Why We May See $55 Oil in 2020

Description

There's a common belief that oil prices, which currently remain close to US$60 per barrel, will rebound sooner or later. As a result, most of Canada's top energy companies trade at a rich premium.

For example, **Crescent Point Energy Corp.** (TSX:CPG)(NYSE:CPG) trades at a premium to the value of its reserves, even when assuming that oil prices will reach US$95 by 2020. Similarly, **Suncor Energy Inc.** (TSX:SU)(NYSE:SU) shares trade as if oil sells for more than US$90 per barrel.

If an oil rebound were a foregone conclusion, then these stocks would not be overpriced. But oil prices could stay low for many years according to research analysts from **Goldman Sachs**. Below we take a closer look.

Very pessimistic

Over the past few years, costs to extract oil have come way down, especially in shale oil formations. This cost cutting has only accelerated in the past six months as producers grapple with low prices. And according to Goldman, costs will continue to decrease.

For that reason they expect to see US$55 oil in 2020. This forecast is much more pessimistic than earlier predictions, and about US$20 below the futures price for 2020 oil.

Interestingly, the analysts are predicting US$65 oil from 2016 through 2018. So, if they are right, then oil prices will tick up, then fall back down later on. This is in contrast to other major forecasts, which predict steadily rising prices in the medium term and long term.

Some strong evidence

Goldman's forecast may seem overly harsh at first, but there are some reasons to believe it may come true.

First of all, U.S. oil production has increased in the past few months despite low prices. Back in late November, when oil prices really started to plummet, the United States produced about 9.1 million barrels of crude oil per day. Last week that number was close to 9.4 million. Those numbers don't even account for the fracklog, which refers to wells that have been completed, but are not yet producing.

Secondly, a lot of producers are getting ready to ramp up production further. **EOG Resources Inc.**, one of the largest American shale oil drillers, has said it plans to increase drilling as soon as oil stabilizes at US$65 per barrel. **Pioneer Natural Resources Co.** already has plans for more rigs.

What should investors do?

It should be clear that Canadian oil companies, especially those with strong balance sheets, are probably overpriced. But that shouldn't discourage you from Canadian stocks altogether. After all, some stocks (in other industries) are trading as if oil will crash further. Even Goldman thinks this won't happen.

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1. Energy Stocks
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