

coverstory

THE END OF BLACK GOLD?

Predictions about dwindling world supplies of oil could create new challenges for superannuation fund investors, reports **Michael Laurence**.

Howard Rosario, chief executive of the industry fund Westscheme, left a recent talk by influential proponent of the peak oil phenomenon Chris Skrebowski much more aware of the need for his fund to consider its risks and opportunities. Rosario then raised the issue with Westscheme's investment adviser, Access Economics.

Peak oil is the point where global oil production hits its highest point before beginning an irreversible decline. Both proponents of the peak oil theory and the recently released interim report from the Senate committee inquiry into oil supplies outline predictions of oil production reaching its high point somewhere between 2025 and 2050.

Rosario believes all long-term investors in infrastructure heavily reliant on energy consumption such as toll ways should take an interest in the peak oil issue.

"In our portfolio of unlisted assets," he says, "we take into account other risks such as inflation, interest rates and economic activity. We now need to start thinking about global warming and peak oil."

"Risk is something that needs to be managed, rather than avoided. Risks can be an opportunity to invest. But we need to analyse the risks, and ask what is our compensation for taking them and are they worth taking."

Dealing with warnings

Superfunds has interviewed several superannuation fund executives and their investment advisers about their views on how funds should deal with the warnings on the inevitable arrival of peak oil, but they tend not to be rattled by the mounting debate about the issue. This even includes funds with sizeable exposures to oil reliant infrastructure such as toll ways, urban tunnels and airports.

Some funds say they have begun monitoring the sensitivity of their unlisted assets to rises in oil prices. Most are optimistic about the development and widespread use of alternative energy sources. However, unquestionably there is growing concern among superannuation funds about global warming, which in itself, should accelerate the development of alternative energy sources.

A key aim among these funds and

their investment advisers is to ensure their investment portfolios are sufficiently diversified to deal with the uncertainty of such looming issues as oil supply and global warming. That diversity, they believe, should provide some protection against the negatives and also a means to take advantage of the opportunities. The funds also talk of the need to continually assess all risks.

The Senate committee on oil supply noted commentators who reject concerns about peak oil commonly argue pessimistic forecasts do not sufficiently allow for the increases in oil exploration and technological advances in oil recovery that would be spurred on by higher oil prices.

superannuation fund investments.

The submission stated, "It is doubtful whether many superannuation funds and investment advisers are sufficiently aware of the risks they run in not adjusting their portfolio selection for the likelihood of expensive oil."

Richard Campbell, co-author of the submission by ASPO's finance working group to the inquiry, describes the organisation as an informal network of oil industry executives, geologists and transport consultants.

As one of only two professional securities advisers in the Australian branch, Campbell says it "tells you how little the basic facts [about peak oil] have penetrated the securities industry".

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However, the committee believes the point will be reached where the costs of obtaining oil from new sources will outweigh the benefits.

The committee noted no official agency publications, to its knowledge, had attempted to provide detailed point by point rebuttals to the arguments of the peak oil proponents.

"In the committee's view," the interim report states, "the possibility of a peak of conventional oil production before 2030, even if it is no more than a possibility, should be a matter of concern. Exactly when it occurs, which is very uncertain, is not the important point. Australia should be planning for it now, as Sweden is doing with its plan to be oil free by 2020."

Future plan awareness

In a submission to the Senate committee inquiry, the Australian Association for the Study of Peak Oil & Gas (ASPO), directly addressed the issue of

Among superannuation funds, he says industry funds were the first to show an interest in the peak oil issue.

"It is now 30 years since the world discovery rate [of oil] equalled the consumption rate," Campbell says. He has dire warnings of what this means for world economies and long-term investors, noting that although alternative energy sources will continue to be developed, there will be plenty of pain along the way.

A recent paper by Winston Hickox, a senior portfolio manager with the California Public Employees Retirement System, examines the possible positives and negatives for retirement savings in the event of a decline in world oil supplies.

"On one hand, a decline in global oil production could dampen the world's economic growth," Hickox wrote. "On the other hand, it is likely to make renewable energy sources more economically attractive."

"Early bets by institutional investors in clean technology and particularly

clean and alternative energy enabling new technologies, will be handsomely rewarded.

"Fiduciary duty requires that institutional investors make every effort to understand and quantify risk, as well as mitigate [it] and find opportunity in its wake."

In his paper, Hickox notes 70% of daily oil supplies is from oil fields that have been in production for 30 years or more. Production is in decline in 33 of the 48 largest oil producing countries.

Diversified portfolio value

The chief strategist for Access Economics, Ric Simes, includes peak oil among emerging risks such as global warming and terrorism that superannuation funds should monitor for their possible impact on investment portfolios.

"Risk analysis is [of course] an important ongoing task. And specific risks are likely to hit in different ways," he says.

Simes believes superannuation funds should try to determine how well their portfolios could cope with those risks. In his view, a suitably diversified portfolio should "deal with the one or more of the risks pretty well".

Access Economics is investment adviser to the two top performing superannuation funds for 2005-06, according to SuperRatings. These were Westscheme's Trustee's Selection option and MTAA Super's Balanced option, both of which have high allocations to alternative assets including toll roads and airports.

Simes says the biggest concern for superannuation fund investments is "peak oil could knock global growth around in a big way and get into ongoing inflation". However, he says there have been no signs to date of higher oil prices causing this economic damage and the inflation risk is manageable.

"The next level is what does peak oil mean for individual stocks and investments? Is a fund too heavily exposed to energy stocks or is it under exposed because prices might go up with less access to oil?"

According to Simes, peak oil is not going to suddenly change life as we know it.

"Everything is not going to hit a brick wall in one day. Oil prices will become

much higher than in the past, on average. And during the adjustment phase, the economy has to get used to higher prices and as consumers change their reliance to alternative fuels," he says.

"My bottom line is that peak oil is not going to hit us quickly but over decades. It would be an overreaction to adjust a portfolio in a big way for the risk of peak oil. Superannuation funds will be well serviced with a diversified portfolio."

Phil Brown, the investment relationship manager at MTAA Super, says the fund's investment adviser Access Economics, has assessed the oil price sensitivity of its 40 plus unlisted assets making up about 45% of its overall portfolio. These unlisted assets include infrastructure such as ports, toll roads and airports, private equity and unlisted property.

Access Economics also assesses the fund's unlisted assets for sensitivity to a range of other factor risks that may affect their value. This is intended to ensure the portfolio is not overly exposed to any one risk. The analysis shows a rise in oil prices would have a negligible impact, as expected, on MTAA Super's unlisted property investments but would have a big impact on investments in airports and ports.

The gloomy camp

The executive director of JANA Investment Advisers David Holston says he is "not in the all gloom camp regarding oil supply. Investment will follow and fund successful technology to replace fossil fuelled vehicles."

JANA is investment adviser to about 45 corporate, public sector and industry superannuation funds. Holston says his consulting firm takes possible movements in oil prices into account in its pricing and inflation model for superannuation funds. These projections generally extend out for 10 years. Nevertheless, projections of 10-20 years are made for private equity and infrastructure investments. "The further you go out, the less reliable the data," he notes.

Holston believes a vital consideration is that anyone making projections regarding peak oil cannot make accurate compensations for changes in

technology. "If you assume that existing technologies will remain, the results of projections would be quite erroneous."

He believes the best way for a long-term investor such as a superannuation fund to deal with concerns about oil supply is for its advisers to obtain a diversified range of views and to ensure its investments are sufficiently diversified.

The chief executive of the Catholic Superannuation Fund Frank Pegan, says predictions about peak oil do not frighten him. However, the issues of peak oil, global warming and alternative fuel supplies "keep me absorbed".

"We are investing for the next 25 years, not tomorrow. Oil can have a big impact on the future of our investments," he explains.

Executive chairman of Industry Fund Services Garry Weaven, says he has believed for some time global warming and peak oil are extremely important issues. In his view, the two go together.

"That said, there is going to be a boom in alternative energy." He explains this thinking was behind his group's successful but highly competitive buyout of hydroelectric and wind power operator Pacific Hydro in 2005.

Weaven says it is unknown whether the economic system and technology have the capacity to adequately and rapidly respond to the challenge of peak oil.

Opportunities to benefit

David Hartley, the chief investment officer at Sunsuper, is an optimist when it comes to the development of alternative energy supplies and what this means for superannuation fund investments.

He says investors should have some exposure to alternative energies but "you don't want to bet the house on a single one". Some may succeed, others may fail.

"Past lessons indicate that investors should not get over excited about any one technology," Hartley says.

"We're going to see more and more research in alternative energy sectors such as solar, nuclear, cleaner fossil fuel and wind. In such an environment, diversification is the sensible option."

He claims the prospect of the world running out of oil does not frighten him as an investor but rather views it as "an opportunity." **SF**