Should Investors Bet on an OPEC Deal?

Description

Rumours of an OPEC agreement to freeze production have fueled much of the gains in oil prices this year.

With OPEC’s critical November 30 meeting just around the corner, let’s take a look at whether or not a deal might be in the cards.

default watermark

Background

The Organization of the Petroleum Exporting Countries (OPEC) was set up in 1960 and counts Saudi Arabia, Iran, Iraq, Kuwait, and Venezuela as founding members. Nine other countries are also part of the group, which is responsible for 40% of global production.

Analysts blame the drop in WTI oil prices from US$100 per barrel in 2014 to below US$30 per barrel earlier this year on a game of chicken between Saudi Arabia and American producers.

The theory goes that the Saudis wanted to push high-cost American shale-oil companies out of business to guarantee market share and ensure long-term price strength.

The fight has come at a heavy cost for Saudi Arabia and other OPEC members who rely on oil revenue to finance their economies and ensure political stability.

American producers didn’t fold as expected, so OPEC has been forced to talk up the market price.

Chatter about an agreement to freeze output began in the winter and subsequently pushed oil back above US$50 in May and June. As the market realized no deal was imminent, and Saudi Arabia continued to break production records, the market began to sell off.

By late July it looked like oil could drop back below US$40, so the marketing spin started again and has more or less continued in recent months.

An agreement to discuss an agreement

At a meeting in Algeria in late September, OPEC announced it had agreed to target OPEC daily production of 32.5-33 million barrels per day, which would result in a cut of more than 700,000 barrels per day based on OPEC's stated August output.

Shortly after the announcement, Iraq said it might walk away from a deal if it doesn't agree with the production levels allocated to each country.

Trying to pin down each producer's actual output is a difficult chore, and every member will want the number to be as high as possible.

On October 23, Iraq threw another wrench in the process by saying it wants to be exempt, citing the need for additional cash flow to continue its fight against rebel forces in the country. Iraq is OPEC's second-largest producer, so it is critical to any deal being put in place.

Iran is still ramping up output after the lifting of sanctions against the country. Getting the producer to agree to any limit is going to be difficult, so OPEC might have to let Iran run the taps wide open.

With Iran and Saudi Arabia supporting opposite sides of wars in Yemen and Syria, it is unlikely the Saudis are going to allow Iran to build strength while they restrict their own cash flow.

default watermark

What about Russia?

Russia is not an OPEC member, but the country is among the top three producers on the planet.

The Russians have played along with the ploy to talk up prices, saying they would entertain the possibility of a production cap. The rhetoric is expected, but the country's production hit a record in September, and few market watchers expect the growth to slow.

Should you buy the hype?

OPEC needs higher prices, and the group may actually announce a "firm" agreement at the end of November, but investors should be careful about making long-term bets based on any additional pop in oil prices.

Most analysts are skeptical any deal will be honoured, and a sharp rise in prices could be short-lived. As a result, I would avoid the pure-play producers for anything other than a short-term trade.

Investors who are looking for a longer-term bet might want to consider an integrated producer like **Suncor Energy Inc.** (TSX:SU)(NYSE:SU). The company is expanding its asset base through strategic acquisitions, it owns refining and retail operations that provide a nice hedge when times are tough, and it has the financial flexibility to ride out another downturn just in case things get ugly again.

CATEGORY

1. Energy Stocks
2. Investing

POST TAG

1. Editor's Choice

TICKERS GLOBAL

1. NYSE:SU (Suncor Energy Inc.)
2. TSX:SU (Suncor Energy Inc.)

Category

1. Energy Stocks
2. Investing

Tags

1. Editor's Choice

Date
2025/09/17
Date Created
2016/10/25
Author
aswalker

default watermark

default watermark