



Could Oil Be the Next Uranium?

Description

Predicting the future price of any commodity is often a fool's game. But there are certain patterns that they tend to follow.

For example, when the price of a commodity increases, you can count on suppliers to ramp up production. End users tend to substitute to something else (for example, to natural gas when oil prices are high). These two factors eventually cause the price to come back down.

Likewise, when the price of a commodity falls, suppliers become unprofitable and exit the market. Meanwhile, the low price encourages end users to buy more. Eventually, the commodity's price recovers until producers earn an acceptable return. This is just basic economics.

Or so we thought

The uranium market has certainly tested these theories. Its price dropped from over US\$70 per pound in early 2011 to roughly US\$50 that year. Since producers generally need \$70 uranium to break even, you would have expected the price to recover.

Instead, uranium continued to drift down, falling below \$30 per pound for a few months in 2014. And it still trades well below the cost of production. Throughout this process, uranium supply actually increased. So what caused this?

Well, uranium supply is very expensive to shut down, especially if employees are unionized. Some producers are well-hedged, and didn't need to cut production. Others expected the price to recover swiftly, and wanted to be ready. In any case, no one wanted to shut in production just to see competitors benefit. So what's resulted is a game of chicken.

Could this happen with oil too?

Absolutely, for a number of reasons. First of all, shale producers aren't ready to shut in production just yet. Instead, they seem intent on proving just how profitable they can be at current prices. And again, some are well-hedged.

Meanwhile, Saudi Arabia seems determined to destroy U.S. shale production. In other words, what we have is a game of chicken. But costs to extract oil from shale have fallen, so this game will not end any time soon.

It's true that some producers, especially in Canada, need oil to rise from here. So we will probably see some bankruptcies if oil doesn't recover. But overall supply will likely keep humming along.

What should you do?

One very compelling option is quite simple: Avoid the Canadian energy sector altogether. After all, Canadian oil is generally higher cost than American production.

If you're insistent on owning Canadian energy stocks, two worth considering are **Suncor Energy Inc.** ([TSX: SU](#))([NYSE: SU](#)) and **Canadian Natural Resources Ltd.** ([TSX: CNQ](#))([NYSE: CNQ](#)).

Suncor is much more disciplined than in years past, and much of its business is in refining and marketing, helping to soften the blow. Better yet, its balance sheet is strong, with net debt of less than \$7 billion. That's not much for a \$54 billion company.

CNRL has its own strengths – over the years, it's done a fantastic job controlling costs and spending money wisely. As a result, it has survived downturns more easily than competitors. It's even been able to prey on weaker peers (by buying assets at a bargain) when times are rough.

CATEGORY

1. Energy Stocks
2. Investing

TICKERS GLOBAL

1. NYSE:CNQ (Canadian Natural Resources)
2. NYSE:SU (Suncor Energy Inc.)
3. TSX:CNQ (Canadian Natural Resources Limited)
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