Why You Should Be Aggressively Buying the Latest Dip in Oil Prices

Description

The oil market has shown massive volatility over the past month, and investors have been subject to constantly fluctuating headlines on the outlook for the oil market — from being massively bullish early in the month as oil was rallying to bearish now as oil is declining.

Investors can profit immensely in this environment by ignoring the constant slew of news and frequently changing sentiment around the oil market. Instead, focus only on the fundamental picture for oil. Unlike the manic headlines that focus on the latest OPEC rumour, the weekly EIA storage report, or the latest U.S. rig count, the trend for oil fundamentals has been one of gradual, steady improvement.

Analysts at **Goldman Sachs** agree; Goldman analysts stated in a recent note that the fundamentals do not justify the recent 6% plunge in oil prices, and they forecast oil approaching $60 in the second half of 2017.

Why the recent sell-off is unwarranted

What caused the recent sell-off in oil prices? Many attribute the sell-off the EIA oil storage report that was released on Wednesday. The report showed that crude storage declined by around one million barrels (the market was expecting more), and gasoline inventories grew for the first time since February.

U.S. crude inventories recently hit a record high (they have fallen, however, for the past two weeks), which has discouraged many investors, but the broader trend is that total petroleum inventories both in the United States and globally have been in a steady, predictable decline. Total petroleum inventories include everything from crude to gasoline to distillates, and total U.S. stockpiles actually fell by 1.7 million barrels in the latest report.

In fact, last week was the first time that total stockpiles fell into a year-over-year deficit. This means that total stockpiles are less than they were during the same week last year, and it has been years since this happened. Overall U.S. inventories have actually been in a steady decline since July 2016 after building constantly since November 2013.

It is not just U.S. inventories that are declining — total OECD nation inventories, excluding the United States, have also been in a steady decline since July 2016. While the market seems to focus heavily on the U.S., 73% of the decline in OECD inventories comes from outside the U.S.

The reality is that while the market is focused on the short term, the long-term trend is positive. Currently, the IEA sees global market being roughly in balance (supply meeting demand) and falling into a deficit in the second half of the year.

Going forward, U.S. storage draws should continue, as refinery maintenance season in the United States is now coming to an end. This means refineries will be back online to purchase more crude.

Stocks to position yourself for the upside

It is a good idea to have a well-balanced oil portfolio including large senior producers, smaller produces, and undervalued names. **Cenovus Energy Inc.** (TSX:CVE)(NYSE:CVE) is one of those undervalued names. Cenovus recently announced it was buying oil sands assets from **Conoco Phillips** for $17 billion. The stock intensely sold off after investors became concerned over the massive hit to the balance sheet that Cenovus incurred to make the acquisition.

As a result, Cenovus shares are now trading close to where they were last February when oil was trading under US$30 per barrel. Cenovus's latest acquisition will flourish if oil prices improve, and investors can buy it now for cheap.

Canadian Natural Resources Limited (TSX:CNQ)(NYSE:CNQ) is a high-quality name that should be a key part of a balanced portfolio. Like Cenovus, Canadian Natural also made a recent acquisition, but this acquisition was praised by the market due to the massive discount Canadian Natural paid for the oil sands assets it purchased ($20 billion in assets for $12.7 billion), and the massive production growth and cash flow growth boost it will provide for the company over the next several years.

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