



The Smartest Way to Invest in Today's Volatile Oil Sector

Description

Investors trying to figure out what oil will do in 2016 are likely confused—analyst predictions have ranged from \$10 a barrel to above \$75 per barrel.

Analysts at **Royal Bank**, for example, see oil trading in a range between \$45 and \$65 per barrel in 2016, a considerable premium on the current price of around \$30 dollars per barrel. On the other hand, a prominent analyst from T Rowe Price who accurately predicted the current decline in oil prices sees oil prices declining and staying in the \$20 range over the next six months and then will move into the teens from there.

Knowing how unpredictable the price of oil is, pipeline players like **Enbridge Inc.** ([TSX:ENB](#))([NYSE:ENB](#)) and **TransCanada Corporation** ([TSX:TRP](#))([NYSE:TRP](#)), offer investors stable earnings growth regardless of the price of oil as well as upside if oil recovers, which should lead to multiples in the sector expanding.

Why investors should assume a “lower for longer” scenario

Currently, oil demand is not the problem. In fact, oil demand is currently growing at the fastest pace since 2010. The issue is on the supply side. Currently, global oil markets are about two million barrels per day oversupplied. While demand growth is strong, there are many forces in place that should prevent supply from declining quickly, which should leave the market imbalanced going forward.

There are some encouraging signs coming from non-OPEC oil (which includes U.S. production). The IEA, for example, sees this production declining by about 600,000 barrels per day in 2016. This is occurring as U.S. producers suspend production and investments as they see operating cash flows decline.

Some analysts, however, see U.S. producers having cash costs of around \$25 per barrel—and constantly going lower—and these producers also have an incentive to keep production up in order to service heavy debt loads. As a result, this supply can be slower to come offline than many are expecting.

At the same time, OPEC supply is set to grow with Iran potentially adding 600,000 barrels per day by the middle of the year and Saudi Arabia set to grow production as well. As a result, it is safer to be pessimistic on oil for the year.

Pipelines are a safe place to be

Both Enbridge and TransCanada offer investors exposure to oil, but within a diversified business model. For example, regardless of prices, the Canadian Association of Petroleum Producers expects the oil sands to add about one million barrels per day of production by 2010. This is from projects that were sanctioned many years ago and are still set to come online.

Since pipelines are exposed to volumes rather than prices, the growth environment for the oil and liquids segments of TransCanada and Enbridge is optimistic over the next several years. Most importantly, there is currently insufficient pipeline capacity to meet this growth (as well as any additional growth beyond 2020).

Enbridge and TransCanada both have solutions to meet this growth. Enbridge is restarting its Line 3 pipeline in 2017 (which should add around 400,000 barrels per day), and TransCanada is putting its massive \$12 billion Energy East pipeline through the approval process.

Currently, TransCanada has \$13 billion of commercially secured projects that are set to be in service by 2018, and this should drive stable earnings growth of 8% annually until then, regardless of oil prices. This could grow to 14% annually until 2020 if TransCanada's larger scale projects are approved.

Enbridge is in a similar position with a highly predictable 11-13% annual earnings-growth rate through to 2020, driven by \$25 billion in fully secured and \$13 billion in unsecured capital projects.

Both of these businesses also offer exposure to natural gas and power generation, making them a safe way to play oil in 2016. Both TransCanada and Enbridge have seen their shares beaten up due to overall weakness in the sector, which creates an opportunity since the shorter-term earnings-growth potential of these companies has remained largely unchanged.

CATEGORY

1. Investing

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2. NYSE:TRP (Tc Energy)
3. TSX:ENB (Enbridge Inc.)
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