



Why Oil Prices Could Return to \$40 Again (and What You Should Do)

Description

West Texas Intermediate prices have lost over US\$9 bbl from year-to-date highs of nearly US\$52 per barrel set in early June in a major market pullback that many investors were expecting. After all, markets do not move in straight lines, and the steady 90% rally that started in Q1 was due for a pause to allow market fundamentals to catch up with prices.

The pullback in prices was driven by a few factors, such as returning supply from places like Nigeria, and supply back online after the Canadian wildfires. An even more important reason, however—and the likely driver of further downside pressure—is the expectation of weakened gasoline demand due to the quickly approaching end of the U.S. summer driving season.

This should lead to seasonal weakness in crude for the next few months. It's at this time, when markets are bearish, that investors focused on longer-term, bullish fundamentals should be actively buying names like **Suncor Energy Inc.** ([TSX:SU](#))([NYSE:SU](#)) and **Baytex Energy Corp.** ([TSX:BTE](#))([NYSE:BTE](#)).

Refinery shutdowns will weigh on prices going forward

Normally, refineries (which are a main source of crude oil demand) shut down for seasonal maintenance at the end summer (to coincide with lower gasoline demand that occurs at the end of driving season), and this leads to a fairly predictable reduction in crude oil demand. Between July and October over the past five years, crude oil demand from refiners dropped by 1.2 million barrels per day on average.

While this is a seasonal occurrence, the demand drop off may be worse this year than usual due to extremely high levels of gasoline inventory. Not only are gasoline inventories the highest they've been since April (at 241 million barrels), they are just slightly off all-time highs set earlier in the year (258 million barrels) and are currently at the highest seasonal levels since 1990.

This is bad news for crude oil demand, since refiners will likely cut back even more on activity to protect their profit margins, especially if they see that refined product demand simply is not there. Refiners see shrinking margins as they boost their capacity utilization and as inventories rise, and they

are unlikely to continue producing more with margins shrinking.

While crude oil inventories may be falling, total oil and petroleum product stocks are at an all-time high. Markets are shifting their focus from falling inventories to the overall surplus of petroleum products.

Other factors are also pushing crude prices down

While a slowdown in gasoline demand is pushing crude down, other factors, like a recently strengthening U.S. dollar and a pickup in oil rigs, are also weighing down prices. The U.S. dollar has been performing well lately since it is seen as a safe-haven currency after the Brexit and the outperformance of the U.S. economy.

Since oil is priced in dollars, as the dollar strengthens it becomes more expensive to purchase with other currencies, which reduces demand. This is on top of news that U.S. drillers added 41 rigs over the past four weeks, which is a precursor to more production.

This is an excellent buying opportunity

While the market may be focused on shorter-term, bearish fundamentals now, the long-term fundamentals are still bullish with the IEA predicting a supply deficit in 2017 and the year-over-year surplus in crude inventories likely to be flat by the fall.

Many oil names have been holding up well despite falling prices, but Baytex Energy shares have recently caved, plunging 17% since the beginning of July and 30% off its June highs. Oil prices were US\$50 when Baytex reached these highs, and Baytex could see 45% upside should oil prices return to those levels.

More conservative investors could consider buying Suncor Energy, which has fallen about 6% since early July.

CATEGORY

1. Energy Stocks
2. Investing

POST TAG

1. Editor's Choice

TICKERS GLOBAL

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

Category

1. Energy Stocks
2. Investing

Tags

1. Editor's Choice

Date

2025/08/18

Date Created

2016/07/27

Author

amancini

default watermark

default watermark