16, 2015, at 7:39 AM, Nelson, John C. <John.Nelson@gs.com> wrote:

Goldman Sachs Global Investment Research

Feedback to "lower for even longer": tail risks keep investors sidelined

Less pushback on oil view, partly due to demand concerns
Investors were generally receptive to our lower for even longer oil call as many see a prolonged down-cycle possible given the supply side of the market may take longer to find a new margin of adjustment. The biggest debate centers on how long the recovery will take and whether upside oil price optionality is capped by abundant short cycle US supply waiting to be produced. Investors appear more concerned on demand – that decelerating EM/China demand could extend the duration of the rebalancing period and create near/medium-term downside oil price risk.

Greater pushback on midstream downgrade, E&P ratings changes
On midstream, investors pushed back on the timing of the call, but some agree that stock price performance could be weak over the medium term as US growth slows. On the OKS downgrade to Sell, the Street seems more confident on its optionality to transition commodity exposed revenue to higher fee-based revenue streams. On E&Ps, generalists questioned the downgrade of Permian favorites CXO/RSPP to Neutral and the upgrade of weaker balance sheet stocks ECA/WLL given the lower 2016 WTI oil forecast ($45/bbl from $57/bbl). As conversations progressed, it was evident dedicated investors that believe in a longer down-cycle (into 2017) viewed the CXO downgrade more favorably and are concerned for growthier E&Ps where 2016-17 expectations may need to fall (EOG/MRO).

Portfolio allocation favors equities with CF visibility going forward
Energy sentiment reflects a continued lack of conviction, as outsized tail risks (potential storage breach/geopolitical uncertainty) keep investors sidelined from meaningfully stepping up to buy North American oil-levered equities and less willing to press directional views. Investors are broadly underweight with focused buys on stocks with cash flow visibility. The refining sub-sector has been the biggest beneficiary of this quest for cash flow. Conversations also indicated a preference for oil service bellwethers (SLB), midstream stocks with strong fee-based cash flows (KMI/ETE/LNG), well-hedged E&Ps (PDCE/PXD) and gassy equities (COG).

So what will it take for investors to warm up to Energy?
We think the appetite to buy hinges on the alignment of three factors: (1) oil price stability for a sustained period of time (months not weeks), (2) improved supply/demand data points supporting a move higher in longer dated futures, and (3) more attractive valuation risk/reward, especially if investors feel that a potential “cash cost” oil price scenario is less likely.

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