The 3 Biggest Reasons Why Oil Could Crash Further

Description

There's no denying that the oil rout has been devastating for the energy sector. That being the case, there seems to be a belief prices will come roaring back.

If you don't believe me, look at the stock prices of companies like **Suncor Energy Inc.** (TSX:SU)(NYSE:SU) and **Crescent Point Energy Inc.** (TSX:CPG)(NYSE:CPG). Since the beginning of 2014, Suncor's share price has actually increased, even though oil prices have halved during this time.

Crescent Point's stock price has decreased over this time, but its shares trade at a premium to the company's net asset value, even assuming a robust oil recovery.

So, investors seem fairly optimistic. Is this optimism warranted? Well, I would argue there's just as much risk to the downside. Below are three reasons why.

1. Iran

On Thursday Iran reached a framework agreement with the international community, one that will gradually eliminate sanctions against the country. As a result, Iran will be able to export more of its oil. Over time, this could add an extra one million barrels per day to the oil supply.

To put this in perspective, today the oil market is oversupplied by about 1.5 million barrels. So, a fully productive Iran is the last thing oil companies like Suncor need.

2. Lower costs in the United States

Canadian oil executives, including those at Suncor and Crescent Point, like to talk about reducing costs. Ideally, these reduced costs will allow the companies to survive during this temporary price slump. Then when prices recover, profitability will be higher than ever.

There's a big problem with this narrative: American companies are reducing costs as well. To illustrate, **Continental Resources Inc.** expects its well costs to decrease by 15%, which is not unreasonable in this environment. If this happens, its Bakken wells will return 10-20% with oil in the US$40s.

So, if you're waiting for oil production to fall off a cliff in the United States, you may have to wait for a while.

3. Storage

Thanks to this surge in production, more and more oil is being diverted to storage tanks. This is actually helping to sustain demand. Unfortunately, storage capacity is running low. If it runs out, then all newly produced oil will have to be dumped on the market. This would surely send prices crashing further.

So, when could this happen? Estimates vary, but Kevin O'Leary said that he expects this to happen around August. Others have called for capacity to run out even sooner.

Here's the most important point: if you're thinking that oil companies' stock prices can't get any lower, you're wrong.

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