

# When does black gold lose its lustre?

More and more energy companies assume that global hunger for energy will continue to be fed by fossil fuels, while there are clear signs of a long-term decline for fossil fuels. Can strategies focussing on fossil fuels really be successful on the capital market in the long term?

By *Angela Quiroga and Karsten Holetzek*

At the end of 2023, the oil and gas company Chevron announced that it would pay \$ 53 billion to acquire its competitor Hess. ExxonMobil even wants to spend around \$ 60 billion on the acquisition of Pioneer National Resources. These examples show that the momentum in the global energy sector is high. Oil and gas companies are currently expanding their traditional fossil fuel extraction and production capacities again. The rationale behind such major investments? Not only industry heavyweights such as Chevron and ExxonMobil are evidently assuming that demand for oil and gas will remain strong. More and more energy companies around the world share the conviction that the global



hunger for energy will continue to be fuelled to a large extent by fossil fuels in the future.

But can strategies focussing on fossil fuels really be successful on the capital market in the long term? Do short-term opportunities for returns outweigh the impending entrepreneurial risks associated with a decline in demand for oil in the coming years? The key question here is: when exactly will the turning point in oil consumption, or peak oil, be reached?

## **If not now, then when?**

The scenario of a trend reversal in demand for oil – but also for other fossil fuels such as gas – has already been outlined several times in the past. However, global demand for fossil fuels is still rising continuously. In its forecast from 2023, the International Energy Agency (IEA) sees a turning point on the horizon.

For oil in particular, the IEA expects demand to stop rising towards the end of this decade and instead to see a structural trend reversal. There are several important reasons for this expected trend reversal.

In the fight against climate change and to limit the rise in global temperatures, the global goal of climate neutrality must be achieved, as set out in the binding targets of the Paris Climate Agreement. Oil and gas companies in particular have a duty to implement the necessary CO<sub>2</sub> reduction targets. The energy sector is still one of the largest CO<sub>2</sub> emitters in the world and contributes significantly to climate change through the emissions attributable to it.

The urgency of achieving these reduction targets is increasing. This is because the serious consequences and costs of climate change are becoming ever more

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apparent. They are placing an increasing burden on economic stability, infrastructure facilities and functioning healthcare systems in the affected regions and countries.

In addition, triggered by the war in Ukraine, the security of supply and sources of fossil fuels have been scrutinised and adapted in many countries around the world. On the other hand, the expansion of renewables has been increased to reduce dependency on national energy supplies in the future.

Improved energy efficiency, technological advances in industrial processes – such as the production of ‘green’ steel – and changes in consumer behaviour will also contribute to a long-term decline in demand for fossil fuels. Examples include the growing appeal of electric vehicles in the automotive sector and the increased use of heat pumps and solar systems in buildings and homes.

The adjustment processes outlined above, which have already begun, represent a challenge for the future economic development of oil and gas companies on their own, but above all in combination. This is because the impending decline in demand for fossil energy sources triggered by this will have a fundamental impact on price, sales, and ultimately profit development in the entire energy sector. For companies in the sector, this also means that their costly and long-term investment projects may be at risk of losing value or even totalling in some cases. So-called stranded assets represent an economic sword of Damocles for past

and current investments by oil and gas companies in the coming years.

### Peak oil scenario requires transformation pioneers

The risks of structural declines in demand and future unprofitable business areas in the energy sector are hugely relevant on the capital market, and therefore also for asset managers. As trustees, asset managers are required to analyse and take account of these risks in their investment decisions on a case-by-case basis. Especially after the peak in demand for oil, it is crucial for asset managers to select those companies for investment that are best prepared for the changed, more difficult conditions.

The focus in this regard is on companies that are as CO<sub>2</sub>-efficient as possible in the extraction and production of traditional fossil fuels in the long term and have a comparative cost advantage over their competitors in this respect.

What is even more important in the analysis is that the companies under review clearly demonstrate a willingness to transform their traditional product portfolio. To do this, companies must have credible CO<sub>2</sub> reduction targets that include climate neutrality in line with the Paris Climate Agreement. This requires a new focus on investment spending in sustainable business areas. Above all, this involves increased spending on low-CO<sub>2</sub> alternative forms of energy generation. Examples of this include the development and expansion of a product portfolio in the wind and solar sectors or

the expansion of traditional petrol stations to include modern electric charging stations.

For asset managers, this analysis raises an important timing issue regarding future positioning in the energy sector. On the one hand, it is necessary to disinvest in good time from companies that have high stranded asset risks and whose ecological footprint is also a burden from a cost perspective. On the other hand, the individual exit time from the individual oil and gas companies must be selected in such a way that possible performance losses in the portfolios are minimised. In this area of tension, asset managers with a clear, future-oriented investment strategy can succeed in limiting risks from a peak oil scenario in their investments, and at the same time identify transformation pioneers. In this way, asset managers also make an important contribution to the transformation of the oil and gas sector as a whole, which is necessary from a climate perspective. ■

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**Angela Quiroga**

Senior ESG Analyst,  
Union Investment



**Karsten Holetzke**

Senior Client Relationship  
Manager, Union Investment

## SUMMARY

Existing dependencies on oil and gas still support the development of the fossil energy sector.

Ambitious climate targets, technological progress, and the quest for a secure energy supply form the basis of a peak oil scenario in the energy sector.

Asset managers must take the resulting upheavals into account when timing their oil and gas investments.