Why 1 Hedge Fund Manager Thinks Oil Is Headed to $100 Per Barrel

Description

Since the oil rally began a few weeks ago, investors have been exposed to countless different forecasts as to where the price of oil is headed. As usual, analysts vary hugely on their estimates; most are now bullish on oil over a medium time frame.

Goldman Sachs, for example, is estimating WTI crude will average US$38/barrel for 2016. **Royal Bank** is estimating it will average US$40.28/barrel. And Eric Nuttall (manager of Sprott Energy Fund) thinks oil will average US$55 per barrel. Nuttall's forecast stands out as being on the higher end of analyst forecasts.

Recently, however, Jeffrey Ubben, founder and CEO of the of the $19 billion hedge fund ValueAct Capital, said that he believes oil is headed to US$100/barrel by 2019. This is well outside the long-term range of even the most bullish oil investors. Here's why he could be right.

Ubben thinks a shortage of labour and equipment will drive prices higher

While Ubben did not speak in depth on the topic of oil prices, he did say they could "easily" reach US$100/barrel by 2019 thanks to the huge amount of disinvestment, the loss of labour, and equipment shortages. There have been massive amounts of layoffs in the oil industry, and this means that oil supply will not have the flexibility and will not be able to respond as quickly to come back online once prices move up.

Ubben also mentioned equipment, stating that many types of equipment (he mentioned pressure pumping equipment specifically) basically become inactive if they are not run for a significant period of time. These factors should lead to the oil supply not being able to meet growing demand quickly, which could force prices back above $100/barrel.

Could Ubben be correct? The fact is, oil demand is still growing by over one million barrels per day annually, and this growth rate is estimated by many to continue to at least 2019 or 2020 (possibly dropping below one million barrels per day as 2020 approaches).

Global demand was 94.5 million barrels per day in 2015, and this could grow to 100 million barrels per day by 2020 if growth expectations are true. This means 5.5 million barrels of new supply will be necessary. In addition, global supply also declines every year by about 8%. Not only does supply need to grow to meet demand growth, but it also needs to come up with 8% per year just to keep production steady and offset natural declines.

Due to low prices, massive capital budget cuts are occurring, and projects that produce 13 million barrels per day (most of which are in the oil sands) have been delayed indefinitely. Much of this production requires years to develop, and this means this supply will not be available when it is needed.

In addition, Ubben is right about labour shortages. Canada, for example, is expecting that 31,000 construction jobs will be lost due to the oil price drop. These workers are often moving to other provinces and other fields, which could lead to a major shortage of labour.

Suncor, Baytex, and Crescent Point are good ways to play an increase

It is important to be diversified when playing an increase in oil prices, and **Suncor Energy Inc.** (TSX:SU)(NYSE:SU), **Baytex Energy Corp.** (TSX:BTE)(NYSE:BTE), and **Crescent Point Energy Corp.** (TSX:CPG)(NYSE:CPG) would make a solid diversified portfolio.

Suncor is likely the safest way to play oil in Canada due to the fact it has refining operations that benefit from falling prices. Suncor shares were fairly stable during the price collapse, and the company has made major investments into future production growth.

Baytex and Crescent Point have much better upside as oil increases, are conventional producers of light oil with the ability to grow production as oil prices increase, and have above-average profit per barrel and high-returning wells even in a weak pricing environment. Should Ubben be correct, this portfolio should help investors successfully ride out the ups and downs in prices that will occur as oil climbs over the next several years.

CATEGORY

1. Energy Stocks
2. Investing

POST TAG

1. Editor's Choice

TICKERS GLOBAL

1. NYSE:SU (Suncor Energy Inc.)
2. NYSE:VRN (Veren)
3. TSX:BTE (Baytex Energy Corp.)
4. TSX:SU (Suncor Energy Inc.)
5. TSX:VRN (Veren Inc.)

Category

1. Energy Stocks
2. Investing

Tags

1. Editor's Choice

Date
2025/08/25
Date Created
2016/03/23
Author
amancini