

# CTA Intelligence

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## Back from the Dead

THE SEC RESURRECTS ITS MUTUAL  
FUND DERIVATIVES RULE

### ENERGY MARKETS SPECTACULAR RIDE

What's fuelling this year's top  
performing commodities funds



### A SLOW CLIMB FOR OIL PRICES?

The second order effect of the  
Iran nuclear deal unravelling

### FINDING A HOME FOR YOUR UCITS FUND

The key questions managers  
should ask when moving platforms



# THE SECOND ORDER EFFECT OF THE IRAN NUCLEAR DEAL UNRAVELLING

**T**rump's decision on 8 May to pull out of the Iran nuclear deal will have far reaching impacts on and beyond oil. The decision has never been far from the realm of possibility, but it is somewhat surprising he did not leave room for negotiating a 'better deal'.

Domestically, Trump appears tough to his supporters and it seems the hardliners have the upper hand in the White House. Gasoline prices may spike short term, but his base should forgive him. If prices go too high too fast Trump might bash Opec or tap the Strategic Petroleum Reserve (SPR) as a gesture even though it will accomplish nothing.

With Venezuela's oil production plunging, a curtailment of 200 to 300Mb/d of Iranian oil is

an additional tailwind for oil prices. Although America is acting unilaterally, US extra-territorial sanctions will still cause multinational oil companies, especially European ones, to comply because of their inability to bypass US banks and the dollar. However, with prolific US shale production and plenty of Opec production slack, this shortfall can be made up relatively easily. In fact, analysts are expecting Opec and Russia to loosen the 2017 production cutback agreement to cap world oil prices. Therefore, limited impact on the short-term fundamentals is expected, but a large second order effect can surface depending on how various players respond.

## How will Iran handle ongoing oil production?

Iran will likely resume its old trick during the

Obama-era sanctions: storing oil in tankers and selling at a discount. China has been asked by Iran to step up its purchase from Iran and it may very well comply because China has little to fear from the US.

In fact, China was and still is a steady buyer of Iranian oil through the 2011-13 sanctions. Some of the 'lost' barrels will likely just be shuffled around in the world market.

## How will Iran react politically?

President Rouhani, a moderate, having been an advocate for the nuclear deal, has been significantly weakened (they have politics too). Hardliners are not likely to take the new sanctions sitting down.

To encourage them to stay off the nuclear path, the Europeans are stuck trying to mini-



## Kronos Management on why the world is likely to see a slow climb and higher plateau of oil prices

mise the sting of potential US sanctions while Iranians are demanding concessions. The hardliners in Iran will likely gain significant political grounds and so increased regional conflict escalation can be expected.

### How will this affect the rest of Middle East?

While it is for Saudi Arabia, Turkey, and Israel, a clear political win to cripple Iran, they will also have to prepare for intensifying conflicts in Syria, Yemen, Lebanon, and possibly elsewhere. Russians got a boost in influence in the form of closer military coordination with Iran and economic cooperation with Saudi Arabia, at the expense of America.

Combined with the resentment caused by the move of American embassy to Jerusalem,

there is a noted increased risk of accidental miscalculations fuelling existing conflicts or leading to new ones. In a circular logic kind of way, the newly emboldened Trump national security and foreign policy advisors may see that as vindication and justification for further pressure on their belligerent counterparts, with potentially disastrous feedback loops.

### How will North Korea react?

Actually, no big change. After the Singapore summit, Kim Jung Un has already achieved his nuclear objectives and international recognition for now. He has a few more decades of staying in power to worry about and judging from his shrew diplomatic charm offensive lately, he likely knows that by giving Trump good headlines he can stay out of trouble and wait it out. If

beat everyone else to comply with its sanctions is destructive. It will likely generate resentment and further encourage Europeans and Chinese to sidestep the institutions created by the US in which Americans benefit tremendously since the 1950s. America First seems to have turned into America Alone. The current administration may enjoy the satisfaction of wielding a big stick, but it is a dire development for America's long-term influence.

### How will it affect nuclear stability around the world?

Globally, numerous nuclear non-proliferation treaties and multilateral disarmament agreements already in place needing renewal or completion will be jeopardised. A degree of trust is necessary that different administrations can

“Iran will likely resume its old trick during the Obama-era sanctions: storing oil in tankers and selling at a discount”

anything, the unwinding of Iran deal reaffirms for Kim the importance of maintaining his nuclear options. Recent talk of applying a Libya model on North Korea definitely strengthened his resolve.

### How will our European allies react?

High level French, German, and British lobby has failed. Optically and substantively, this is a big setback in America's traditional alliance with Europe, consistent with recent trade skirmishes, support of Brexit, and the undermining of Nato. Trump's wholesale ignoring of difficult European internal politics has made their leaders job much harder and his threat to impose sanctions on European firms while saving a Chinese sanction-violator on questionable grounds has outraged many.

America is signalling a return to the world order where small fish survive at the mercy of great powers. China and Russia had seized on this to try to impose their world order while small countries scramble to pick their protectors; Europe will lean further away from America. This longer-term effect is not immediately obvious, but it is likely to negatively affect global commerce and stability in a meaningful way.

### How will it affect American power?

America's unilateral exit of the deal without an effort to improve the terms is a blow to its prestige. America's wielding of its currency as the world reserve and its banking prowess to brow-

honour past commitments. America's abandonment of a past commitment on flimsy evidence despite the cooperation of all major powers is not likely to inspire confidence in any party in negotiation. It may even lead to more cheating and violations of existing pacts. The erosion of good faith among nuclear players and the lack of inspection and verification programmes can lead to massive geopolitical miscalculations.

### Conclusion

All in all, with still-robust oil demand growth forecast and heightened geopolitical risk, a further rise in oil prices is all but a given. Through a few years of restraining production, Opec and Russia have achieved sufficient inventory drawdown and held oil prices stable and provided a floor. The structural decline in oil volatility, however, has its roots in the US shale plays. Despite recent calls by analysts for a hundred-dollar-oil, with their short cycles, fast response time, ever-increasing productivity and export capabilities, shales have become a powerful swing producer that can effectively cap the price advance. Barring a rapid collapse of Venezuelan production or a war breaking out that causes a major supply disruption, the world is likely to see a slow climb and a higher plateau of oil prices. ■



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