What's Next for Crude Oil After Breaching Crucial $100/Barrel Levels?

Description

The Russia-Ukraine conflict escalated quickly, and energy commodities zoomed to record levels. Brent crude oil breached US$100-a-barrel level on Thursday — its highest level since 2014.

The increased uncertainties, especially when supplies are tight, make things more challenging in the oil market. Crude oil has soared 25% this year and will likely keep trading at elevated levels.

Crude oil prices at US$103 per barrel

Following the Russian invasion, the U.S. announced its first set of sanctions on two big Russian banks. Though oil remains at the centre stage of these geopolitical developments, the energy sector may never see such sanctions. That's because an already constrained crude oil supply will magnify the imbalance, ultimately pushing prices higher.

With approximately 18 million barrels a day, the U.S. is the second-biggest crude oil consumer globally. So, higher oil prices could send the elevated inflation to even higher levels.

Even before the Russia-Ukraine crisis, crude oil was on the rise due to higher demand increases but slower supply increases. Some of the smaller members of the oil cartel OPEC, like Nigeria and Libya, have been falling far lower to fulfill their production quotas.

At the same time, energy production companies are reporting record profits with little or without hiking their production, thanks to higher oil prices. So, there is, in fact, little incentive for them to raise production and reorder the demand-supply imbalance.

Interestingly, shares of oil production companies are trading at the highest levels in years. Apart from the steep financial growth, they are aggressively repaying debts and improving their balance sheet health.

According to **JP Morgan**, crude oil prices could hit US$125 levels in the second quarter of 2022. That means enormous profits for energy producers and increased inflationary pressures in countries like

U.S. and India.

Energy TSX stocks on the rise

Suncor Energy (TSX:SU)(NYSE:SU), Canada's biggest oil sands producer and integrated energy company, is an apt case. It doubled the shareholder dividend last year after its free cash flows exceeded expectations. As a result, its net debt-to-EBITDA ratio declined from 10 in December 2020 to 1.4 in December 2021.

Energy stocks have created massive wealth for investors since mid-2020. And, importantly, there still seems to be significant steam left underlined by their valuations and earnings-growth prospects.

If Russia-Ukraine tensions ease soon, crude oil might see an interim pullback. However, oil will likely keep going up mainly due to supply concerns.

Oil production from the U.S. is expected to increase substantially to 12 million barrels per day later in 2022. Nonetheless, apart from the U.S., higher output from Iran could also stabilize supply to some extent.

How the nuclear negotiations between Iran and U.S. go remains to be seen. Also, how fast the Middle East oil giant ramps up its production, if talks succeed, will also be interesting to see.

What's next for energy investors?

Despite the uncertainties, the energy sector looks attractive from an investment perspective. Even if oil prices fall, it will not substantially dent energy companies' prospects.

Because many have issued encouraging guidance given crude averaging around US$75 a barrel in 2022. So, the current gains will likely produce considerable windfall gains for them and investors for the next few quarters.

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