The Last Time This Happened, Canadian Oil Stocks Rallied Over 100%

Description

It’s hard not to see some similarities between early 2016 and early 2017 in the Canadian energy stock universe, and investors paying close attention could be rewarded just as handsomely as they were last year for similar reasons.

Just like last January and February, Canadian energy stocks have endured an abnormally large sell-off — many names have sold off by over 20% in the span of only a month or so. **Crescent Point Energy Corp.** (TSX:CPG)(NYSE:CPG) sold off 24% in January, and **Baytex Energy Corp.** (TSX:BTE)(NYSE:BTE) sold off over 30% in January.

Nearly the entire Canadian energy stock sector (with the exception of the major names) saw similar sell-offs. Investors would need to look back to early 2016 to see this kind of selling activity in the sector. At this point in 2016, pessimism around Canadian oil stocks was at an extreme, and what followed (as it often does during periods of extreme pessimism) was the doubling and, in some cases, tripling or quadrupling of Canadian energy names.

There are some differences between January and February 2016 and 2017. Unlike in early 2016 (when oil was plummeting), the price of oil itself has actually been fairly steady early in 2017. For the most part, only Canadian energy stocks have sold off.

Like early 2016, however, the sell-off has been irrational and based on doomsday predictions that are unlikely to come true. In early 2016, the fears were based on the idea that oil could plummet to $15 or even $10 per barrel (despite the fact that almost no producer in North America can sustainably maintain production at those prices). Today, the fears are based on an unlikely border adjustment tax by the Trump administration.

The fact that this tax is unlikely combined with the fact that the picture for oil prices is extremely favourable compared to last year means that investors who get in now could possibly expect a repeat of last year’s performance in Canadian oil names.

Trump’s border adjustment tax is losing support … for good reason

In order to see a repeat performance of last year in the Canadian energy world, the reason for the major recent sell-off will have to not pan out, and oil prices will need to continue improving.

The reason for the sell-off was due to fears that Trump will implement a tax on American businesses importing goods. This could apply to crude oil, which would mean U.S. refiners buying Canadian crude would have an incentive to look to other sources. In theory, this would both hurt Canadian oil prices and export levels.

Fortunately, it is very unlikely to happen. **Suncor's** CEO recently stated that he thought Rex Tillerson (current secretary of state and prior **Exxon** CEO) would shield oil from such a tax, because Tillerson knows that U.S. refineries depend on Canadian heavy oil since the U.S. makes very little.

The end result is that higher costs would be passed to consumers, and some analysts see this translated to $500 of extra gasoline costs per year for consumers. It seems this proposal is already dying; one Republican senator stated the plan was on life support.

OPEC is complying with cuts and the market is rebalancing

Once fears over a border adjustment tax fade, another leg up in oil prices would be all that is needed for Canadian oil stocks to rally, and this seems likely. In the fall, OPEC agreed to cut around 1.8 million bpd of production, and recent IEA data shows that OPEC is about 90% compliant with these cuts, which would be historic compliance levels.

OPEC production (which was supposed to be reduced to 32.5 million bpd) came in at about 32 million bpd in January, exceeding expectations. As a result, the IEA sees the global oil market being short by 800,000 bpd in early 2017, which is good for oil prices.

Investors should take advantage by adding to high-quality energy names such as Baytex and Crescent Point while they are still weak.

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amancini