Will Energy Markets Really Recover in 2021?

Description

Investors breathed a sigh of relief when crude oil breached a $50/barrel level early this year. Oil has rallied more than 55% in the last three months since the vaccine launch. But can it really keep up the momentum? Can the energy sector, which has dug a deep hole in investors' pockets in the last few years, finally become a great investment avenue?

Energy markets in 2021

That's a million-dollar question with no simple answer. With the underlying uncertainties, it seems certain that the year 2021 will see a paradigm shift in the energy sector.

Even if the short term looks gloomy, driven by the new coronavirus variants, we will likely see the pandemic's end in the second half of 2021. The mobility restrictions could significantly wane by then, and energy demand should reach respectable levels.

Apart from the bullish case on the demand side, the supply side also looks promising. Saudi Arabia's surprise production cuts and lower investments from the oil majors for 2021 indicate that there won't be a sharp rise in the crude oil supply.

Can we see peak oil demand again?

The pandemic dented global oil demand by almost one-third early last year. By the end of 2020, the demand significantly recovered and was 8% lower against 2019. That's why we saw crude oil prices rising sharply in the latter half of 2020.

However, a slower-than-expected vaccination rollout could pose a severe threat to the recent crude oil price rally. Although oil demand is expected to rise this year, it will probably be lower than pre-pandemic levels.

The U.S. Energy Information Administration has recently increased its estimate of Brent oil to $49 a barrel for the current year from $43 per barrel earlier. Crude oil seems to have soared to high too soon. With vaccinations in the early stage and fresh movement restrictions, oil could have limited upside for the next few months from the current levels.

What should energy investors do in such uncertainties?

Valuation should play a vital role. Overvalued energy stocks that went too high following the exuberance of oil should see some pullback in the short to medium term. Canadian investors have a fairly valued option to bet on the recovering energy markets, and that is **Suncor Energy** (TSX:SU)(NYSE:SU).

While U.S. shale plays have a much higher breakeven point, Suncor Energy's breakeven point is close to $35 a barrel, much lower than the current WTI crude oil price. It also has one of the best balance sheets among its peers.

It gave up on growth projects last year and trimmed capital spending by 30%. To maintain the balance sheet strength, Suncor also cut its dividends by 55% in Q2 2020.

Warren Buffett backed-Suncor Energy has an all-round presence on the energy supply chain. It produces oil from oil sand assets, has large refining operations, and markets the final product through its retail outlets. Thus, Suncor Energy's downstream operations should compensate for the upstream segment's underperformance in case of lower oil prices.

It offers a stable dividend yield of 3.6% at the moment. With a discounted stock valuation and a decent dividend yield, Suncor Energy seems a relatively safe bet to play the energy market recovery.

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