



## Miss the Oil Rally? Now Is Your 2nd (and Final) Chance to Get Back in

### Description

What many oil-market observers have been calling for over the past several months is finally underway: a double-digit pullback in oil prices. After peaking at close to US\$52 in early June, oil prices have pulled back close to 14% due to concerns about global demand and returning supply.

While it is impossible to say how low oil will go or for how long (for example, in March prices corrected about 15%), oil fund manager Eric Nuttall, who was one of the early forecasters and buyers of the oil rally, sees a 15% correction as reasonable.

Fortunately, predicting exact bottoms in prices is not important for long-term investors. The key is to realize that prices do not move in straight lines and to take advantage of pullbacks to fair prices to either average down costs in quality producers or initiate new positions. Names such as **Crescent Point Energy Corp.** (TSX:CPG)(NYSE:CPG) and **Baytex Energy Corp.** ([TSX:BTE](#))(NYSE:BTE) are now on sale.

### The oil price outlook: near-term weakness followed by long-term strength

While there are no sure things in markets, the fact that the current bout of weakness in oil prices is temporary is close even with the most conservative view of oil-market fundamentals. Looking at the causes of the recent pullback shows why.

Returning supply from recent outages has been focus of the market recently. Millions of barrels of lost production in Canada (from the wildfires), Nigeria, and Libya led to much of the rally in oil prices last quarter, tightening the market ahead of sustainable production cuts. Much of this supply is now returning; Canadian production is back to levels before the wildfires, and Kuwait and Saudi Arabia are considering restarting 500,000 bpd of shared and idled production.

The market is also concerned about returning investment activity in the oil sector with oil rig counts now climbing again (up 25 in the past month). There are also concerns about demand in the U.S. (as gasoline inventories remain high and the peak summer driving season comes to a close) and globally (related to Brexit concerns). These forces should keep prices under US\$50 for a period. For investors looking for oil stocks, this should provide a decent window to accumulate shares.

With oil prices currently around US\$45.50 and breakeven prices for U.S. producers being around US\$60, buying oil names at these price levels is not a bad idea. While prices could go lower (which would offer even better opportunity), US\$45 is a fair price given significantly higher breakeven prices for U.S. producers.

### **What names to buy?**

While it is impossible to say how high oil prices will go, it is safe to say they will be much higher than current levels, and not just because of the high breakeven prices just mentioned. Oil workers have been laid off globally (350,000 workers), and 60% of U.S. field workers that drill shale wells have also been laid off. This means production is unlikely to recover as quickly as some expect.

Crescent Point is a good place to start. Crescent Point shares have declined by 16% since oil peaked in early June, and it is not unreasonable at all to suggest prices will exceed those highs once oil begins to rally again. Crescent Point offers low debt (a net debt-to-cash flow of 2.2 versus the peer average of 3.3) as well as free cash flow of \$300 million at current oil prices.

Baytex offers a higher-risk, higher-return alternative to Crescent Point, and shares have declined 22% off the highs in June. Baytex has higher debt levels (a net debt-to-cash flow of seven this year) and saw declining production, but it's expected to post a slight free cash flow this year. As prices rise, these issues for Baytex will mean less, and the share price should reflect that.

### **CATEGORY**

1. Energy Stocks
2. Investing

### **POST TAG**

1. Editor's Choice

### **TICKERS GLOBAL**

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

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