Tales of the Trans Mountain Pipeline

The path from Edmonton to Burnaby spans just over 1,000 kilometres and covers some of the most picturesque landscape in Canada, including the breathtaking Jasper National Park. Since 1953, the Trans Mountain pipeline has occupied this route, carrying Alberta oil to the B.C. coast at a current rate of 300,000 barrels per day. In 2012, Kinder Morgan – the owner of the pipeline – announced plans to expand the line capacity to 890,000 barrels per day and received approval from the Canadian government in 2016 to do so. This decision sparked considerable political debate – particularly since the change in government in B.C.

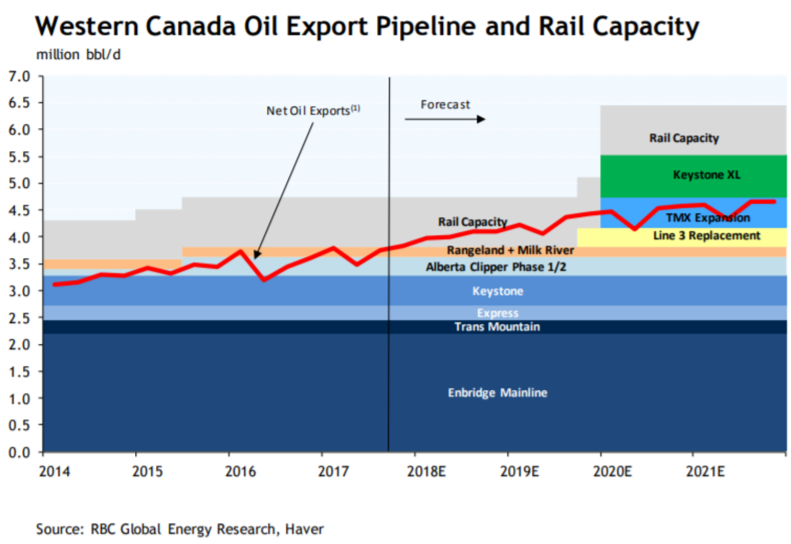
Alberta and the Federal government believe that the Trans Mountain expansion project is critical to the national economy as it will provide wider access to global markets for Alberta's oil producers and demonstrates that Canada is "open for business". The B.C. government, as well as some First Nations communities along the route, oppose the expansion over concerns that it poses risks to the environment.

In the face of the political backlash, Kinder Morgan announced in early April that it would stop all "non-essential spending" on the project unless it reached an agreement with the B.C. government to proceed by May 31st. Two days before the impending deadline, Finance Minister Bill Morneau announced that the Federal government would buy Trans Mountain from Kinder Morgan for $4.5 billion. The deal, pending approval from Kinder Morgan shareholders, includes the existing pipeline, rights of way along the route and the marine terminal in Burnaby; however, it doesn't include the construction costs of the expansion – estimated at $7.4 billion.

While the Federal government doesn't plan to own the pipeline long-term, its decision to intervene comes at a time when oil-industry leaders and executives from major Canadian banks have warned that the project's failure will make Canada seem like a less attractive investing destination. The decision is also politically sensitive for Justin Trudeau as it pits his various commitments to the environment, Indigenous people and opening Canada's natural resources to global markets against each other.

The path of oil prices

Since the oil shock two years ago, benchmark prices have risen considerably as the dynamic of the oil market has transitioned from excessive supply to the prospect of insufficient inventory. This occurred as strong global economic growth boosted demand for oil while OPEC members remain committed to production limits. Geopolitical issues have also resulted in reduced supply stemming from the U.S. decision to reapply sanctions on Iran and from issues with Venezuela's economy impeding the country's oil production.



Traditionally, heavy fuel from the Canadian Oil Sands trades at a discount to the main North American price (WTI) as it must be shipped long distances to refineries and it takes extra energy to convert it to usable fuel. The hope for Canadian oil producers is that the Trans Mountain expansion, along with other projects to relieve the transportation bottlenecks within Canada's energy infrastructure, will offer a lasting solution that allows them to be more competitive in the global market.

The energy sector makes up approximately 20% of the S&P/TSX Composite Index making it a core segment of the Canadian market. Within our Canadian equity portfolios, we favour energy companies with long-life, low-decline assets, strong balance sheets and management teams that are well-aligned with shareholders.

Publication Date: May 30, 2018.

Global Asset Management