Is the Oil Rally Really Over?

Description

The near meltdown of financial markets that recently occurred caused oil to plummet with West Texas Intermediate (WTI) and the international benchmark Brent both off by roughly 5% from their January 2018 highs. While the correction has rattled some investors, leading to claims that the oil rally is over, in the scheme of things, it is a minor blip. Not only do all the major stock indices appear to have found their footing, but there are a range of indicators that higher oil is here to stay.

It should serve as warning to investors that they shouldn't lose sight of either market fundamentals nor their investment goals. In the case of oil, there is every sign that over the long term it will recover, which will be a boon for beaten-down energy stocks.

Now what?

Surprisingly, the correction that cascaded across global financial markets occurred at a time when underlying economic fundamentals are strong. The International Monetary Fund, in its World Economic Update, lifted its global GDP growth forecast for 2018 and 2019 to 3.9%, which is 0.2% higher than its earlier predictions. Much of that increased growth is expected to come from emerging markets, notably China and India, with every sign that Beijing and Delhi remain focused on stimulating their respective economies by investing in much-needed infrastructure.

Meanwhile, a weaker U.S. dollar has been one of the key fundamentals supporting higher oil prices. Larger than expected crude inventory draws as well as higher-than-expected demand growth are also supporting firmer oil, and there is every sign that trend will continue. This is because the global economic upswing will drive higher energy consumption, because oil and natural gas combined meet over half of total global energy needs; any uptick in global growth will boost demand.

Underlying geopolitical factors also bode well for higher oil with a range of crises from the Middle East to Venezuela indicating that international oil supplies from OPEC and non-OPEC members could be easily disrupted once again. It has been speculated that those geopolitical risks could dislocate up to one million barrels daily off global supplies.

So what?

For these reasons there is every sign that oil's rally is far from over and that prices will inch higher over the course of 2018. Investment bank **Morgan Stanley** has predicted that Brent will stabilize at ~US$75 per barrel in third quarter of this year, while banking giant **JP Morgan** has predicted that the international benchmark will surge to US$78 per barrel.

At those levels, energy companies such as **Crescent Point Energy Corp.** (TSX:CPG)(NYSE:CPG) will return to profitability and be able to significantly boost investment in much-needed exploration and well development.

Despite sharply weaker prices as well as taking a knife to investment in exploration and development, Crescent Point's third-quarter 2017 production grew by an impressive 10% year over year, highlighting the quality of its oil acreage and ability to benefit from higher crude. That strong performance saw Crescent Point revise its 2017 guidance upwards by 1,000 barrels daily.

Meanwhile, 2018 oil production is projected to rise by 5% compared to 2017, and the additional cash flow that higher production as well as firmer oil prices will generate has allowed Crescent Point to boost its capital expenditure by 16% to $1.8 billion. This will fund the drilling of 630 net wells, which should lead to further production as well as reserves growth, giving Crescent Point's earnings, and ultimately its value, a boost.

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