

Do Investors Need to Brace Themselves for \$20 Oil?

Description

Have you ever been to a party and spent time talking to someone who just *has* to one-up every story you tell?

These days, analysts in the energy sector are that guy. But instead of hearing about the time he scored on a breakaway while seven defensemen hung off his back, we're treated to a race of who can make the most outrageous call for the price of oil. First the bottom was in the \$50s, then the \$40s, and finally the \$30s.

An analyst from **Citigroup** thinks all those numbers are too optimistic. In a note to clients on Monday, Edward Morse, the head of the global bank's commodity division, laid out his case defending an eventual low for crude of \$20-something per barrel.

Morse's thesis is relatively simple. He believes that there is so much potential production from U.S. shale that OPEC no longer has the ability to control prices with just its own production.

"It looks exceedingly unlikely for OPEC to return to its previous way of doing business" Morse wrote. "While many analysts have seen in past market crises 'the end of OPEC,' this time around might be different."

Over the entire year, Morse's prediction isn't quite so dire. After the price of crude dips below \$30, Morse predicts crude to trade in the \$45-\$55 range before rallying to end the year at approximately \$75 per barrel.

Although I think it's unlikely that oil drops to even \$30-something per barrel, this Citi prediction is a good reminder of a couple lessons for investors.

Buy mid-tier

Everywhere I look, I see the same advice to investors who are looking to buy crude. Buy quality; that way you know the company won't go bankrupt.

On the surface that seems like great advice. But I'm not doing it, and I don't think you should either. This stock chart of **Suncor Energy Inc.** ([TSX:SU](#))([NYSE:SU](#)) does a great job of explaining it.

[Suncor 1 Year Price Chart](#)

Although the price of oil has plunged nearly 50% over the last year, shares of Canada's largest energy company are actually up. That doesn't make a whole lot of sense to me. If you're bullish on Suncor now, then you should have been really bullish a year ago.

Investors want exposure to the sector, and are willing to pay a premium to get it. Shares of **Imperial Oil** have reacted in much the same way.

Meanwhile, shares of **Husky Energy Inc.** (TSX:HSE) have fallen more than 15% over the last year. Husky also has a great balance sheet, downstream assets to shield it from crude, and a bunch of potential oil sands growth once crude prices recover. But most importantly, it has upside potential without giving up much in quality.

Stop trying to predict crude

In 2008, when crude was on its way to a record high, **CIBC** analyst Jeff Rubin famously predicted it would hit \$200 per barrel by 2012. Needless to say, that prediction was a little off the mark.

We can all point and laugh at Rubin's call now, but I choose to look at it a different way. Rubin has decades of experience analyzing oil. He's probably read more about the commodity than everyone reading this put together. If he's capable of getting oil so spectacularly wrong, what chance do us mere mortals have?

I learned a long time ago not to bother trying to predict the price of crude, gold, coal, the stock market, the real estate market, or anything else. Mr. Market is too flaky, I have no idea what his idea of value is.

Instead, I focus on the one thing I can control — finding cheap energy companies with great balance sheets. Husky is one, and if you value **Canadian Oil Sands Ltd.** (TSX:COS) by the value of its reserves rather than its ability to generate cash flow, it's obvious that the value of oil in the ground exceeds the value of the shares at today's levels. The only assumption I have to make is whether the company can survive the current bear market.

Forget about outlandish predictions. Assuming crude recovers, there are some incredible bargains in the energy patch right now.

CATEGORY

1. Energy Stocks
2. Investing

TICKERS GLOBAL

1. NYSE:SU (Suncor Energy Inc.)
2. TSX:SU (Suncor Energy Inc.)

Category

1. Energy Stocks
2. Investing

Date

2025/09/18

Date Created

2015/02/12

Author

nelsonpsmith

default watermark

default watermark