Why the OPEC Secretary General Believes Oil Prices Have Bottomed

Description

Nowadays, you'll find plenty of predictions about the future direction of oil prices. But some are worth paying particular attention to. On Monday, Abdullah al-Badri, the Secretary-General of OPEC, said that he expects oil prices to bottom out around current levels. He would know as well as anyone.

That said, what makes US$45 per barrel such a logical bottom for oil prices? Is there a risk that prices could fall lower? And how should you react as an investor?

Why oil prices may have reached a bottom

There are reasons to believe the Secretary-General. With such low prices, producers have already been cutting back. According to oil services giant **Baker Hughes**, the number of oil rigs fell for the seventh straight week, and is now at its lowest level since January 2013.

For now, the industry is still able to maintain current production levels. But sooner or later — likely the second half of this year — output will be affected. German bank Commerzbank said as much in a note to clients on Monday, according to *The Globe and Mail*.

In the meantime, consumers are benefiting from lower gas prices, which should eventually lead to greater consumption. This is especially the case in the United States, where the economy is firing on all cylinders. Eventually, oil prices could benefit as a result.

Why the bottom could be a lot lower

Not everyone shares Mr. al-Badri's optimism. For example, **TD** analyst Dina Ignjatovic expects oil prices to sink below US$40 per barrel this year.

There are reasons to believe Ms. Ignjatovic too. Production remains at very healthy levels, with no major producer (American or Canadian) planning to cut output. Inventories have reached an 80-year high for this time of year, and Ms. Ignjatovic expects this trend to persist until late 2016.

Another thing has become clear: oil companies are simply unwilling to cut output, no matter how low prices get. Few people want to work for a shrinking oil company, and production cuts send a bad signal to investors. No wonder former **Suncor Energy Inc.** (TSX:SU)(NYSE:SU) CEO Rick George said that producers will maintain output at "an oil price down below $30 a barrel."

So what should you do?

At this point, it looks like the industry is adjusting to lower prices. As an investor, you should stick to financially healthy companies (i.e., ones that surely can persist through a prolonged slump). One candidate is **Crescent Point Energy Corp.** (TSX:CPG)(NYSE:CPG), whose forward debt-to-cash flow ratio is only 1.3x, compared to the industry average of 1.8x. Crescent Point has also hedged half of 2015 estimated production at prices above US$90 per barrel.

Another candidate should be Suncor, whose net debt of $6.6 billion is miniscule for a company valued at over $50 billion. Like Crescent Point, Suncor should have no trouble surviving the current slump. At the very least, it should outlast its competitors!

There's another energy company that should be on your radar screen, and it's also The Motley Fool's top stock pick for 2015. You can read all about it in the free report below.

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