



OIL

With oil and gas on the rise, is it time to buy Oil and or Oil Stocks?

Crude oil prices came under pressure on Monday, from expectations of higher supplies and weakening demand. Both Brent and WTI markets have dropped for the last three weeks, both negatively affected by a strengthening dollar, and the very real possibility that the Biden administration could move forward and release oil from the US Strategic Petroleum Reserve to cool prices.

I also note that OPEC have lowered their forecast for oil demand growth this year by 160K bbl/day. This due to the significant increase in fuel costs combined with the effects of a global energy crunch, which is reducing demand. Add to that the fact that we will also likely see reduced demand for oil from China and India, and its unlikely to see significant upside short term.

Given we are entering winter it is this which will either make or break this market

Noting that there has been recent data which suggests that the acute shortage in crude oil and other fossil fuels caused by COVID and COVID-related policies is ending. The past few weeks have seen crude oil inventory build and natural gas underground storage levels return to near normal seasonal levels. The storage of some other related commodities, such as propane, is still significantly below normal season levels; it looks like winter shortages in propane are a given.

While total crude oil production has risen from last year's lows, today's production levels are still well-below pre-COVID levels. There has been a minimal increase in total US crude oil storage levels in recent weeks, which has caused crude oil to decline slightly.

Some reports point to the fact US crude stocks are near 2014 (pre-glut era) levels, crude oil production is still below pre-COVID levels. This is added to by recent OPEC moves which have continued to restrict production which remain low despite the Biden administrations push to increase. The Energy Information Administration is forecasting that production will normalize in 2022 but will it?

Some reports highlight that US refinery capacity utilization is currently at 86%; down from over 90% during the summer. At the same time, total gasoline storage levels have declined to the lowest level since 2014.

Our analysts point out that it's normal to see US refinery capacity utilization decline in the winter and rise in the summer.

The EIA are forecasting a decline in crude oil's value in 2022. Their reasoning assumes an impending US and OPEC+ production hike. However, an in-depth analysis of oil & gas productivity and rig utilization shows that the recent increase in oil and natural gas productivity is due to the immense depletion of drilled but uncompleted-well inventories.

However, the EIA may not account for the fact that most oil and gas companies have kept capital expenditures well below pre-COVID levels as Reuters reported recently. After years of negative cash-flows, all of the five largest oil companies have quick ratios below 1.

In conclusion I would point out that there is also increased risk from recent legislation which may stop banks lending, reducing the ability to invest in the oil industry, due to the hard push on decarbonization. Looking forward we could see this regulatory action have a negative impact on oil stocks values.

That said, I don't see the regulation gaining steam in the short term as further oil & gas production cuts would almost certainly exacerbate the inflation issue. On that note, a quick thank you to all members who had commented that RIO's forecasts on inflation were accurate.

Over the coming months, I expect oil and gas prices to remain constant, and potentially rise higher if analysts expect production to fall (due to depletion and a lack of drilling activity). To respond to Paul T's , David M's and Jochen O's question; yes it is feasible for oil to surpass \$100 if oil inventory continues to trend lower. We could also see oil move back into the \$65-\$80 range which it had held for years before the COVID crash.

As for oil stocks, I would wait in anticipation of being able to buy into any correction in oil. The fall in the commodity will almost certainly drive down related stocks. Today, most valuations are historically close to the average for energy companies. I would suggest caution as oil stocks are only undervalued should your personal core belief be that oil and gas will continue to rise in value, but will it, given the above?

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