Oil Stocks: Canadian Markets Could Go Into Free-fall

Description

Canada heavily depends on the oil industry. Energy is responsible for roughly 10% of GDP, not to mention tens of thousands of jobs. Unfortunately, there's reason to worry.

Already this year, stocks like **Suncor** (TSX:SU)(NYSE:SU) and **Imperial Oil** (TSX:IMO)(NYSEMKT:IMO) are down more than 50%. Layoffs are happening *en masse.*

The pain may have only just begun.

Here's what is happening

The energy market has a disproportionate effect on Canada's economic future. It's not only jobs and GDP. When oil prices fall, even the loonie moves lower, weakening your buying power.

The prognosis doesn't look good.

"Canada's largest oil companies continue to post quarterly losses this year as low crude oil prices and low refining margins hit earnings," reports *Oil Price*.

Those expecting a rebound this year should think again.

"Oil market participants are concerned that the return of lockdowns in Europe will significantly weigh on economic recovery and fuel demand," *Oil Price* continues. "Two of the largest economies in Europe, Germany, and France, announced lockdowns, which the market was not expecting two or three weeks ago."

The problem is simple: supply and demand are out of whack, and it's not even close.

Demand is sharply lower, with no signs of a near-term recovery. Just look at airplane traffic, which is still 95% lower than 2019 levels. Meanwhile, industry supply continues to *rise* as producers scramble to generate sales in low-cost regions.

Time to ditch oil stocks?

None of this looks good.

If you only produce oil, the clock is ticking. Your profits are a direct function of commodity prices, and there's no sign of recovery there, perhaps for another year or longer.

If you're an integrated oil company like Suncor or Imperial, your fate is a little better. These businesses also own support infrastructure like refineries and pipelines, which can generate profits even with low pricing.

That'll allow them to survive for longer, but there's no denying that both Suncor and Imperial still need higher pricing to survive long term. At current levels, they're scraping by at best. Fossil fuels are a commodity business, and nothing can save the industry except a tightening of supply or a resurgence in demand.

The fallout has already begun. Just take a look south of the border.

"Thirty-six producers with $51 billion in debt filed for bankruptcy protection in the first eight months of the year," *Reuters* reports. "The coronavirus pandemic crushed fuel demand and left debt-laden producers without access to credit."

There's a chance that we're already witnessing a zombie industry. Cash costs allow the industry to keep pumping, but markets are starting to take a step back from capital funding. That could slowly raise the cost of capital, forcing more and more incumbents from the market.

"Over time, companies and countries that do not respond to stakeholders and address sustainability risks will encounter growing skepticism from the markets, and in turn, a higher cost of capital," writes Larry Fink, in direct reference to fossil fuel producers. His opinion matters considering he's the CEO of $7 trillion asset manager **BlackRock**.

This isn't a place you want to trust your money. The long-term challenges are too great.

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