Market Rally Alert: Time to Buy Oil Stocks?

Description

The market rally has brought renewed confidence to investors. Many stocks that were hit hard during the downturn are now surging higher. Better yet, there's still time to capitalize on some incredible deals.

Value investors have been specifically curious about oil stocks. At the start of 2020, oil was priced at US$60 per barrel. Prices are now under US$20 per barrel. There's been a lot of pain, but investors are now betting that there's a lot of opportunity.

Should you be buying oil stocks amid the market rally?

The pain is real

To understand if oil stocks are a bargain, we must first look at why the downturn started in the first place.

The most obvious factor has been a dramatic, nearly unprecedented decline in demand. Due to the coronavirus pandemic, billions of people are limiting their social activities. Vehicle traffic has fallen off a cliff. Air traffic has fallen even more. Business activity has also stalled, further reducing demand for fossil fuels.

The market rally has pushed up stock prices, but it hasn't done much to increase oil demand.

How quickly could demand resurface? A reprieve will be felt when economies start to reopen, but it's unlikely that demand will retest former levels, at least for the rest of 2020. Contagion fears will reduce air traffic, while unemployment and reduced travel will hit automobile traffic. Meanwhile, the ongoing rise of renewable energy and electric vehicles continues to add another long-term demand headwind.

But demand concerns aren't the only problem. Oil prices remain under US$20 per barrel due to an aggressive pricing war from Saudi Arabia. The country has been increasing production significantly, flooding global markets. At first, analysts believed the moves were in retaliation to OPEC dissent. Today, it's becoming clear that Saudi Arabia aims to permanently shutter its foreign competition.

Buy the market rally?

Let's say that a market rally really does prop up global economies, and that oil demand miraculously recovers. Even under these optimistic assumptions, oil prices may still not recover significantly. That's because Saudi Arabia will still be intent on pushing out higher-cost competition.

Take **Suncor Energy** and **Imperial Oil**, for example. These companies rely heavily on oil sands production. Unfortunately, these are some of the highest-cost projects in the world. Many don't break even, unless prices remain above US$40 per barrel. That would require a 100% increase from today's levels.

It's likely that Saudi Arabia's strategy is specifically tailored towards shuttering the likes of Imperial and Suncor. A brief market rally will do nothing to change that dynamic.

Pipelines stocks, often a safe port during the storm, are also at risk. **Inter Pipeline**, for example, derives more than half of its revenue from oil sands producers. If these customers are forced out of business, the decrease in production volumes will directly hit Inter Pipeline's bottom line.

Even high-quality pipeline stocks like **Enbridge** will get hit. That's a big reason why oil stocks in general haven't benefited much from the market rally.

Enbridge is significantly more diversified than Inter Pipeline but still operates a high fixed-cost business. Even a slight decrease in volumes will disproportionately impact profits. That's likely what Saudi Arabia is hoping for.

Should you buy oil stocks? Not a chance. There are dozens of low-priced stocks worth snapping up, but stay far away from these money losers.

CATEGORY

1. Coronavirus
2. Energy Stocks
3. Investing

POST TAG

1. Editor's Choice

PARTNER-FEEDS

1. Business Insider
2. Msn
3. Newscred

4. Sharewise
5. Yahoo CA

Category

1. Coronavirus
2. Energy Stocks
3. Investing

Tags

1. Editor's Choice

Date
2025/08/27
Date Created
2020/05/01
Author
rvanzo