S&P/TSX Composite Tumbles On Fed Taper Talks

Description

Equities posted their biggest losses in weeks over fears of a pullback in the Federal Reserve stimulus program following a provisional budget deal from the U.S. Congress. Welcome to the strange world of Wall Street, where good news is bad news.

The **Dow Jones Industrial Average** tumbled 129 points, or 0.81%, closing below the 16,000 milestone. Canadian equities were deep in the red with the **S&P/TSX Composite Index** (^OSPTX) down 191, or 1.43%.

The biggest drag on the market indices was **Encana** (TSX: ECA, NYSE: ECA), whose shares fell 5.94% following the release of its 2014 production outlook and a downgrade from **National Bank**. Although we don't believe in obsessing over short-term volatility, we do like to keep an eye on daily events in case they impact our investment thesis.

Overall, there was nothing in this report that Bay Street shouldn't have expected already.

Encana stated that its capital expenditure, or CapEX, budget will be 10% lower next year. The company plans to spend three quarters of its $2.4 billion to $2.5 billion CapEx budget on five liquids-rich plays including the Montney, the Duvernay, the DJ Basin, the Tuscaloosa Marine Shale, and the San Juan Basin.

To illustrate the profitability of these plays, Chief Executive Doug Suttles predicted that Encana will derive 45% of the company's cash flow will be derived from these five formations, while only accounting for 25% of projected production.

Shifting production mix driving profit growth

	2013F	2014F	%

Production (MMcfe/d)	3,100	3,100	
NYMEX Gas Price ($/Mcf)	3.75	3.75	
WTI Oil Price ($/brl)	95	95	
Average Wellhead Price ($/Mcfe)	4.30	4.65	
Netback – Ex-hedges ($/Mcfe)	2.25	2.50	

Source: Encana Corporate Guidance Presentation

Much of the tough turnaround measures have already been taken. Last month, Encana slashed its dividend 65%. The company's announced 4,900 full-time layoffs have already been completed.

What's our take here? It's steady as she goes at Encana. Suttles has the right strategy of shifting to an oiler production mix which should boost returns. The company is still on track to derive 75% of its cash flow from oil and natural gas liquids by 2017. It's a long overdue change that shareholders have been waiting five years for.

The only blemish may have been the company's production guidance. With the stock up over 10% these past few weeks, shares were priced for perfection. With oil and natural gas liquids production expected to grow only 30%, that might have been a bit shy of the street's expectations.The miss provides a nice excuse to take some money off the table.

Outside of that, there was nothing damaging here to Encana's long term investment thesis. The company is on track to implement its turnaround strategy and there're plenty of catalysts to send shares higher in 2014.

CATEGORY

1. Investing

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