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INVESTMENT NOTE

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Product wars: winners and losers in the new oil-refining order

Europe's oil refiners face perfect storm as global trade map in crude oil production is redrawn and exporting nations increase their refining capacity according to Hermes Commodities Portfolio Manager David Hemming.

Traditional exporters of crude oil are increasing their refining capacity with huge implications for gasoline and diesel trade flows. Inefficient European refiners are particularly vulnerable to losing market share.

In the second half of 2014, non-OECD demand will surpass OECD demand for the first time, and account for all the growth in the oil sector. With this trajectory only set to continue, regions such as the Middle East and China are increasing their refining capacity.

Russia has the world's third-largest refining system; it is also undergoing significant changes to its tax regime for oil refiners increasing incentives to produce more higher value petroleum products. These moves aim to increase the share of value derived from Russia's oil reserves.

Developments in emerging markets are being matched in the US which has been able to capitalise on cheap crude oil from the shale boom, plus cheap natural gas and power, giving US refiners the strongest margins in the world. Its release of 1m bpd of distillate is adding to the congestion in the Atlantic Basin.

This combination will eradicate the margins European refiners gained upgrading low-quality Russian crude oil as well as the arbitrage in sending gasoline to the US East Coast and Africa as stronger US Gulf Coast refiners compete for market share.

David Hemming, Portfolio Manager, Hermes Commodities, said: "Europe's inefficient refiners face certain defeat in the oil products sector as emerging markets and exporters of crude develop the capacity to produce their own diesel and gasoline. Traditional sources of revenue are set to disappear, reducing margins and ultimately leading to closures and consolidation within the European refining industry"

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Notes to Editors:

Hermes Fund Managers

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