Bell
Institutional Investment Management

EQUITY & FIXED INCOME OUTLOOK OCTOBER 2021

Traders Take Aim at $40 US Natural Gas in Bet on Supply Shock … China Orders Top Energy Firms to Secure Supplies at All Costs … European Gas Hits Record 100 Euros as Energy Crunch Worsens … These are all examples of recent energy headlines scrolling across my screen. They're all referring to the energy crunch in natural gas, and it's worthwhile to look at how this came about.

First, let's look back to when the energy grid was more balanced among the supply of available fuels. Fast forward to more recent times, and we learn that the average nuclear reactor producing electricity is 39 years old. Coal is being phased out due to environmental concerns, with those plants being taken offline at a rapid pace. Hydroelectric power requires running water, and most of those sources have been claimed. Wind and solar are expanding, but their energy production is intermittent.

That leaves natural gas as the remaining source for consistently producing electricity with less environmental impact than coal, and these plants have been expanded at a rapid pace. Today, natural gas represents 40% of electric generating capacity in the U.S. Coal and nuclear are each at 20%, with renewables at 20% as well. Ten years ago, coal and natural gas were reversed, with coal generating about 40% of electricity and natural gas at 20%. These figures are representative of global energy production as well. The rapid transition away from coal toward natural gas has created a supply/demand imbalance, today reflected in rapidly rising natural gas prices. In an effort to solve one problem, a different problem has taken its place.

This is similar to what is happing in the investment world. Fixed income investors, who used to rely on bonds to provide a source of income along with a good margin of safety, have seen their yields decline to the point where interest income after accounting for inflation is actually negative. This has those same investors looking for other options that historically have provided income, but without the same safety of principal. Those options include real estate, preferred stock and even Bell's popular equity income strategy (stocks that have attractive dividend payments). There is nothing wrong with these options as long as all aspects of each asset class have been considered. In other words, we don't want new, unexpected problems to take the place of the initial problem being solved.

Clients using these options should remain aware of the prospective differences compared to safer assets such as bonds. These alternative strategies have performed admirably. This performance has been supported by the number of investors moving toward these asset classes, pushing up the price – similar to what we see happening to natural gas prices. However, it does not mean these asset classes' inclination to volatility won't appear at some point. When it does, it will create noticeable discomfort for investors. It is important to remain calm, revisit long-term investment goals, and know your purpose for moving toward these asset classes in the first place.

Remember, the best way to avoid going into the ditch when driving on an icy road is to remain calm and avoid any sudden lurch of the steering wheel! That's my tip to prepare you for that first winter snow … or disruption in the market.

Thank you for your business and confidence in Bell!

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