



What Does OPEC's Historic Agreement Mean for Your Oil-Stock Portfolio?

Description

OPEC shocked market observers earlier in the week by coming to its first production-cut agreement since 2008 and its first potential agreement involving Russia since 2001.

Canadian oil investors should not underestimate how bullish this is for oil stocks—not only does the agreement mean up to 1.8 million barrels of production per day will be removed, but it also means that OPEC is back to market manipulation, ending the free-market model that was partially to blame for the oil rout and putting a firm floor under oil prices.

What was the deal? The deal featured a few significant accomplishments. Overall, OPEC producers agreed to cut production from 33.7 million bpd to 32.5 million bpd—a cut of 1.2 million barrels per day. In addition, non-OPEC producers are expected to contribute another 600,000 bpd to the cut (half from Russia), bringing the total to 1.8 million bpd. These details will be fleshed out more next week.

Where did the cuts come from? The bulk comes from reliable states with a history of sticking to cuts. Saudi Arabia will cut 486,000 bpd, and the UAE, Qatar, and Kuwait will cut another 300,000 bpd. Iraq also agreed to cut 210,000 bpd. This is significant, since this would be decades since Iraq actually agreed to an OPEC cut.

Of course, many cite the fact that Iran, Libya, and Nigeria were basically exempted from the deal, but even if Libya and Nigeria restored their production and Iran was allowed to add 90,000 bpd of production (an unlikely situation), OPEC would still see a nearly 600,000 bpd supply cut, not including any non-OPEC producers.

Will OPEC stick to the agreement?

One of the big concerns surrounding OPEC agreements is that producers will not comply fully. To enforce the agreement, OPEC is setting up a committee comprised of three smaller OPEC producers as well as two non-OPEC producers. This should help to ensure compliance, but it is important to note that there are better reasons to be optimistic about compliance.

As mentioned earlier, the bulk of the cuts is coming from Saudi Arabia and its Gulf State allies, all

nations which have a solid previous track record of sticking to cuts. During the economic crisis cut back in 2009, Saudi Arabia, Kuwait, Qatar, and the UAE all stuck to cuts.

Other OPEC producers (including Iraq) had a less favourable track record, but it is important to note that nearly all OPEC producers complied during the dot-com bust cut. It is also important to note that OPEC producers like Iraq can't simply hike production rapidly, unlike other periods in history.

Iraq has only 100,000 bpd of spare capacity, according to some estimates, as it as near record production levels. Most importantly, Iraq is in a dire financial situation and at current oil prices, it can just afford to keep production flat.

What it means for your oil stocks

Even in a case where the deal is poorly implemented, it will result in an oil market that clearly moves into deficit in 2017. Analysts at **Bank of Nova Scotia** state that even in a situation where non-OPEC producers contribute nothing, and Iran, Libya, and Nigeria all ramp up production, the global oil market would remain very slightly oversupplied in the first half of 2017 before moving into a deficit in the second half.

Of course, if non-OPEC producers contribute, or if production growth in Libya or Nigeria is minimal, the markets would move strongly into a deficit position, forcing prices higher. Most importantly is the fact that after the OPEC deal, sentiment in oil markets will be much better, as investors will see a clear floor in the market and be more willing to take risk.

Investors looking to overweight energy in their portfolio should choose a diversified set of names. This includes large-cap, low-risk dividend payers like **Canadian Natural Resources Limited** ([TSX:CNQ](#))([NYSE:CNQ](#)) and higher-risk, more leveraged names like **Baytex Energy Corp.** ([TSX:BTE](#))([NYSE:BTE](#)),

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Author

amancini

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