EYES ON ENERGY

FROM GAS-LOCK ADVISORS, LLC

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At Gas-Lock Advisors we track major developments in the energy markets following the leading sources from industry, government and academic research. When conditions warrant, usually about once a month, we refine the crude information and deliver a simple, readable product.

We present the most important information from three perspectives:

1. Economic trends affecting energy
2. The risk level from short-term threats and events
3. Current fuel pricing

We are your eyes on energy.

Macroeconomic Factors

The economic picture remains mixed, with below-trend U.S. growth of about 2%. Recent data on employment has been solid. Initial jobless claims have fallen to healthy levels. The housing market is showing strength. Despite the continuing fiscal drag from budget cuts, leading economic forecasting firms Moody's Analytics and Macroeconomic Advisers both see the probability of a strong 2014 as the economy reaches "escape velocity."

There are some modest signs of improvement in European consumption. Chinese GDP is now projected to be somewhat lower, perhaps 7.7% growth instead of 8%. The overall picture may be stronger than energy markets reflect. We will get the Fed's updated forecast next week.

Potential Risks

Refinery outages pushed gas prices higher in the Midwest last month, particularly around the Memorial Day weekend. Demand remained consistent as prices continued to soar - starting off the summer driving season with a sharp kick. [The USA Today reported]:

> "Gas prices in Minnesota, Iowa, Missouri, North Dakota, South Dakota, Nebraska, Ohio, Oklahoma and Wisconsin have spiked up to 40 cents a gallon the past week alone…
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> While the USA may be dripping in new found crude oil deposits and early May supplies were at their highest levels since the early 1930s, issues at a handful of refineries that turn crude into gasoline and diesel fuel underscore how kinks in the supply chain can cause quick surges in what consumers pay at the pump.
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> In Minnesota, regular, unleaded gas averaged $4.15 a gallon heading into the weekend — an all-time state record. With some Twin Cities outlets now selling gas for more than $4.50 a gallon, making Minnesota the priciest state for gasoline in the continental U.S., overtaking California, which now averages $4.06 a gallon. In oil-rich North Dakota, prices average $3.98, also a record-high.
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> 'It's amazing what problems refinery issues can cause,' says Patrick DeHaan, senior analyst for price tracker gasbuddy.com. 'If another refinery went down, all hell would break loose.'"

These refinery shutdowns continue to upset Midwest oil markets. More recently, the Great Lakes region has been feeling the squeeze. Average prices in Michigan are now the highest in the continental United States - shooting up 23 cents in only a week. According to the [Detroit Free Press]:

> "Analysts said it is difficult to predict how long the higher prices will last, but warned they could continue to climb before coming down. 'The Midwest refineries are plagued with problems,' said Phil Flynn, chief energy analyst

> with the Price Future Group in Chicago. 'While the rest of the country is swimming in supply, the Midwest is seeing 22-year lows of supply. We can't seem to get a break.'
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> Michigan was especially hard hit this weekend because it depends on aging Midwest refineries that have had problems this year. However, unlike other Midwest states, which also had higher prices, Michigan doesn't have as many other refinery and pipeline options, one analyst said.
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> In addition, speculation among Midwest refiners likely is causing them to panic and buy gasoline at a premium to meet contract orders from wholesalers. Other oil producers see a competitor's vulnerability and ratchet up prices, which the buying refinery passes on to wholesalers, who, in turn, raise their prices to retailers, who then boost what they charge consumers."

While there is no end in sight to the domestic woes in America's heartland, geopolitical instability continues to loom over international commodities markets.

Over the past month, the ongoing crisis in Syria is still most threatening to international stability. Russia has recently ramped up its aid to the established government of Bashar Al-Assad, supplying them with new and advanced anti-aircraft systems. A Huffington Post editorial suggests this policy is meant to play on Mideast tensions for political gain:

> "Oil has become perhaps the key mainstay of the Russian economy. Oil and gas account for two-thirds of its exports, half its budget revenues and nearly one-third of economic output ("From Pump to Putin" Financial Times 06.02.13). In addition, Russia's gas giant Gazprom exports massive quantities of gas to European consumers on contracts for which the price of gas is pegged to the price of Brent Crude, resulting in gas prices higher by a factor of more than three when compared to prices paid for American natural gas by American consumers and industry.

> The sale of oil and gas, and their ability to deliver it to wherever the market dictates, together with the tie in between the price of oil and the price of gas in Russian gas supply contracts, has made oil a crucial element to the Russian economy and the Putin presidency. The Russian economy and "Putinism" has become deeply dependent on the price of oil.
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> In a refrain of that old adage "plus ca change...," an article in the New York Times back in 2012 ("An Embargo and a Boon" 02.17.10) commented, "The Russian oil industry was already reaping the rewards of higher oil prices from Iranian tensions..." Back then, the Russians were cashing in brilliantly on higher oil prices, while rendering support to Iran by such acts as vetoing or emasculating any and all meaningful U.N. resolutions that would have forced Iran to comply with the terms of the U.N.'s International Atomic Energy Agency mandates. Iranian adherence to those resolutions would have dramatically abated tensions, forestalled the boycott of Iranian oil and sharply reduced the price of oil."

This suggests the Russian government may continue to exacerbate these tensions for economic gain at the expense of the consumer.

However, there is recent good news in the commodity markets: Saudi production is up substantially. According to a June 4 commodities note from the Bank of America reports:

"Saudi Arabia, by far, led the gains this month, with production rising by 170 thousand b/d MoM to 9.35 million b/d. Output has risen by 0.35MM b/d over the past three months and should continue to find support given greater shipments to the US Gulf Coast's Saudi Aramco-Shell Motiva refinery, ongoing ramp-up of the local Jubail refinery, and seasonal demand for crude burn for power generation."

This increase in supply could conceivably help to keep prices lower through the summer. But if the last month has proven anything, it's just how susceptible the price of oil and gas is to unpredictable shocks.

Pricing

The best way to look at energy prices is through what is called the forward curve. This is much more informative than the popular media reports of the front month spot price. Sometimes the front month price moves, but the rest of the curve does not.

The curve for the month of June reflects anticipated higher prices moving into the summer driving season. Though higher than May, it is important to note that the forward curve had not reached the peak it did in April earlier this year. It is likely that speculation over geopolitical tensions is likely for the exaggeration in spring prices.

Most importantly, you can see that there are still good opportunities to lock in prices for twelve-month periods beginning in October, 2013 or later.