Oil Trends Flat Despite Big Numbers

Oil is trading at five-week lows in early May, as experts say 'get used to it.'

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Where do oil prices go from here? (GETTY IMAGES)

When oil prices fell below the benchmark $50 level in late April, due primarily to climbing U.S. oil production and stronger overseas exports, (especially in Libya), energy investors are left to ponder a single, yet critical question.

Where do oil prices go from here?

Performance-wise, major oil producers like BP (ticker: BP), Chevron Corp. (CVX) and Exxon Mobil Corp. (XOM) had a banner first quarter of 2017, causing some investors to lean toward a bullish sentiment on oil stocks and funds, even with recent price declines.

"[First-quarter] earnings were strong for the majors and crude oil inventory continues to decrease, although this is partially due to seasonality effects," says Paul Jansen, managing director at Conway MacKenzie in Houston.

That said, the macro-economic environment remains challenging and Saudi Aramco's planned IPO might put pressure on its production, thereby potentially increasing crude oil supply from OPEC and non-OPEC countries, Jansen says. "There is a number of production reducing initiatives and commitments that have created a delicate balance supporting the current $50 crude oil price levels. It might not take much to disrupt this balance and undo those production cuts."

Other industry experts say that the robust first-quarter earnings are in large part due to strategic moves oil companies are making to adjust to the "new normal" of lower oil prices.

"The numbers suggest the majors are making progress in driving efficiencies in their business to increase margins and drive productivity in the world of foreseeable, and perhaps, longer term $45 to $60-per-barrel prices," says Peter Bryant, managing partner at Clareo, a business consultancy based in Chicago that works with energy companies.

This scenario increases returns, Bryant says. "But more importantly, it frees cash flow to pay dividends and reduces borrowings and asset sales to fund those dividends."

Nick Poradek, director of Houston-based ST9 Gas + Oil, says that focusing on short-term oil prices is misguided – and that there are better places to look in picking oil-related portfolio picks over the long haul.

"Oil is likely to remain stuck in a trading range between $41 to $68 for the next few years, assuming there are no major geopolitical events," Poradek says. "As such, many oil stocks will remain heavily correlated to the price of oil. The stocks that decouple from the price of oil will be those companies that have managed to generate exceptional cash flow or are on the verge of default."

He likes undervalued energy companies, regularly looking for companies that are fundamentally strong but have dipped down due to a missed quarter, poor news coverage or are simply in a cyclical downturn. "Two companies that I like are ConocoPhillips (COP) and Centennial Resource Development (CDEV)," he says. "To my line of thinking, COP has an upside of 19 to 24 percent over the next year as they continue to decrease their operating costs and refocus their operations away from capital intensive projects. CDEV operates in arguably one of the best basins in the United States and is led by an incredible management team."

Jansen, who likes stocks in mature low-cost basins such as the Permian for oil and Marcellus for gas, believes an industry downturn or rebound that is heavily impacted by commodity prices doesn't mean a company is either good or bad. "Rather, you should take a closer look at the business and balance sheet as a whole," he says. "Strong companies can exist in depressed pricing conditions and thrive once prices rebound. I would focus on exploration and production companies with access to development capital who capitalized on the depressed commodity price environment."

Industry-wide trends are also in play, and investors need to track three of them right now – high storage levels, OPEC/non-OPEC voluntary production cuts and growth in U.S. production, says Adrian Garcia, managing director at Venture Investment Associates, in Houston.

"Furthering the challenges is the simple fact that U.S. production and storage levels are reported on a more frequent and more accurate level than storage and production in all other parts of the world," Garcia says. "That leads to markets vacillating and effectively day trading against changes in U.S. production and storage levels by extrapolating these data as leading indicators of what is going on with respect to global inventories and production levels."

At the moment, the stock market is particularly focused on whether the production cuts will continue, and the market currently mostly believes they will be continued for another six months, Garcia says. "If they are not continued, or there is significant OPEC in-fighting on sticking with the cuts or large non-OPEC producers elect not to stay the course on cuts, then prices are likely to fall from current levels," he says.

Going forward, the single most important driver of oil prices in May will be the OPEC meeting on May 25, other experts say.

"On the bullish side, there have been increasing expectations that OPEC will extend production cuts when the group meets in a few weeks," says Tamar Essner, director of energy and utilities at Nasdaq Advisory Services. "Rhetoric from all OPEC members, as well as Russia, regarding their commitment to extend production cuts will be market movers over the coming weeks."

Essner says there is skepticism that extension of the cuts at current levels would be enough to move global inventories to more normalized levels, but the bar for increasing the level of cuts would be more difficult. "Investors will also look to comments from [exploration and production companies] in the U.S., who will report earnings throughout the month, with investors looking for any additional updates on production guidance for read through on the levels of U.S. shale growth," he says.

Money managers tuned into the energy markets advise investors not to be fooled by strong quarterly performance by a handful of major oil producers.

"Corporate profits and oil prices are not moving hand in hand," says Michael E. Chadwick, a financial planner based in Torrington, Connecticut.

Chadwick, who says he is "not upbeat" on oil prices, says the liquid commodity "is getting beat up because the demand simply isn't there, and without a big economic turn it's not in the foreseeable future."

"Energy efficiency has been increasing over time and the Middle East pumped so much oil to try and lower prices to put pressure on our domestic producers, but it backfired," he says. "We'll see a bottom at some point but this [at $48 per barrel in early May] isn't likely it."

"Oil is cheap for sure and I'm stalking it," Chadwick says. "When it turns, there is a big upside in the sector. The key is not to get to too beat up along the way as it's going down."

Up and down – that about sums up the oil market right now, with less of the former and more of the latter going forward – much to the chagrin of "black gold" investors.

Top Stocks of Major Oil Companies

Stock Name	1 Year Return
Petrobras ADR PBR	27.15%
Suncor Energy Inc SU	23.39%
YPF ADR YPF	22.91%
China Petro & Chem ADR SNP	20.16%
BP ADR BP	17.48%
Royal Dutch Shell ADR RDS/A	14.27%
ENI ADR E	13.52%
Total ADR TOT	13.47%
Statoil ADR STO	8.98%
Chevron Corporation CVX	8.08%

Stock information as of May 8th, 2017

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