Is the Oil Slide Over?

Description

According to *The Globe and Mail*, some major asset managers are calling a bottom in the energy markets.

"Firms including T. Rowe Price, Fidelity, and American Funds have been adding shares of exploration and production companies that they say have the most to gain from oil prices stabilizing," the paper said. "Fund managers say that they are buying exploration and production companies in part because they expect the oil glut to dwindle this year as production halts begin to take effect, setting up for a rally in revenue and earnings in 2017."

The idea that oil markets are rebalancing isn't new. Right now, global oil production is about two million barrels per day above consumption. By 2017, however, the EIA expects this gap to close completely. The last time the market was balanced, oil was at $100 a barrel.

Could the slide really be over?

A rebound by 2017?

According to **Thomson Reuters Corp.,** large energy companies are expected to see profits fall 67% this year. By 2017, however, earnings are expected to grow over 200%. That timeline also matches the EIA's expectations for the market rebalancing. Even Kuwait, a major OPEC exporter, expects the price of crude oil to rise to $50 per barrel by the end of 2016, citing "increased demand and shrinking supply."

With nearly every metric indicating higher oil prices in coming years, it's no wonder portfolio managers are starting to pile in. Jeremey Grantham (co-founder of $120 billion asset manager Grantham, Mayo, Van Otterloo) believes the average oil producer needs at least $65 oil to finance new oil exploration. "Currently ultra-low resource prices are not sustainable," his recent report said. "Resource prices will inevitably rise."

OPEC needs to play along

Predictions for the market rebalancing hinge on reining in U.S. shale oil plays. As shale production exploded following the mass adoption of fracking, the United States nearly doubled its domestic oil production from 2007 to 2015. Because OPEC refused to cut production—instead focusing on retaining market share—oil prices collapsed. If shale oil supply can be normalized, prices have a chance of rebounding.

While the focus is on U.S. marginal producers, OPEC still has the clout to keep prices depressed.

“Through 90% of oil history, if oil producers wanted to outproduce demand they could have. And it would always have buried oil prices. But mostly they restrained their competitive market share instincts in the interest of a more stable price,” writes Grantham.

If it chose, OPEC could continue pumping profitably for years, especially considering its breakeven production price is between $10 and $20 for most of its members. That could slow a pricing rebound considerably.

What to buy?

If you’re playing the oil markets, it’s best to choose a company that not only will benefit from higher prices, but can withstand a slower-than-expected rise. **Crescent Point Energy Corp.** (TSX:CPG)(NYSE:CPG) fits the bill well. Its management team has a proven ability to drive high shareholder returns over the entire business cycle, and over the next few years it could become a dividend machine.

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1. Editor's Choice

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