Oil Stocks: Next Leg Up in October?

Description

Recent political developments have given oil traders reason to think that crude oil prices might rise in October. This year, the supply of oil is being held back by the conflict in Ukraine and OPEC (a major oil cartel) consistently missing its production targets. So far, the rise in prices has been held back by countries releasing oil from their strategic petroleum reserves (SPRs). SPRs are stockpiles of oil that countries keep around for emergencies; the U.S. has been draining its SPR at a rate of one million barrels per day. If it keeps going at this rate, then the SPR has about one year and three months' worth of oil left.

The U.S. SPR release is scheduled to end in October. When it does, oil will trade based on market factors, which include short supply and high demand. It looks like oil could take another leg up in October. The question is whether this will actually happen or whether other factors could emerge that prevent it from happening.

Why October could be big for oil stocks

If oil takes another leg up in October, that would be good news for oil stocks like **Suncor Energy** (TSX:SU)(NYSE:SU). Suncor Energy makes money by extracting and selling crude oil. It also operates gas stations, which benefit from higher oil prices as they are associated with higher gasoline prices.

In its most recent quarter, Suncor grew its sales by 75% and its profit by 360%. That was largely due to the high oil prices observed in the second quarter. If oil prices take another leg up and rise in the fourth quarter, then similar growth could be observed in the winter. In fact, the growth in the fourth quarter could be even higher than in the second, as Suncor is retiring its debt and lowering its interest expenses.

One risk to keep in mind

As I showed above, oil stocks will likely deliver strong results if oil prices rise in the winter. If we simply assume that oil prices will rise, then high oil company profits logically follow from the assumption.

However, we can’t just assume that oil prices will, in fact, rise. There are a number of factors that could cause them to fall:

- The U.S. and other countries extending their SPR releases
- The conflict in Ukraine ending
- Russia and the European Union working out a deal on sanctions
- China entering another prolonged lockdown (this would reduce demand for oil, as it would cause Chinese citizens to drive and fly less)

Any of the factors above could cause oil prices to behave differently than most people currently predict they will behave. For this reason, it’s wise to diversify your portfolio. Certainly, the gains in oil stocks this year have been impressive to witness, but the last thing you want to do is chase a group of rising stocks just because they’re rising. In many cases, upward price momentum suggests a bubble that’s on the verge of bursting. Nobody knows what the future holds, so stay safe.

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