Oil Is Breaking Out

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Oil Is Breaking Out

By Robert Rapier
April 17, 2018

In late 2016, OPEC agreed to cut production in order to address an oversupplied oil market. Global crude oil inventories had reached record highs, and the price of oil had crashed.

OPEC's strategy is having the desired effect. Over the past year, despite strong U.S. shale production growth, global inventories have steadily declined.

In response, global oil prices have steadily increased, reaching a three-year high last week. West Texas Intermediate closed last week above $67/bbl, while Brent closed above $72/bbl. These prices are approximately 50% higher than they were last August.

Energy Companies Moving Higher

Energy companies are on the rise but have mostly lagged the surge in crude prices. The **Energy Select Sector SPDR ETF** (NYSE: XLE), which represents the largest energy companies in the S&P 500, is up by only 15% since the lows of last August. The **S&P Oil & Gas Exploration & Production SPDR ETF** (NYSE: XOP), representative of the smaller-cap drillers, is up 27% over the same time-frame.

U.S. Master Limited Partnerships (MLPs), which I highlighted two weeks ago in Master Limited Partnerships Are On Sale, are finally showing some signs of life. The Alerian MLP Index (AMZ) has now out-performed the S&P 500 for three straight weeks, and last week turned in its best week of the year.

Nevertheless, there remains a disconnect between the strong rally in oil prices and the modest rally in oil and infrastructure companies. This disconnect only makes sense if oil prices will soon turn lower. This seems unlikely.

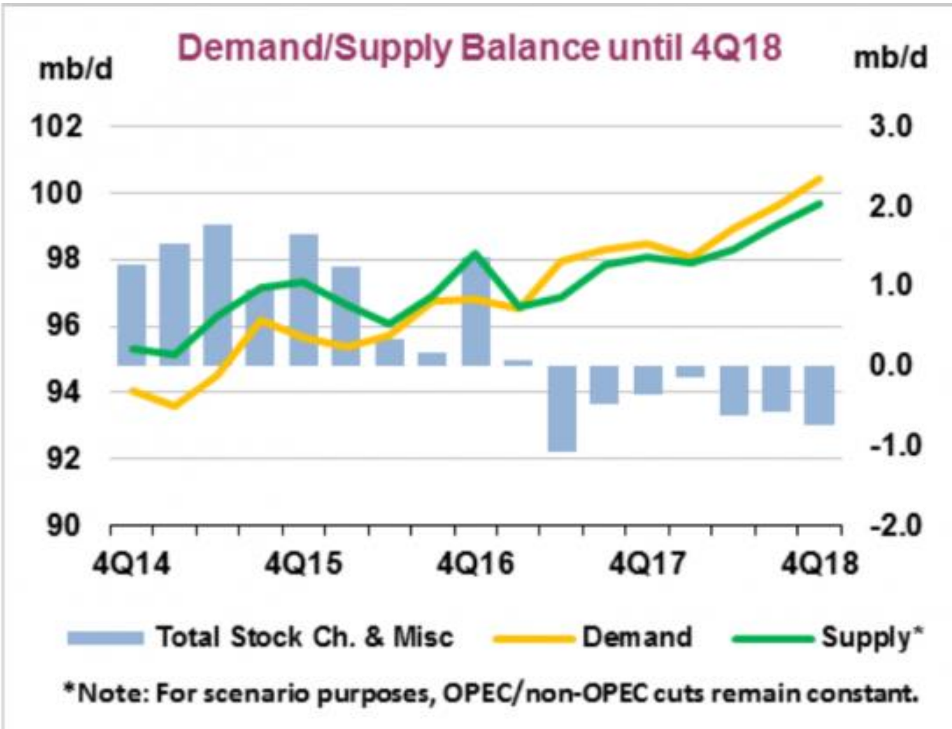
In fact, last week Bloomberg reported that Saudi Arabia has its sights set on a target of $80/bbl. Given that Saudi Aramco is the single largest producer of oil in the world -- with the power to move oil prices -- investors should take this target seriously. Despite the disastrous price war on shale producers, Saudi Arabia usually achieves its aims in the oil markets.

Demand Projected to Outrun Supplies

Global oil demand is projected to increase by another 1.5 million BPD in 2018. The biggest unknown in the supply/demand picture is how much production the U.S. will add to the market.

The International Energy Agency (IEA) is projecting that U.S. production will grow by another 1.3 million BPD this year but warns of potential infrastructure limitations in the Permian Basin. This is also a topic I covered in a recent article for Forbes -- The Permian Basin's Looming Bottleneck.

The net impact of growing demand, OPEC's supply cuts, and U.S. production growth is that the IEA projects that demand will remain ahead of supply for the rest of 2018, which will continue to deplete global crude oil inventories.



Conclusion: Oil Companies are Undervalued

If the IEA is correct, this means one thing for energy investors. Oil prices should remain strong, and will likely move higher unless U.S. production exceeds expectations this year. For energy investors, it's just a matter of time before oil companies catch up to the rally in oil prices.

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ABOUT THE AUTHOR

It's hard to imagine anyone better suited to covering the energy-investment waterfront than Robert Rapier. Robert is no armchair analyst—he has two decades of in-the-trenches experience in a wide range of fossil fuel and biofuel technologies, including refining, natural gas production, gas-to-liquids, ethanol production and butanol production. During a six-year stretch at ConocoPhillips, Robert ran a team of engineers in Scotland working on oil and gas projects in the North Sea.

For two years, Robert was an efficiency expert in a Texas petrochemical plant. The process changes he implemented saved the facility $9 million a year. He later worked as the Engineering Director for a Dutch environmental-technology company and provided engineering support for a Chinese facility the company was constructing.

Robert was also a butanol engineer in Germany for the Celanese Corporation, where he designed a novel butanol unit that cut production costs by $5 million per year.

In all, Robert has spent more than a dozen years working on liquid fuels technologies. Along the way he's picked up five patents, including one for a breakthrough way to convert ethane into ethylene (U.S. Patent 7,074,977).

Now, in addition to guiding readers to timely energy plays in his twice-monthly *Energy Strategist*, Robert travels the world evaluating startup energy companies for deep-pocketed investors. After grilling management and assessing the technology on-site, he makes a go/no-go investment decision. His wealthy private investors and hedge fund backers trust him to make the right choice for the same reason we do: his vast real-world experience in just about every facet of the energy industry. If Robert votes thumbs-up, millions of dollars flow into these cutting-edge outfits.

Robert earned his master of science in chemical engineering and a bachelor of science in chemistry and mathematics (double major) at Texas A&M University. He tells us he was "this close" to finishing his Ph.D. before he decided he was having a lot more fun making money in energy stocks.

A prolific writer, Robert's articles have appeared in *Forbes*, *The Wall Street Journal*, *The Washington Post* and the *Christian Science Monitor* — and he has been a featured expert on *60 Minutes* and *The History Channel*. His new book, *Power Plays: Energy Options in the Age of Peak Oil* (Apress, 2012), helps investors sort through doom and gloom, hype and misinformation to understand the true costs, benefits and trade-offs for each of our major energy options.

In what little spare time he has left, Robert consults for a number of energy projects, including biodiesel, ethanol, butanol and biomass gasification facilities.