What's the Outlook for Oil Stocks Going Into 2019?

Description

Oil stocks have given back some of their 2018 gains over the past month and investors are wondering if this is a good opportunity to add to their positions or take profits and head for the sidelines.

Let's take a look at the current situation to see if energy companies deserve to be on your buy list through the end of the year.

Global oil outlook

WTI oil prices are holding up well after a rally that took the commodity from US$50 per barrel a year ago to highs above US$74 in recent months. At the time of writing, oil is trading near US$70.

Intervention by OPEC and a handful of other producers to stabilize the market over the past year has proven to be successful, but geopolitical disputes and trade battles threaten to disrupt the situation in the coming months. Both demand and supply could be at risk.

A reduction in Iranian oil supply is expected due to the U.S. sanctions that are set to begin in November. This is worth watching, but the drop could be offset by increased production from other OPEC members and Russia.

However, Iran has mused it might block the Strait of Hormuz as new U.S. sanctions against the country start to bite. A significant part of the world's oil passes through this narrow stretch of water between Iran and Oman, so oil prices would spike if Iran were to follow through on its threats. In the event this occurs, it's possible the U.S. would intervene. A military conflict between the U.S. and Iran would probably send oil prices even higher, hitting levels that could put the global economy at risk.

Moderately higher prices are better for oil producers, but a sharp spike would likely trigger a broad pullback in the equity markets, and oil stocks would probably get caught in the sell-off.

What about demand?

The larger concern might lie on the demand side. Analysts are suggesting a full-blown trade battle between the United States and China could result in a steep drop in Chinese oil demand. This would have a negative impact on prices, and the downturn could be significant if OPEC members and other producers are unable to cut output quickly enough to stabilize prices.

The Iran sanctions and the possibility of a protracted Chinese trade war are both important aspects to consider as we head into 2019. At this point, it's anyone's guess how things will pan out, but volatility should be expected in the coming months.

Canadian challenges

In Canada, the recent decision by the Federal Court of Appeal to block the government's plan to build the Trans Mountain pipeline expansion means Canadian producers remain unsure if they will ever be able to get adequate access to international markets. For the moment, the situation doesn't look good and Western Canadian Select (WCS) continues to trade at a steep discount to WTI.

Are any Canadian oil stocks attractive?

The integrated companies carry less risk than the pure-play producers. As a result, stocks such as **Imperial Oil** (TSX:IMO)(NYSE:IMO) and **Suncor** (TSX:SU)(NYSE:SU) might be safer bets in the current environment. Both companies have assets all along the hydrocarbon value chain, including refineries and large networks of service stations, providing a hedge against the hit the production side takes when oil prices fall.

If WTI oil remains stable in the US$70-80 range, Imperial Oil and Suncor should see their share prices move back up to the 2018 highs. In the event the market tanks on falling demand, these stocks should hold up better than their peers, and you get paid decent dividends while you wait for a recovery.

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