swiss Franc are trading higher as well.

Investors Weigh the Severity of a Disruption in Oil Production

Rebels in Yemen claimed responsibility, but the U.S. quickly pointed to Iran as being responsible, whether directly or through its proxies in the region, including in Yemen. This comes at a time when tensions between the U.S. and Iran are already elevated, with the U.S. having pulled out of the nuclear accord and following several recent incidents disrupting shipping traffic in the Persian Gulf.

It also comes at a time when investors were shaking off their worries from August over the seemingly intractable trade war between the U.S. and China, the threat of a no-deal Brexit, and increasing talk of recession. During the previous three weeks, the S&P 500 had risen by almost six percent, while the yield on the ten-year note had climbed from 1.49 to 1.90 percent. The MSCI ACWI Ex-U.S. index had climbed by just over five percent.

Suddenly, however, investors are reminded of the risk that oil supply disruption poses to the global economy. The degree of that risk depends not only on the extent and duration of the supply disruption caused by this attack but also the extent of any new risk premium investors now price into crude to reflect its potential vulnerability to future attacks, acting as a tax on future economic activity. It also depends on the response from the U.S. and Saudi Arabia, and to what extent that might cause a further rise in the oil risk premium.

The U.S. Oil Supply Hedges Some Risk

The good news for the U.S. is that domestic oil production has surged in recent years. As a result, there should be no interruption in the domestic supply, although the price will likely be higher for an indeterminate period. To the extent that higher prices show up at the gasoline pump, U.S. consumers will feel a little pain. But, WTI is now trading at a price similar to where it was trading in the spring, at that time causing little headache for the strong consumer sector.

In addition, the Federal Reserve meets this week and is widely expected to lower the overnight rate by another quarter-point, following a similar cut in July. And this follows last week's ECB announcement of additional stimulus.

But there is no denying that the rising confidence of the past several weeks has been interrupted. Investors must now wait for any response to the attack before deciding if an adjustment to risk exposures is warranted.

Important Disclosures:

The views expressed are as of the date given, may change as market or other conditions change, and may differ from views expressed by other Ameriprise Financial associates or affiliates. Actual investments or investment decisions made by Ameriprise Financial and its affiliates, whether for its own account or on behalf of clients, will not necessarily reflect the views expressed. This information is not intended to provide investment advice and does not account for individual investor circumstances.

West Texas Intermediate (WTI) is a grade of crude oil commonly used as a benchmark for oil prices. WTI is a light grade with low density and sulfur content.

Brent Crude is a major trading classification of sweet light crude oil that serves as a major benchmark price for purchases of oil worldwide.

The STOXX Europe 600 Index is derived from the STOXX Europe Total Market Index (TMI) and is a subset of the STOXX Global 1800 Index. With a fixed number of 600 components, the STOXX Europe 600 Index represents large, mid and small capitalisation companies across 18 countries of the European region.

The MSCI ACWI ex USA Index captures large and mid cap representation across 22 of 23 Developed Markets (DM) countries (excluding.

Past performance is not a guarantee of future results.

Indexes are unmanaged and are not available for direct investment.

Ameriprise Financial Services, Inc. Member FINRA and SIPC.