Did Crude Oil Prices Just Bottom for 2017?

Description

With regards to the recent plunge in oil prices potentially being the bottom for 2017, it could not be better stated than how Ed Morse, head of commodities research at **Citigroup**, put it in a recent interview: "The market really is fundamentally tightening up; it is never possible to call a bottom, but I suspect this is a great buying opportunity before a big jump in prices by the end of the year."

Morse has the right idea, and to understand why, it is important to understand why crude plunged nearly 6% in a single day (before rebounding) and what is going to happen in both the short and medium term.

It is important to note that while oil may have dropped nearly 7% in the past week alone, there was little, fundamentally (in terms of actual changes in the supply/demand/inventory outlook), that justified the sell-off and extreme pessimism. Just how pessimistic is the oil market? Many top-tier Canadian producers are currently trading at the same levels they were last year when oil was under US$30 per barrel.

The only real "fundamental" news from the oil market this week was an inventory report that was fairly neutral, and news that a Libyan oil field resumed production. The inventory report showed crude stockpiles in the U.S. fell by 930,000 barrels (smaller than the market expected, but this figure would have been under two million if it weren't for crude from the U.S. strategic petroleum reserve being released). It also showed that total petroleum product stocks in the U.S. fell year over year (a significant positive milestone).

There were also some concerns over demand from China, but oil demand is still expected to be impressive this year (1.6 million bpd, which is 60% higher than the 10-year average). None of this seems to justify the massive plunge in crude, and as analysts from **Goldman Sachs** recently stated, the move was due to technicals, not fundamentals.

In other words, crude plunged below its key 200-day moving average, as well as below a major price trend-line, and this resulted in many large hedge funds being forced to sell to adhere to their risk-management policy.

What does this mean going forward?

Investors would be wise not to let the recent price action trick them into thinking oil fundamentals going forward are horrible. As Ed Morse stated, the market is tightening and has been since July 2016, when U.S. total petroleum inventories and OECD global inventories started declining.

The market is currently waiting for U.S. crude inventories (which make up total U.S. petroleum inventories and are near all-time highs) to decline substantially before bidding up oil prices. U.S. crude inventories have now fallen several weeks in a row, and this is set to accelerate.

Typically, crude inventories rise at this time of year, and the fact they have been falling is bullish. In fact, looking at the 10-year median, crude oil stocks do not typically start to decline until the end of May, which coincides with the start of driving season.

This should lead to much larger draws in inventories, and a much more bullish outlook on oil prices (especially if OPEC agrees to extend their production-cut agreement, which is widely expected).

Over the longer term, should demand hold up, several years of major underinvestment due to the oil price crash should lead to supply issues and should support prices.

Baytex is one way to play the rebound

Baytex Energy Corp. (TSX:BTE)(NYSE:BTE) is extremely leveraged to oil prices, meaning should oil recover, it has significant room to outperform. It also means investors can take a much smaller position.

About half of Baytex's production is in the highly economic Eagle Ford play in the U.S., and Baytex is adding rigs in this area. The stock currently trades at a 25% discount to its peers, according to **Bank of Nova Scotia**, giving it plenty of upside potential in the event of an oil recovery.

CATEGORY

1. Energy Stocks
2. Investing

POST TAG

1. Editor's Choice

TICKERS GLOBAL

1. TSX:BTE (Baytex Energy Corp.)

PARTNER-FEEDS

1. Msn
2. Newscred

3. Yahoo CA

Category

1. Energy Stocks
2. Investing

Tags

1. Editor's Choice

Date
2025/07/19
Date Created
2017/05/09
Author
amancini