Ninepoint Energy Fund Marketview

June 23, 2022

Strategy Update

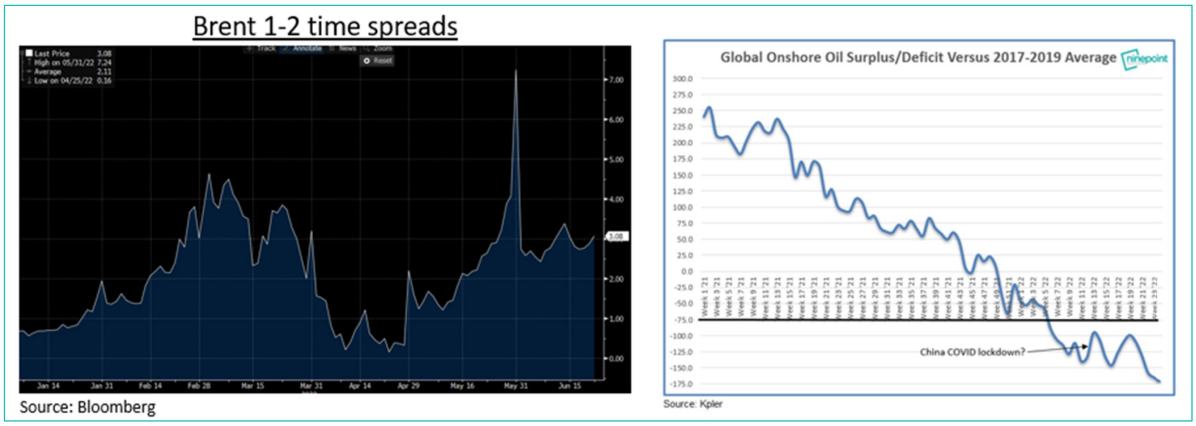
Since mid-May, oil has fallen by about 13% while energy stocks have been obliterated. In recent days, with stocks falling by 8%-10%, the action feels capitulative. Why have energy stocks collapsed, even when they were mispriced in our opinion to begin with?

Investment Team

Eric Nuttall, CIM
Partner, Senior Portfolio Manager

For much of the year, energy was the only positive performing game in town and we had received much feedback from advisors that having energy allocation had "**saved their year.**" *Could it be that with recessionary fears increasing and the broader market selling off further that energy stocks have been a source of funds? Is it easier to sell your winner or sell your losers? This could partially explain it.*

Currently, fear of a recession is causing extreme concern about the outlook for oil demand. We do NOT share these concerns. Real time gauges suggest ZERO degradation in demand so we are essentially fighting the equivalent of the boogeyman, while we can forecast that looming supply growth challenges will offset any degradation in demand growth. All we can do is continue to monitor our macro indicators for any sign that we are wrong but these two that we follow suggest our macro call remains valid:



On to energy stocks, they have been absolutely obliterated with some falling by over 35% in the past 2 weeks. Feedback from traders today suggests there is NO large selling, but rather retail panicking, institutions preferring to sit on their hands given the volatility, and algo/quant funds having a field day.

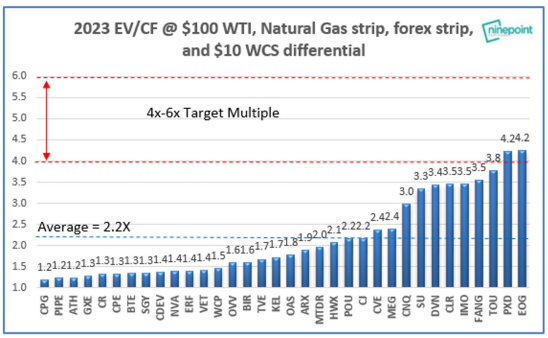
On to energy – Wear a helmet, but fear breeds opportunity.
Difficult tape across the board, and a tough time for all. What are people doing???

1) **Specialists are adding or fully invested** – knife fighters getting increasing net exposure, specialists adding exposure through equities, and options (writing puts, buying call spreads). That said, activity levels are MUTED relative to recent experience. Example: yesterday we saw 3-12% dispersions in the space and convincing people to do opportunistic pair trades was akin to me asking girls out when I was ~17.
   ** See Berkshire bought another 9.55m OXY???
2) **MF doing pretty much nothing**... We are not seeing any reactionary activity. Block for sale??? Yawn... Huge buyer of and outperforming name?? pass the nachos.
3) **Retail SELLING**. There are some HUGE winners out there... BTE still up 157% in a year, MEG +106%, CVE +110%... while the S&P500 is -11% and the Nasdaq is -19%.
4) **Buybacks** – recent filings showed May was a VERY robust buyback Q.. SU ~$1B, CNQ, ARX, IMO, lots of others... ***Have to think corporates take out the vacuum here and HOOVER up this cheap stock***.
5) **Will note that more broadly we have turned better to buy most cyclicals**... EXCEPT MINERS

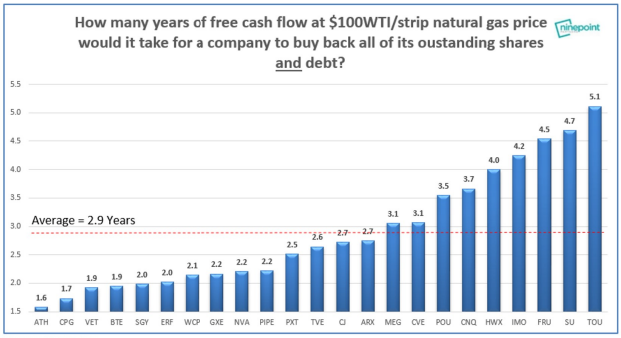
Conversations and questions??
HOLY PULLBACK!, recession risk, demand elasticity, demand destruction, Russian barrels, and more... ***ENTER Mr MIKE TRAN*** *with another EXCELLENT and timely note.*
Spoilers:
"What has changed fundamental wise? Not much, nada, zilch..."
When will oil start pricing in a recession??? : "oil has long since been pricing in a global recession, which is why we have been confined to the $105-$120/bbl range rather than pricing at $150/bbl".
"Our marginal barrel framework continues to suggest that ***North Sea and West African physical crudes are seeing incredibly strong buying trends***"
Demand destruction: "*minimal major signs of material demand destruction* despite elevated crude price and record US retail gasoline pricing, and the strength in crack spreads re-iterate that notion."

Source: RBC, June 23, 2022

What of valuations? The panic of today to me feels exactly like March 2020, which is staggering as oil is still trading above $100WTI. We still believe in all of the tenets of our multi-year bull market thesis and as such believe in a $100WTI fundamental floor over the next 5-6+ years, while acknowledging that at times we can undershoot this if panic becomes rampant. At $100WTI energy stocks are PROFOUNDLY mispriced:

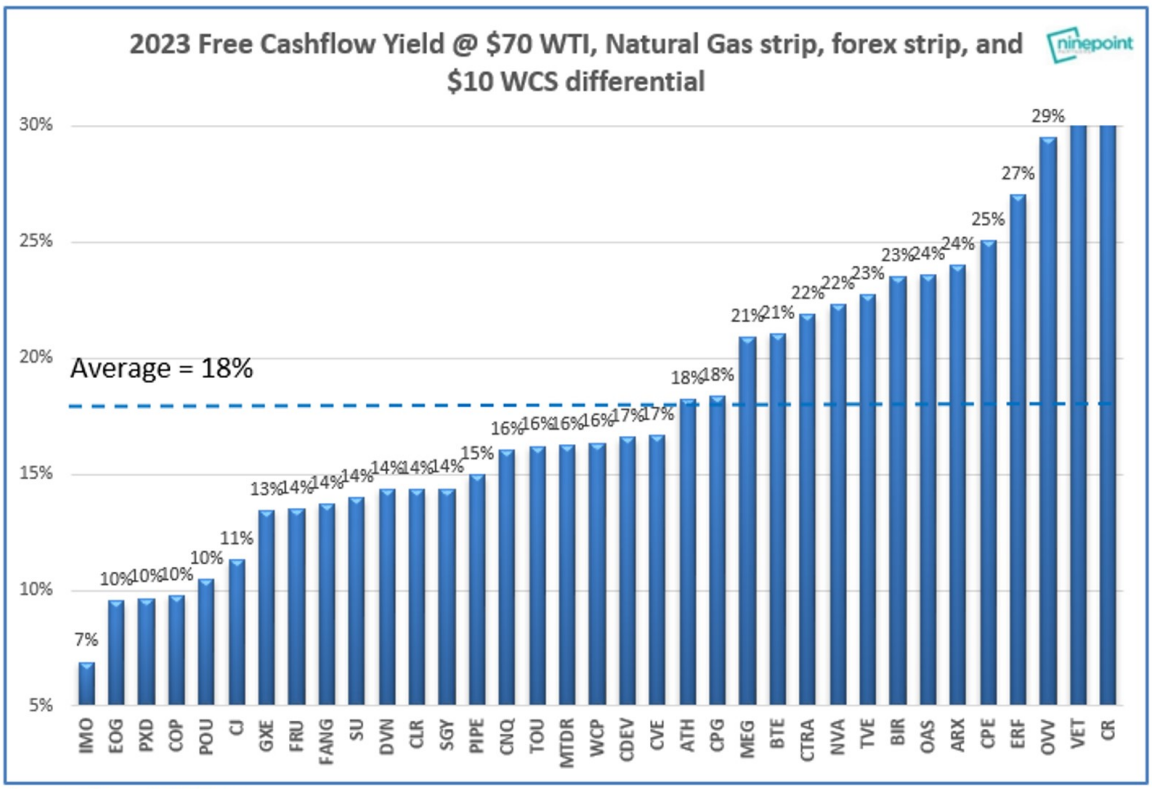


Source: Bloomberg, Ninepoint Partners
For illustrative purposes only
EV calculation uses year-end '23 value to account for multiple compression from free cashflow generation



Source: Ninepoint Partners
Assumptions: $100WTI, strip natural gas and USD/CAD exchange, $10WCS differentials, 2023 values, chart uses YE'23 net debt to account for meaningful FCF being generated
Free cash flow = Cash flow minus maintenance capital (the amount needed to be spent to keep production flat)
For illustrative purposes only

Even if oil were to collapse, energy stocks would remain attractively valued with the sector trading at an average free cashflow yield of 18% at $70WTI:



Source: Ninepoint Partners
For illustrative purposes only

In summary, we remain very bullish, and can find little to no fundamental explanation for the severe pummeling of recent weeks. Below is a report from RBC that corroborates what we are seeing in the physical market, and we have to the best of our ability exposed the fund to high quality companies, trading at valuations that make no sense to us, and who have committed to returning most if not all of their free cashflow back to us in the form of dividends and buybacks. As in the past, this too shall pass and we are adding to core names as funds flow allows.

Eric Nuttall
Senior Portfolio Manager
Ninepoint Partners

Capital Markets

June 22, 2022

Oil Market in 60 Seconds: Thoughts on the Recent Pullback

- Major crude oil benchmarks fell some 4.5% today. Spot WTI prices have retraced by 13% over the past 10 days. What has changed fundamental wise? Not much, nada, zilch, but macro concerns of a recession are clearly dominating sentiment. In my discussions today, I posed the following question: "Is oil, which has been one of the last major financial asset classes not pricing in an economic slowdown, beginning to succumb to the bearish macro pressure?". One sharp energy trader responded: "oil has long since been pricing in a global recession, which is why we have been confined to the $105-$120/bbl range rather than pricing at $150/bbl". Commodity risk allocators will let the length liquidation run its course, but further dips are likely to be ferociously defended. The low to mid $90/bbl range has served as strong support on pullbacks in the event the rout deepens. This is certainly not our base case, and the strong physical market supports that notion.
- The financial, paper market is plunging, but the physical market remains undeniably strong. Our marginal barrel framework continues to suggest that North Sea and West African physical crudes are seeing incredibly strong buying trends. In fact, we recently highlighted a major physical inflection point in the Atlantic Basin physical differentials. The velocity of the move in pricing differentials suggests a massive physical bid into the market for the global marginal barrels. In fact, we hypothesized as to whether this was China returning to the market.
- The bulk of our recent client conversations start and end with demand destruction. There are minimal major signs of material demand destruction despite elevated crude price and record US retail gasoline pricing, and the strength in crack spreads re-iterate that notion. However, we would be remiss if we did not highlight that consumers are altering their behavior at the margin. For example, consumers are flocking to discount gas stations, which are seeing volumes sold at higher than pre-pandemic levels, while conventional gas stations continue to see sales below pre-COVID levels. The 30¢/gal discount at the pump (or $7.50 per fill up, assuming a 25 gallon tank) is enticing enough for many to drive further and queue longer to fill their tank.
- Travel inflation is eating into future demand. Our Get Out and Travel (GOAT) index includes leading indicators of future travel. Search interest for air travel and accommodation are down 13% and 14.2%, MoM. US wide traffic congestion has softened by 10.5%, MoM while public transit usage has increased by 5.2%. Those interested in real time mobility trends to monitor our Get Out And Travel & Get Out And Live indices can visit our website, which updates every Wednesday ahead of the US equity market open.
- Given soaring retail pump prices, demand destruction remains central among discussions, but our view remains that demand does not have to be profoundly strong, it just simply cannot be weak. This is where we sit in the cycle given that the market is pricing in scarcity given multi-decade low OECD diesel inventories. Refilling product stocks is why the market continues to search and price for demand destruction. The potential for President Biden's gasoline tax holiday effectively leads to demand preservation, which comes with the unintended consequence of further drawing down product stockpiles and keeping prices elevated for longer. Such policy likely leaves the market in an even bigger inventory hole exiting the summer.

NINEPOINT ENERGY FUND - COMPOUNDED RETURNS[1] AS OF MAY 31, 2022 (SERIES F NPP008) | INCEPTION DATE APRIL 15, 2004

	1MTH	YTD	3MTH	6MTH	1YR	3YR	5YR	10YR	15YR	INCEPTION
FUND	12.2	63.4	20.9	79.3	132.4	64.8	20.8	9.1	3.0	8.3
'S&P/TSX CAPPED ENERGY TR	11.6	66.0	29.9	73.2	114.2	28.3	11.4	4.6	1.2	5.5

[1] All returns and fund details are a) based on Series F units; b) net of fees; c) annualized if period is greater than one year; d) as at May 31, 2022. The index is 100% S&P/TSX Capped Energy TRI and is computed by Ninepoint Partners LP based on publicly available index information.

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