Oil: Where to From Here?

Description

Crude has firmed significantly since the end of 2019 when OPEC and Russia announced they would curb their collective production by a further 500,000 barrels daily commencing in 2020. Now, sharply rising tensions in the Middle East, notably between Iran and the U.S., have boosted prices even higher. After Iran retaliated with missile strikes against U.S. targets in Iraq, Brent rallied to over US$71 per barrel, but it has since pulled back to around US$68 per barrel after Tehran stated that it is not seeking war.

Higher crude and the increased optimism surrounding its outlook has been a boon for energy stocks with many soaring higher over the last month. A major beneficiary has been Canada's oil sands, with integrated energy company **Suncor** (TSX:SU)(NYSE:SU) soaring by almost 12% over the last year after spiking significantly since the start of 2020.

Higher geopolitical risk

The combination of higher Middle East tensions, OPEC's decision to increase production cuts, and flat U.S. oil production growth will buoy oil prices for the short term, but there are signs that the long-term outlook is not as positive. The direction that crude will take hinges on how the Trump administration reacts to Iran's missile strikes, and there is considerable uncertainty surrounding what path the president will take.

It's even more so when it is considered that much of the current conflict and tensions in the Middle East can be attributed to the fallout from the U.S. invasion of Iraq and overthrow of Saddam Hussein. The ongoing proxy conflict between Shiite Iran and Sunni Saudi Arabia is also weighing heavily on the region, as the two nations battle to become the dominant power in the Middle East. While those factors are all creating considerable uncertainty, which is bolstering the price of crude, there are signs that oil will eventually fall once tensions ease.

A significant risk premium has already been priced in by energy markets, because it is anticipated that the latest conflict could trigger a massive supply disruption, which will only occur if a general war breaks out. The likelihood of war appears less and less likely, especially after Teheran's muted response to U.S airstrikes that led to the death of leading figure in the regime. That means as tensions come off the boil, oil will fall.

Improved outlook for the energy patch

The long-term outlook for the oil sands has improved appreciably over the last year. Greater uncertainty in the Middle East, underpinned the deterioration of the relationship between the U.S. and Iran, along with falling heavy oil production in Latin America and Alberta's mandatory production cuts, have bolstered the price of Western Canadian Select (WCS). This will give Suncor a solid boost, as it expands production and improves the profitability of its operations, leading to higher earnings.

The oil sands giant recently released its 2020 guidance where it forecast that oil production would grow by up to 6% year over to as high as an average of 840,000 barrels daily. Suncor also expects refinery throughput to climb by up to 2% to 460,000 barrels daily, which will further boost earnings. What makes Suncor a particularly appealing investment is that, unlike many of its peers, it can refine a large proportion of the bitumen it produces, therefore removing the risk posed by WCS trading at a discount to West Texas Intermediate (WTI).

The planned expansion in oil production and the volume of crude to be refined combined with Suncor's low cash costs will give its earnings a solid lift, particularly if oil remains firm.

Foolish takeaway

The outlook for crude remains highly uncertain, and there are signs that after Iran's limited relation that a general war has been averted, and the significant risk premium priced into crude over the last week will deflate. That means oil prices will eventually weaken, making it imperative for energy investors to select oil stocks like Suncor that have quality long-life assets with low operating costs and growing production. Suncor's appeal is further enhanced by its sustainable dividend, which is yielding a juicy 3.8%.

CATEGORY

1. Energy Stocks
2. Investing

TICKERS GLOBAL

1. NYSE:SU (Suncor Energy Inc.)
2. TSX:SU (Suncor Energy Inc.)

PARTNER-FEEDS

1. Business Insider
2. Msn
3. Newscred
4. Sharewise
5. Yahoo CA

Category

1. Energy Stocks
2. Investing

Date
2025/08/16
Date Created
2020/01/08
Author
mattdsmith