

Big Oil, small short

Ulf Erlandsson^(*)

As oil majors have successfully monetized Russia's invasion of Ukraine, their stock prices have been on a relentless rise. But even with efforts to channel idiosyncratic cashflows to shareholders, dividend yields have in many cases fallen dramatically, illustrated in Figure 1 for Exxon Mobil (XOM US). Simultaneously, short-end rates have gone up significantly and oil bond spreads have remained stable. This has resulted in dividend yields that are far inside short-dated corporate bond rate yields, see Figure 2. Framing such capital structure dislocations can be interesting from a climate impact exposure angle.¹ Consider the following illustration, where an equity short is "funded" by a partial long in the corporate bonds:

- Short (-100% risk) XOM US @119.17, **indicative dividend yield of 3.05%**.
- Long (+63%+discretionary excess X% risk) XOM 2.992% 03/25s @96.323, **yield of 4.856%**.
- Use X%-based excess carry from bond position to fund name-specific climate change mitigation engagement.

If we set X=0, then this combination would have net zero carry (expected dividend yield - bond yield) and a net short capital exposure to XOM: the net capital provided is (-100%)+63% = -37% of notional.² Setting X>0 generates positive carry that can be used for engagement efforts. Key financial risk in this set-up is a further appreciation of the stock price from current all time-highs.

Figure 1. Exxon equity returns (blue, LHS), and dividend yield (red, RHS). Source: Bloomberg.

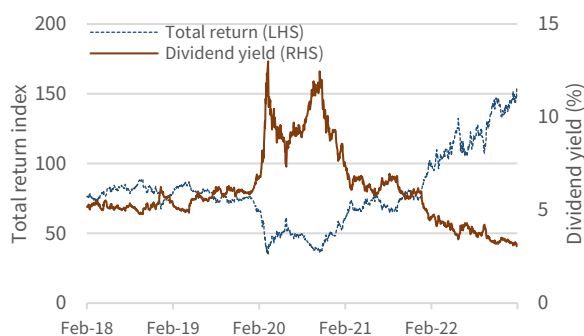
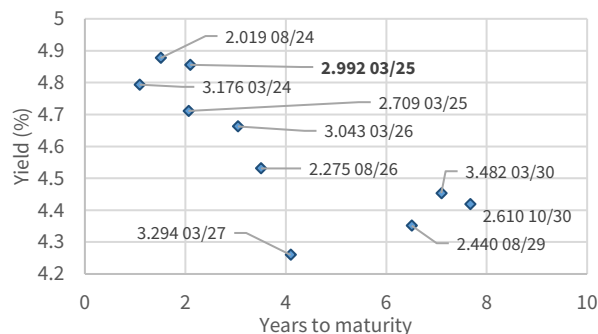


Figure 2. Exxon USD benchmark bonds, front-end. Note the inversion. Source: Bloomberg.



¹ AFII covered the reverse situation in "[Exxon cap structure arbitrage/impact](#)", AFII, 21 May 2021, suggesting a short debt, engage in equity approach at a 15 by 1 ratio (Short 1500% credit, long 100% equity, active engagement for increased debt to pay dividends and reduce capex). At the time, XOM US equity was marked at 58.84 and XOM 5y CDS at 38bps.

² In terms of ESG impact, this number likely underestimates the actual climate footprint, as a larger portion of the ESG footprint should be allocated to the equity/longer duration part of the capital structure. For a further discussion on accounting of short positions, refer to "[Carbon negative leveraged investment strategies](#)", AFII, 12 Aug 2021. For completeness sake, the concept of short positions having impact is controversial, also refer to "[ESG Reporting in Long-Short Portfolios](#)", MSCI, 19 Apr 2022; "[Accounting for ESG factors, What to do with short positions?](#)", AIMA, June 2022.

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(*) Anthropocene Fixed Income Institute (www.anthropocenefii.org), Author for contacts: uge@anthropocenefii.org

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