NATIONAL POST
FINANCIAL POST

DECEMBER 11, 2010

Kim Inglis, BCom, CIM

Global energy outlook sizzling

Canada's economy is dependent on commodities

Economists have been busy forecasting what's in store for 2011. However, much of Canada's economy is dependent on commodities, so the outlook for global energy becomes increasingly important and investors should think beyond 2011.

Near term challenges in the world economy are numerous. Growth in several industrialized countries has lagged and fears of a double dip recession abound. The hurdles of sovereign debt and rising unemployment must be overcome in order to reinstate steady growth.

While these issues are certainly troubling, the long-term energy outlook appears more favorable. In a recent report from the International Energy Agency, global energy demand is expected to increase 36% by 2035; averaging 1.2% per year. A whopping 93% of the projected increase in demand will be due to strong economic growth in the non-OECD, emerging countries.

For example, according to the International Monetary Fund, the Chinese economy is forecast to grow 9.6% in 2011. In comparison, world economic growth is expected to come in at only 3.7%.

As emerging countries develop, their energy consumption will increase accordingly. Consider their growing demand for automobiles. According to the IEA, China will have 135 million cars on its roads by 2035, a significant increase from the 40 million in use today.

The breakdown of fuel sources is a crucial factor when considering the outlook for global energy. The IEA anticipates that fossil fuels – coal, oil, and gas – will account for over 50% of the increase in total energy demand. Within this mix, crude oil is expected to remain the dominant fuel source until 2035.

This is important from an investment standpoint as crude oil plays a major role in total commodity investment. According to the US Energy Information Association, crude oil represents 15% of the 2010 target weights of the Dow Jones-UBS Commodity Index. Natural gas is a close second at 12%, followed by gold at 9.1%.

Those willing to weather near-term volatility in favor of long-term growth might consider adding some energy exposure to their portfolios. The simplest method is to use an exchange traded fund such as the iShares S&P/TSX Capped Energy Fund (TSX: XEG). It provides a modest dividend and holds Suncor Energy Inc., Canadian Natural Resources, and Cenovus Energy among its top holdings.

Alternatively, those looking for indirect exposure might consider one of the pipelines such as TransCanada Corp. (TSX: TRP). Pipeline stocks are typically more defensive in nature, yet will participate in energy market movements.

Kim Inglis, BCom, CIM is an Investment Advisor. The views in this column are solely those of the author. www.kiminglis.ca