Why the Recent Oil Rally May Be Short Lived, and What to Do About it

Description

If you think the recent rally in oil prices will keep going, then you may be in for some disappointment. The International Energy Agency has just released its latest Oil Market report, and the findings do not look good for oil bulls.

On that note, let's take a look at what the report says, and then look at how investors should react.

Oil production remains strong

Even though prices have fallen so drastically, oil production in April remained strong throughout the world. This is true for both OPEC and non-OPEC members.

Among OPEC members, countries like Saudi Arabia, the UAE, and Kuwait are all "bucking the global trend," by raising rig counts and expanding their drilling programs. Production also remains strong in countries like Iraq and Libya despite the instability in these countries. Even Iranian supplies are at their highest in almost three years, and could increase further if sanctions are eased.

Non-OPEC members are also defying expectations. Russian production grew by nearly 200,000 barrels per day year over year despite sanctions against the country. Brazilian production grew 17% despite balance sheet and corruption problems at state-owned giant Petrobras. And in the United States, the recent rebound in oil prices is giving many shale oil producers "a new lease on life."

Overall, oil production came in at 95.7 million barrels per day, about the same as March, but 3.2 million barrels per day more than April 2014.

Demand growth just isn't enough

Global oil-demand growth is now projected at 1.1 million barrels per day for 2015. While this may sound good, it's much less than the growth in output. The problem areas are in the former Soviet Union, the Middle East, and Latin America. This shouldn't be surprising—all of these regions are going through economic difficulties.

As a result, global supply is now outstripping demand by about two million barrels per day. That doesn't bode well for oil prices, especially as production costs continue to decline.

What should investors do?

At first glance, it may seem like a good idea to avoid Canadian oil stocks altogether. Our economy is very dependent on energy, and if the oil price drops again, that would affect a lot of companies on the TSX.

Yet there are a few companies that would benefit from lower oil prices. One is **Magna International Inc.** (TSX:MG)(NYSE:MGA), Canada's largest auto parts manufacturer. The company specializes in making parts for larger vehicles, whose sales benefit as gas prices decline.

Canada's miners also benefit from lower oil prices, for a couple of reasons. First, diesel is a major input cost in mining operations. Second, a low Canadian dollar (which goes hand-in-hand with low oil prices) helps companies that sell their product in U.S. dollars, but incur expenses in Canadian dollars. So, a company like **Teck Resources Inc.** (TSX:TCK.B)(NYSE:TCK) could benefit, even though it owns a stake in the Fort Hills oil sands project.

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