Crude Oil Market Review

Oil prices have been volatile during the first quarter for 2020 to say the least. We have anticipated broadly balanced supply-demand for oil at the beginning of this year. A selloff in crude oil was triggered in March by a ramp up in production by Saudi Arabia of more than 20% to 12 million barrels per day. The production ramp occurred around the same time a COVID-19 pandemic swept across the globe. The dual shock from global demand, especially China, and extended supply caused West Texas Intermediate (WTI) crude oil prices to plummet from US$61.18 at the beginning of 2020 to US$20.48 at the end of the first quarter. Brent oil prices continue to trade at a premium but experienced a similar decline and closed the quarter at US$22.74. At current prices, free cash flow for U.S. mid-sized and small energy and exploration companies are threatened. In Canada, heavy oil spreads were similar to 2019, trading at a discount of US$15.40 per barrel at the end of the quarter.

The International Energy Agency predicted global demand to drop by 2.5 million barrels per day in the first quarter; China’s oil demand is to suffer the most, with a drop of 1.8 million barrels per day. A progressive recovery is then believed to take place through the second half of 2020. The outlook for the oil market is predicated on how quickly governments can move to contain the coronavirus and when OPEC+ members can agree on a large enough supply cut.

Since the fallout in March, OPEC+ agreed upon a 10 million barrels per day supply cut during the G20 meeting in early April. The OPEC+ deal is not contingent upon the U.S. joining with intentional supply caps. The core OPEC-10 group is responsible for cuts of 6.0 million barrels per day while the non-OPEC participants make up the remaining 3.9 million barrels per day to achieve just under 9.9 million barrels per day of supply reductions. The size of the OPEC+ cuts is unprecedented and is the first step towards re-balancing the market this year. However, as these supply cuts won’t be enacted until May, we expect the market impact to take place in June. Assuming the OPEC+ supply cut is enacted as planned, production is expected see a year-over-year decline of 7 million barrels per day to around 92.8 million barrels per day, leaving OPEC with the largest spare capacity since 1985.

Given the uncertainty over demand and supply, the global oil market is likely to remain challenged in the near term. The pace of shale expansion in the United States will likely slow as producers cut spending and scale back drilling activities. Capital discipline will remain a priority for shale producers. Over the short to medium term, the demand side of the equation is expected to improve especially as China’s quarantine measures get lifted. Global demand is also expected to slowly come back online as nations discuss the potential for re-opening their economies. On the supply side, as the coronavirus wanes and economies return to normal, non-OPEC supply will continue to decline due to the sharp drop in capital spending in 2020. We expect non-OPEC production to decline by around 2 million barrels per day in 2020. Over the longer term, the combination of restrained OPEC production coupled with declining non-OPEC production could create the conditions for a much tighter oil market. This could lead to record draws on inventory as well as allowing OPEC to completely unwind its production cuts.

Portfolio Review

Brompton Oil Split Corp. was down 55.1% in the first quarter of 2020 as crude oil sold off abruptly in March. The S&P/TSX Capped Energy Index was down 58.0% while the S&P 500 Energy Index was down 50.5% over the same period. While all the names in the portfolio was down for the quarter, top performers included TC Energy and Gibson, which were down 8.3% and 37.5%, respectively, considerably less than their peers. The weakest performers were Apache, Crescent Point Energy and Vermilion, who were more heavily impacted due to their oil production exposure.

The portfolio is currently comprised of 20 North American oil companies – 13 in Canada and 7 in the U.S. Midstream companies in the portfolio including TC Energy, Gibson Energy and Pembina Pipeline should continue to outperform oil and gas producers and refiners. Pipelines have a smaller exposure to commodity prices given the contracted nature of their businesses. Pipeline capacity demand for egress out of the Western Canada Sedimentary Basin remains high and existing pipelines are operating at peak capacity, which should support earnings for the pipeline operators.
Looking out to the rest of 2020, we expect oil price pressure to remain going into the second quarter before abating towards the second half of the year. Over the years, the industry’s cost structure has come down significantly which grants high quality oil producers the ability to cope with the current crisis. At current prices, oil producers will need to exercise capital discipline and we see the potential for consolidation within the industry. The existing OPEC+ supply cut deal of 10 million barrels a day implies the potential for oil prices to bottom out during the second quarter. Given proper compliance of OPEC+ nations, we believe oil producers are trading at very attractive valuations. In the long term, demand destruction is not expected to be permanent. The demand for transportation fuels has been disproportionately impacted by the pandemic as countries closed borders, but we believe the demand for travel will eventually return as quarantine measures ease. Moreover, on-road transportation fuels (gasoline and diesel fuel) can recover reasonably quickly to offer support as social-distancing and quarantine restrictions get removed.

Given our positive long-term outlook for oil, our view is that the sector is currently attractively valued. We see potential for a positive shift in investor sentiment on the back of a more substantial OPEC+ deal and waning of COVID-19 related risks. We believe that the current risk/reward proposition presents a buying opportunity for the oil producers.

Laura Lau, SVP & CIO
Michael D. Clare, VP & PM

<table>
<thead>
<tr>
<th>Annual Compound Returns1</th>
<th>1-YR</th>
<th>3-YR</th>
<th>5-YR</th>
<th>Since Inception2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brompton Oil Split Corp. - Unit</td>
<td>(56.4%)</td>
<td>(30.8%)</td>
<td>(21.6%)</td>
<td>(21.6%)</td>
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<tr>
<td>S&amp;P/TSX Capped Energy Index</td>
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<td>(20.2%)</td>
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<tr>
<td>S&amp;P/TSX Composite Index</td>
<td>(14.2%)</td>
<td>(1.9%)</td>
<td>0.9%</td>
<td>0.5%</td>
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1 Returns are for the periods ended March 31, 2020. The table shows the Fund’s compound return on a unit for each period indicated compared with the S&P/TSX Capped Energy Index (“Energy Index”) and the S&P/TSX Composite Index (“Composite Index”) (together the “Indices”). The Energy Index is derived from the Composite Index and tracks the performance of equity securities that are in the energy sector of the Toronto Stock Exchange (the “TSX”). The Composite Index tracks the performance, on a market-weight basis, of a broad index of large-capitalization issuers listed on the TSX. The Fund invests, on an approximately equal-weight basis, in a portfolio comprised of at least 15 large-capitalization North American oil and gas companies. Since the Indices have more diversified portfolios that only include TSX-listed issuers, it is not expected that the Fund’s performance will mirror that of the Indices. The Indices are calculated without the deduction of management fees, fund expenses and trading commissions, whereas the performance of the Fund is calculated after deducting such fees and expenses. Further, the performance of the Fund’s Class A shares is impacted by the leverage provided by the Fund’s Preferred shares.

2 Inception Date February 24, 2015.

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There are ongoing fees and expenses associated with owning shares of an investment fund. An investment fund must prepare disclosure documents that contain key information about the Fund. You can find more detailed information about the Fund in the public filings available at www.sedar.com. The indicated rates of return are the historical annual compounded total returns including changes in share value and reinvestment of all distributions and do not take into account certain fees such as redemption costs or income taxes payable by any securityholder that would have reduced returns. Investment funds are not guaranteed, their values change frequently and past performance may not be repeated.

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