Commodities Investors: Avoid Canadian Oil Sands Stocks Until Transportation Issues Are Ironed Out

Description

The crazy disparity between the price that Western Canadian Select (WCS) crude is sold at compared to the price U.S. producers are able to achieve via fracking and "tight" oil production (WTI crude) has widened to epic proportions this week. On Tuesday, a barrel of WCS oil traded at $33.57, while WTI was trading at US$64.75.

That massive chasm, which has been created out of a lack of transportation capacity from the oil sands to U.S. refineries, appears to have been exacerbated in recent days after news that one of Canada's largest railroads, **Canadian Pacific Railway** (TSX:CP)(NYSE:CP), announced that it would not be a "stop gap" measure for the Canadian oil sands and was instead seeking long-term strategic partners that would sign on for much longer periods of time to provide stability to the company.

With CP having some of the best fundamentals of any railroad out there, perhaps this was a negotiating move. After all, forcing companies in the Canadian oil sands to sign on for rail capacity for longer than the three years that are expected for new pipeline capacity to come online is a prudent move. If companies agree to continue to ship via rail (a more expensive and dangerous method for the environment, surprisingly) for, say, 10 years, or however long a contract CP would need to continue shipping crude, this could be a huge win for both the oil sands in the near and medium term, as it resolves periodic transportation capacity issues, and CP, as it would provide the company with the contract length it needs to make this deal viable.

This rejection by CP is also indicative of the fact that CP appears to be very focused on delivering loads on time for its existing customers; it appears that adding on crude to its existing rail schedule may disrupt the flow of other goods by producers and sectors that have partnered with the railroad for decades, and the railroad may not have sufficient capacity to meet the needs of the oil sands at this time.

Bottom line

Whether Canadian oil sands companies agree to sign on for longer rail contracts or not, the future does not look bright for producers at current WCS prices. I would avoid the entire sector until some sort of semblance of a solution to this scenario is worked out and producers can once again receive a reasonable price for their heavy oil from U.S. refiners.

Stay Foolish, my friends.

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