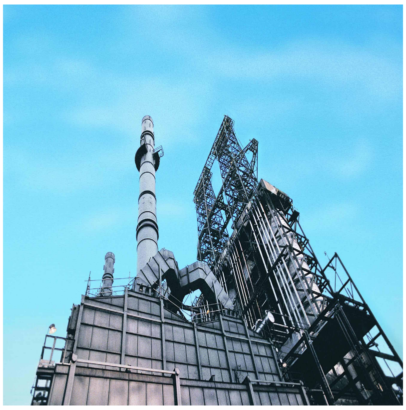

Oil at $150 Per Barrel: Conjecture or Reality?

Description

Well that was short-lived. Dropping to a low of almost $30 per barrel in January of 2016, the price of oil has rebounded. In the midst of the crash, experts were touting a prolonged period of low oil prices. How quickly times change. As of writing, oil is trading at almost 75$ per barrel, up 150% over 2016 lows.

The oil and gas sector is also seeing renewed investment. The TSX Energy Index has risen by approximately 25% over the past year, far outpacing the 8% return of the broader index. Are good times in the oil patch here to stay?

Analysts seem to think so. In case you haven’t heard, the most recent estimates have called for the price of oil to hit $150 per barrel! Yes, you read that correctly. This is more than a 100% increase over today’s price per barrel.

The scary part? It’s not that crazy of a thought.

Significant fluctuations

Although $150 per barrel seems absurd, we’ve been there before. In June 2008, the price of oil hit an all-time high of $161 per barrel. Then the financial crisis hit and ruined the party. Within a year, the price of oil lost 70% of its value and settled near $50.

Over the next two years, the price of oil climbed to a high of approximately $120 in March of 2011. Oil’s most recent crash came in June of 2014, and oil and gas companies have been enduring a bear market until this past year.

What does all this mean? Oil is a highly volatile commodity. Although it may seem like conjecture, $150 oil is not really that farfetched.

What leads to price increases?

The price of oil is mainly influenced by supply and demand. Oil’s most recent bear market was due to significant over supply. As the price of oil enjoyed a three-year bull run, the sector was flush with investment. Rigs hit record highs and the market entered a status of overcapacity.

To re-balance supply and demand, OPEC countries agreed to curb production. Combined with pipeline capacity issues in North America, the oil market is a more balanced position. Here is the problem: during the most recent three-year bear market, investments in the sector slowed to a crawl.

According to analysts at Sanford C. Bernstein & Co., the lack of capital expenditures has led to the lowest reinvestment ratio in a generation. The consequence? Oil reserves have been dropping. Since 2000, oil reserves at the oil majors have dropped by 30% on average.

The demand for oil is expected to rise through 2030, and if oil reserves are dropping, something has to give. This is the crux of the argument for oil to reach $150 per barrel.

Will it happen? I would not discount the possibility. The best investments in the sector are those that will not only benefit from a spike in oil prices, but that can sustain a prolonged bear market — companies like **Suncor Energy Inc.** (TSX:SU)(NYSE:SU) and **Imperial Oil Ltd.** (TSX:IMO)(NYSE:IMO). Over the past year, Suncor and Imperial Oil have rode the momentum with gains of 46% and 20%, respectively.

Over the past 10 years, the TSX Energy Index has lost almost 50% of its value after the price of oil dropped from its all-time high in 2008. What about Suncor and Imperial Oil? They held their own during times of instability. Suncor lost only 10% of its value, while Imperial Oil stemmed the losses at 14% — far better than the sector average.

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