



Oil Stocks Remain a Risky Investment

Description

Despite the considerable optimism that surrounded OPEC's decision to extend its production caps until March 2018, the price of oil has failed to respond as expected. While industry insiders and many market pundits expected it to surge to as high as US\$60 per barrel by the end of 2017, crude has remained under US\$50 per barrel for the last three months. While higher than expected inventory draws have reignited hope of higher prices, they are unlikely to eventuate for some time. This makes it unlikely that there will be any meaningful recovery among oil stocks for the foreseeable future.

Now what?

Strong inventory draws, which saw U.S. oil stocks fall by over seven million barrels earlier this month, have failed to lift oil prices to any significant degree.

More surprisingly, data showing that the North American rig count had fallen by nine also failed to have any real positive effect.

That means markets are preoccupied by other issues — key being the growing oil output from OPEC member Libya. The war-torn African country's oil production reached just over a million barrels in July 2017, which is about 60% higher than where it was in January. That is expected to expand over coming months.

Along with Nigeria, which was exempt from the OPEC production caps, boosting output was responsible for OPEC oil production rising for the fourth consecutive month in July to a 2017 high.

Even more worrying is that OPEC members could break ranks, abandon the production agreement, and expand their oil output.

Impoverished Latin American nation Ecuador did just this in early July, stating that it won't meet its commitment to reduce production by 26,000 barrels daily and instead will work towards growing production. This can be attributed to the fiscal pressures being faced by the oil-rich Andean nation, where crude is responsible for generating over a third of all export earnings and two-fifths of government revenues.

While Ecuador's ability to grow production will have little impact on global supplies because it was only responsible for 56,000 barrels daily in July, it creates a worrying precedent about what could occur should a larger OPEC producer abandon the agreement.

Iran could very well be the next OPEC member to break ranks. Teheran has said that it intends to boost oil production to 4.7 million barrels daily by 2021 as a means of generating the much-needed revenue required to reinvigorate the nation's failing economy which was crushed by a decade of trade sanctions.

To do this, Iran, which was allowed to increase oil production to 3.8 million barrels under the OPEC agreement, will eventually have to ditch the agreement. Given the long-standing enmity between Teheran and Saudi Arabia, escalating regional tensions, and growing pressures to develop its oil resources, this is a very real risk.

So what?

The threat of non-compliance by OPEC members and the very real chance of the deal falling apart continue to weigh heavily on oil prices. That is before rising U.S. oil output, which is 6% higher than it was at the start of the year, and diminishing demand growth are considered.

A meaningful recovery in crude appears a long way off, and the reality is that many operators need crude to be at US\$55 per barrel or more to be profitable. That makes heavily indebted intermediate oil producers such as **Baytex Energy Corp.** ([TSX:BTE](#))(NYSE:BTE) and **Pengrowth Energy Corp.** (TSX:PGF)(NYSE:PGH) high-risk investments. It also means that there is little prospect of oil companies which entered the prolonged slump on a solid footing, such as **Crescent Point Energy Corp.** (TSX:CPG)(NYSE:CPG), ever returning to their halcyon days.

This indicates that there is very little upside available for investors, despite the considerable risks that are present, making now a hazardous time for investors to consider investing in oil stocks.

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