3 Reasons Why Oil Prices Could Remain Low for 20 Years

Description

There's a common belief in Canada's energy sector that oil prices cannot stay this low for long, and that we should see a rebound in the second half of 2015. Until then, it's all about surviving a temporary slump.

To some extent, investors agree with this story, and as a result many share prices haven't declined much. Over the past year, **Canadian Natural Resources Ltd.** (TSX:CNQ)(NYSE:CNQ) shares are down by 9%, **Suncor Energy Inc.** (TSX:SU)(NYSE:SU) shares are down by 4%, and **Imperial Oil Ltd.** (TSX:IMO) shares have barely moved at all. By comparison, oil prices have been cut in half.

Granted, this isn't a perfect comparison. But if investors believed this slump will last, then these companies' share prices would be down a lot more.

Unfortunately, there's a strong case that low oil prices will persist for a long time. In fact, Ruchir Sharma of **Morgan Stanley** recently implied that the oil price slump could last for 20 years! Below are three reasons he might be right.

1. Historical averages

Mr. Sharma did an analysis of oil prices over the past 200 years, and found that US$50 oil is right in line with historical averages. In other words, the last 10 years were not the norm, but rather the exception.

In fact, Mr. Sharma noticed a common pattern with oil prices: they tend to go up for 10 years, then down for 20. We don't even have to go back that far to find the last example — in the 1970s, an oil price surge led to increased production from Alaska and the North Sea. Oil prices then crashed in the early 1980s, not recovering until the late 1990s. Today's world could easily see a repeat scenario.

2. The end of a supercycle

Of course there's one big reason why oil prices have been so high for so long: China. As the country grew at double-digit rates, supply struggled to keep up. Remember, it can take years to bring on new production. But now, supply has clearly caught up to demand. In fact, thanks to growing production in the United States, the world is oversupplied at the moment.

3. Healthy supply trends

Because of low oil prices, producers are slashing capital budgets. But they are generally not cutting production. How is this possible?

Well, companies are simply deferring longer-term projects. And this has a very important consequence: as soon as prices start to recover, these longer-term projects (such as Kirby North at CNRL) will come back online. In other words, supply will continue to keep up with demand. So you can forget about US$100 oil any time soon.

So what should you do?

At this point, many investors have simply hung onto their energy stocks, preferring to “see what happens” rather than sell at a loss. And for this reason, many energy companies still trade at healthy levels.

If oil is about to rebound, then these high stock prices are fully justified. But that may not be the case at all. Your best bet is to wait on the sidelines.

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1. Energy Stocks
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