



Will OPEC Continue to Crush Your Oil-Stock Portfolio?

Description

Warren Buffett is often quoted as saying, “Be fearful when others are greedy and be greedy when others are fearful.” With oil prices down 15% off recent highs (and some oil stocks down even more), fear is now rampant in the oil market. In fact, some experts (like John Kilduff) are even bringing back the old claims that oil could drop below US\$30 per barrel.

OPEC caused the recent sell-off

These are the conditions in which investors should be cautious buyers. Oil’s recent sell-off is largely due to skepticism that OPEC will reach their proposed goal of cutting about 700,000 barrels per day of production from August 2016 levels.

Most recently, Saudi Arabia and Iran (OPEC’s largest and third-largest producers, respectively) fell into conflict. Iran is refusing to freeze its output at 3.6 million barrels per day (August 2016 levels); it won’t cap its output until its production reaches 4.2 million barrels per day. Saudi Arabia, in response, threatened to hike its oil production from 10.6 million barrels per day to 11 million barrels per day.

This bad news shaved about \$1 off the price of oil, and this followed news that Iraq—OPEC’s second-largest producer—is looking for an exemption from the deal as well. With Saudi Arabia, Iraq, and Iran unable to agree, the market is starting to price in no agreement.

In the short term, it is impossible to say how low oil will go, and the market will rise and fall based on OPEC news. A short-term move below US\$40, while unlikely, is possible. Investors, however, should use the current sell-off as a buying opportunity, since the market is showing signs of being undersupplied and the long-term fundamentals are bullish. In addition, the odds of OPEC coming to an agreement are much better than many think.

The fundamentals are going in the right direction with or without OPEC

Before looking at the fundamentals going forward, investors should look back. One additional reason oil prices plunged this week is because U.S. oil inventories rose by a huge 14.4 million barrels, which was the biggest build in 34 years.

It is important to note, however, that this was largely caused by a big increase in imports, combined with lower demand from refineries. Many refineries are currently shut down for fall maintenance, which means less demand. The big spike in imports was likely due to expectations that refineries will return from maintenance over the next few weeks.

Other than last week, U.S. inventories have been in a steady decline, which is a sign that demand is clearly exceeding supply. In August, U.S. inventories were about 120 million barrels higher than last year. Last week, they were 23 million barrels higher. The market is clearly moving in the right direction, and when this seasonally weak refinery maintenance period ends over the next several weeks, this trend should resume. It is important to remember that U.S. producers need \$55-60 oil just to keep production flat.

An OPEC deal is not off the table

As for OPEC, a deal is not off the table yet. OPEC's credibility is on the line, and nearly every OPEC producer is in dire financial shape and needs much higher prices to balance their budgets.

According to Open Square Capital, even in the worst-case scenario that every OPEC country except for Saudi Arabia and its two major Gulf State allies (U.A.E. and Kuwait) were exempt, cutting 700,000 barrels per day would be possible.

If Iraq and Iran could agree to some sort of freeze, OPEC would only need to worry about growing production from Libya and Nigeria. If not, Saudi Arabia and its Gulf State allies could even agree to cut a larger share to offset Iran and Iraq production growth, which a recent *Bloomberg* article suggested.

Investors can use this pullback in oil prices to buy **Baytex Energy Corp.** ([TSX:BTE](#))(NYSE:BTE), which recently moved below \$5 per share after trading as high as \$9 earlier in the year when oil prices were above \$50.

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1. TSX:BTE (Baytex Energy Corp.)

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