

# PALOS

November 15, 2018

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■ **Portfolio Management & Advisors**

**Charles Marleau, CIM**  
 CEO & Senior Portfolio Manager

**Noah Billick**  
 President, Wealth Management

**Hubert Marleau**  
 Economist & Co-Founder

**Wakeham Pilot**  
 Chairman, Wealth Management

**Robert Mendel**  
 Senior Portfolio Manager & Options Strategist

**William Mitchell**  
 Portfolio Manager & Equities Strategist

**Karen Shoffner**  
 Portfolio Manager

**Robert (Bob) Barootes**  
 Vice President, Business Development

**Joany Pagé, CFA**  
 Portfolio Manager

**Amjad Alaik**  
 Portfolio Administrator

■ **Contacts**

**Palos**  
 1 Place Ville Marie, Suite 1670  
 Montreal (QC) H3B 2B6, Canada  
 T. +1 (514) 397-0188 F. +1 (514) 397-0199  
[www.palos.ca](http://www.palos.ca)

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## Palos Weekly Commentary

■ **Palos Funds**

By Charles Marleau

### Oil vs Natural Gas

Oil prices have fallen like a rock for 12 straight days. This is a new record, and never seen before price action. The headlines are having a serious impact on prices, from president Trump tweeting "oil prices should be much lower based on supply" and OPEC increasing production by 1.5MM Bbl/day to replace lost oil from the expected Iranian sanctions.

However, the sanctions have been softening, bringing fear that oil is oversupplied. The market seems to be assuming that there will no longer be any sanctions on Iran. Furthermore, there has been negative headlines on demand, because of China tariffs and interest rate. All this price action started a week before the US midterm elections, and someone could argue that that the Saudis were being manipulated by Trump, especially with the murder of Jamal Khashoggi. Did Trump make a deal? I will back you on Khashoggi but help me on the midterm election by bringing oil prices down.



	FundServ	NAVPS	YTD Returns
Palos Income Fund L.P.	PAL100	\$8.57	-10.01%
Palos Equity Income Fund - RRSP	PAL101	\$5.74	-10.00%
Palos Merchant Fund L.P. (Mar 31, 2018) <sup>2</sup>	PAL500	\$1.83	7.25%
Palos WP Growth Fund - RRSP	PAL210	\$7.70	-28.69%
S&P TSX Composite (Total Return with dividends reinvested)			-4.25%
S&P 500 (Total Return with dividends reinvested)			2.74%
S&P TSX Venture (Total Return with dividends reinvested)			-27.06%

	Value
US Government 10-Year	3.13%
Canadian Government 10-Year	2.43%
Crude Oil Spot	US \$56.25
Gold Spot	US \$1,214.30
US Gov't10-Year/Moody BAA Corp. Spread	204 bps
USD/CAD Exchange Rate Spot	US \$0.7551

<sup>1</sup> Period ending Nov 14, 2018. Data extracted from Bloomberg

<sup>2</sup> Fund is priced annually

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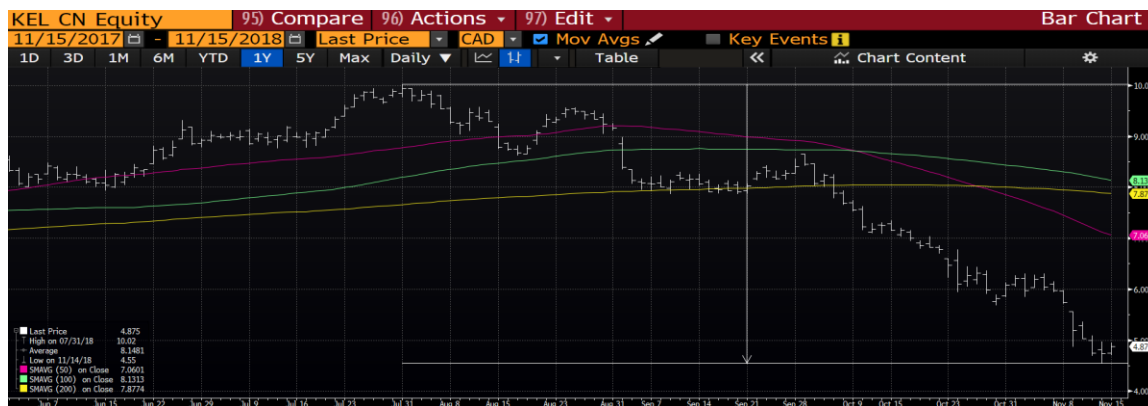
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Meanwhile, NYMEX natural Gas has gone parabolic, going from \$3.63 CAD to \$5.93 CAD. I agree that it got colder the past couple of weeks, but enough to spike gas from \$3.63 CAD to \$5.93 CAD? Yes, storage levels are lower in Canada and the US, but nothing alarming as we are coming from very high storages in previous years. These extreme price actions on oil and natural gas are not making any sense. There needs to be more than cold weather and negative headlines to have such price actions.

There is speculation that energy commodities funds are unwinding their big energy trade. For many years these funds were long Oil and short Natural Gas. For many years these funds made tremendous amounts of money. Things change however, and everyone is cashing in at the same time creating panic. See the chart on the first page.

I believe that there are macro and weather factors that brought this weakness and strength upon the energy market, however, oil prices down 28% and Natural Gas up 60% in 30 days make no sense to me.



## Mendel's Option Corner

By Robert Mendel

Another week and more fun. Here is an update.

On Nov 12, a day before earnings were set to be released, I sold a Nov 16 177.5 put on Home Depot for \$2.11 when the stock was at \$181.00. My thinking was that the stock was straight down from \$215 it touched on September 12 and it seemed to be stabilizing and the earnings, contrary to what the market was thinking, was not going to be bad at all (Home Depot is widely considered to be mostly a housing play, and that was showing signs of weakness.

The funds have been adding to names like Kelt Exploration (TSX: KEL). Our reason is simple, they have exposure to Natural Gas but are trading like an oil stock. For example, below is a chart of KEL. It seems like the market is ignoring their natural gas exposure and only focusing on their condensate exposure. This is probably because they are looking at AECO pricing which is at \$2.12 CAD, a far cry from \$5.93 CAD on NYMEX.

However, 81% of KEL dry gas is exposed to Dawn and Kingsgate pricing which are north of \$5.00 CAD. This gain in natural gas prices is more than doubling their loss in cash flow from the drop in condensate. Prior to the big rise in gas prices, KEL only had 2% of their dry gas hedged, and to our understanding, management is adding hedges during this spike in natural gas prices.

By the way, I don't think it is just a housing play, the market is wrong). Earnings were released on the 13th and they beat. As I write this the stock is set to open at \$181 – let's see what happens, still 3 days to go.

An update on some trades:

- Apple Nov 09 215 puts (last issue): Thinking there would be continued near-term uncertainty I rolled out the Nov 09 puts to Jan 18 215s for a net credit of \$5.10 bringing my total credit to \$11. Now I wait.
- Boeing Nov 09 322.5 puts (issue 44) expired worthless, so a win!

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- Amazon Nov 02 1475 puts (issue 44) expired worthless, so a win!
- Amazon call spread (originally issue 25) rolled to Dec 1525 and have brought down my cost to \$1216.05
- Saputo - Here we go again, love the cheese play. On Wednesday Nov 14 with the stock at \$39.40 I sold a Jan 38 put for \$1.35, a 3.5% return in 65 days and 20% annualized. This with a 3.5% downside protection. It's worked so far, let's hope it continues.

Crazy times, with lots of volatility and this creates opportunities, happy trading and do me a favor, buy some wood from Home Depot

Until next time.

## ■ What is New on the Macro Level?

*By Hubert Marleau*

Hubert is away travelling and will return with his column in next week's issue.

*If you have any questions about the weekly commentary, the securities that we follow, or investment ideas, please contact us at [info@palos.ca](mailto:info@palos.ca)*