Sorry Folks, I’m Still Not Bullish on Oil

Description

After waiting for years for a really piece of good news from the energy sector, oil bulls got their wish last weekend.

Key Saudi Arabian oil facilities were attacked on Saturday, resulting in about five million barrels of oil production per day being kept from markets. It was first reported that a series of drone attacks by Yemeni rebels were responsible for the attack, but the latest reports now speculate the attack was likely made by cruise missiles from Iran or Iraq.

Oil shot higher during Monday morning trading, with Brent crude originally increasing up 20% to US$72 per barrel before retreating after U.S. President Donald Trump tweeting that the U.S. would release some of its energy reserves as a result of the attack.

WTI, the benchmark price for oil in the United States, was approximately 10% higher in early trading on Monday, skyrocketing up to just over US$60 per barrel.

Energy bulls point to any major disruptions in supply as a major bull signal. After years of relative peace in the Middle East, oil’s so-called “political premium” has virtually gone away.

This attack and the aftermath of it could very well bring that premium back, resulting in permanent 10-20% increase in the price of crude oil.

These folks will all tell you the same thing — most oil companies really only need US$60 to US$70 oil to be consistently profitable. So if the new price of oil settles into that range, it could be a very big deal.

Unfortunately, I disagree completely. Here’s why I’d take this opportunity to *sell* most oil stocks, not buy more.

The nature of oil

If oil does maintain Monday’s gains, here’s how I see it playing out.

A higher price will, naturally enough, encourage greater investment by domestic oil producers. After all, five million barrels per day are missing from the market, a significant amount.

Many North American oil producers already have aggressive expansion plans in place, meaning they can start producing relatively quickly. Curtailment plans, like the one currently implemented by Alberta that has limited production in the province, will be lifted.

In short, I believe that North American oil producers can fill the gap vacated by Saudi Arabia fairly quickly, never mind production in places like Iran, Iraq, or Russia, themselves major producers.

At the end of the day, oil is a commodity. Nobody cares where the oil that gets turned into gasoline comes from. All they care about is getting from point A to point B.

The case for high-quality oil

Despite being pretty bearish on oil in general, I still have one energy company in my portfolio — **Suncor Energy Inc.** (TSX:SU)(NYSE:SU).

I like Suncor because of its focus on the oil sands, its shareholder-friendly management team, the company’s steadily growing dividend (virtually no other oil companies can offer that), and its downstream operations, which I view as the best in the business.

There is no doubt that Suncor offers less upside than an intermediate oil producer who needs sustained US$60 per barrel crude to survive. But Suncor is also a much safer play, which protects invested capital.

Suncor earns enough from its downstream operations to pay for the dividend and much of its generous share buybacks, which have been aggressive lately because the stock is still so cheap.

The company is also poised to deliver plenty of cash flow from its oil sands operations too, even if crude remains weak. It has accomplished this by relentlessly cutting costs, driving production costs to under US$20 per barrel.

The bottom line

If I owned many oil stocks in my portfolio, I would take the opportunity to sell them, especially considering the big run-up the whole sector has had over the last month. I would keep high-quality names like Suncor and punt the rest. Perhaps you should too.

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Author
nelsonpsmith