3 Energy Stocks to Avoid at All Costs in 2020

Description

Energy stocks are classic boom-or-bust securities. For decades, the energy sector has minted millionaires and destroyed fortunes. If you want to make big money, pay attention to this segment of the market. Just tread carefully, as several factors are radically changing how the industry operates.

While there's still plenty of opportunity left, there's a growing consensus that stocks like **Imperial Oil Ltd**. (TSX:IMO)(NYSEMKT:IMO), **Canadian Natural Resources Ltd.** (TSX:CNQ)(NYSE:CNQ), and **Suncor Energy Inc** (TSX:SU)(NYSE:SU) are losing bets over the next decade or more. If you own *any* energy-related stocks, you need to understand what's going on.

Renewables rising

The most obvious concern is that the three stocks above produce fossil fuels. If you think it's too early to talk about the rise of renewables, think again.

Sure, it will take decades for renewables to take a leading market position, but they're well on their way. Renewables already serve more than 10% of global energy production. According to the International Energy Agency, renewables should lead the way for decades to come.

"Renewables are forecast to meet more than 70% of global electricity generation growth, led by solar PV and followed by wind, hydropower, and bioenergy," the IEA wrote in its latest market analysis and forecast report. "Hydropower remains the largest renewable source, meeting 16% of global electricity demand by 2023, followed by wind (6%), solar PV (4%), and bioenergy (3%)."

While it's not just renewables (we'll get to an even bigger problem below), the shifting energy landscape has proven difficult for even the best capital allocators.

Take a look at **Exxon Mobil Corporation**. Exxon is lauded for its ability to think decades ahead and optimize for shareholder returns. Yet over the past 12 years, the company's stock has generated *negative* returns. If Exxon can't figure out how to produce positive long-term results, it's not looking promising for the rest of the industry.

Race to the bottom

While renewables will continue to eat into the traditional energy sector, the race to the bottom is the true concern. Imperial Oil, Suncor Energy, and Canadian Natural all have sizable exposure to Canadian oil sands.

Amid a falling cost environment, this is a terrible place to be. Oil sands typically have breakeven levels between US$40 and US$50 per barrel, pushing them into loss-making territory several times in recent years. Looking ahead, conditions are about to worsen.

Take a look at any oil producer and you'll see rapidly falling costs over the last five years. Companies like **Chevron Corporation** and **Royal Dutch Shell** are targeting new shale projects in North America that could break even as low as US$15 per barrel.

Oil sands companies, meanwhile, remain at the top of the industry cost curve. The reason is simple: oil sands have a permanent cost disadvantage.

Oil sands output is typically lower quality versus the rest of North America, and thus requires additional refining. For example, *Oil Sands Magazine* notes that "bitumen produced from the oil sands requires an intermediate upgrading step for partial removal of the heavy hydrocarbon fractions and conversion into light synthetic crude oil." Complex refining results in structurally higher costs.

While the rest of the oil industry is dramatically cutting costs to historic levels, oil sands operators such as Imperial Oil, Suncor Energy, and Canadian Natural remain dangerously close to breakeven.

While costs continue to improve, they're still nowhere close to U.S. shale plays. Long term, these oil sands stocks are in trouble.

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2. NYSE:SU (Suncor Energy Inc.)
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