A New Oil War Begins: Oil Prices Plummet by 86% Since the Start of 2020

Description

The collapse of the OPEC production deal last week has triggered a new oil price war. It was sparked by Russia's unwillingness to agree to further cuts. In response, Saudi Arabia decided to significantly boost oil production and flood global energy markets with crude.

This has had a devastating impact on energy prices. The international Brent benchmark price has plunged sharply over recent days and is down by 86% since the start of 2020.

Brent is now trading at under US$40 per barrel for the first time since early 2016. This has sparked a bloodbath among energy stocks with the largest sector ETF, the **Energy Select Sector SPDR Fund**, losing a whopping 43% since the start of 2020. There are signs of worse to come for energy stocks over the short term.

Gloomy outlook

It is believed that Saudi Arabia can boost its oil production by around 30% or 2.5 million barrels daily, which will create a deluge of excess petroleum in the global energy market, which is already battling a long-term supply glut. Riyadh has also discounted the price at which it sells crude, applying further pressure to oil prices.

Oil demand growth is also expected to slow sharply because of the impact of the coronavirus pandemic on China's economy. The country is the world's second-largest economy and consumer of crude and is responsible for over half of anticipated demand growth for oil.

The coronavirus outbreak may cause China's annual GDP growth to fall below 5% for the first time in two decades. This would have a substantial impact on the global economy and spark considerable fallout for many nations, especially those that are dependent on the extraction of natural resources to drive economic growth, including Canada.

Possible outcome

Riyadh's hope is that it can regain control of oil prices by flooding global energy markets. It will do this by significantly boosting energy exports, pushing U.S. shale drillers into bankruptcy through sharply weaker oil prices, and applying economic pressure to get Russia back to the negotiating table.

Whether the strategy will work is difficult to predict – it has already failed once before. It will certainly spur a prolonged sell-off for energy stocks.

Nonetheless, if Saudi Arabia is successful, there will eventually be a recovery in oil because of diminished U.S. production and Russian cooperation in reinstating production cuts.

Top oil stock to buy

While the short-term outlook for crude and energy stocks is poor, you shouldn't be deterred from investing in the energy patch. There is a range of high-quality oil stocks now trading at very attractive valuations. One, in which Warren Buffett has made a significant investment, is **Suncor** (TSX:SU)(NYSE:SU). The integrated energy giant has lost 33% since the start of 2020, leaving it attractively valued.

Suncor's integrated upstream and downstream operations, including oil production and refining, makes it relatively immune to an oil price collapse. It benefits from being able to refine over half of its oil production, which allows it to profit from cheaper feedstock for its refineries. It also owns a range of low-cost, long-life oil sands assets.

A combination of low decline rates and a long production life means that these assets require minimal capital investment to sustain production. In contrast, shale oil can be a very capital-intensive form of oil extraction. Coupled with Suncor's focus on generating efficiencies and boosting the return from capital employed, these assets have allowed it to remain profitable despite oil's prolonged slump.

If you buy Suncor today you can lock in a very tasty 5.5% dividend yield. While many upstream oil producers like **Vermilion** are slashing their dividends in response to the latest oil price collapse, Suncor's appears sustainable with a 90% payout ratio.

Suncor also has a solid balance sheet. This gives it with considerable financial flexibility, further enhancing the sustainability of the dividend.

Foolish takeaway

Suncor is an attractively valued top stock for contrarian investors. It allows them to acquire a quality energy company and profit from the long-term rebound in oil. While they wait for that to occur, they will be rewarded by Suncor's juicy 5.5% dividend yield.

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