The Oil Price Plunge: Which Sector Benefits?

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The Oil Price Plunge: Which Sector Benefits?

By Robert Rapier
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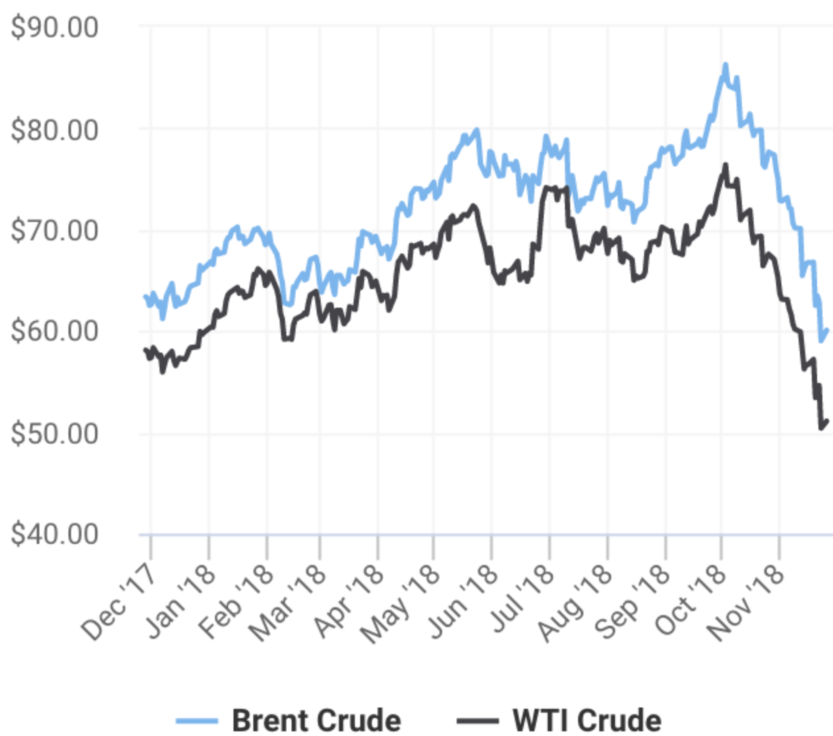
It's hard to believe that oil prices that were closing in on $80 per barrel a month ago have plunged to $55/bbl. President Trump knows exactly where the credit belongs. *"If you look at oil prices, they have come down very substantially over the last couple of months,"* Trump said in a recent news conference. *"That is because of me."*

It is true, the president has had a big impact on crude prices. But not for the reasons he thinks. In fact, there is likely to be a backlash over the way he has influenced the oil patch. Below, I examine the winners and losers of this current dynamic in the energy sector.

Why Oil Prices Fell

The following chart, compiled with data from the U.S. Energy Information Administration, shows the startling descent of crude oil prices:



President Trump has primarily influenced oil in two ways. One is that China, in response to the escalating trade spat, has stopped importing U.S. oil. Earlier this year, China imported more than half a million barrels of day of crude oil from the U.S.A.

Loss of this export market has contributed to inventory growth in the USA and, hence, to the drop in crude oil prices. Presumably, crude oil inventories are dropping elsewhere, but possibly in countries with less transparency about their inventories.

There is fear among some analysts that global demand may be slowing, but Reuters recently reported that China's crude oil imports reached an all-time high in October. Consequently, despite the trade war, demand in China does not appear to be slowing. But China is no longer getting its oil from the USA.

Where is China getting its oil? Iran, for one. The most significant impact that Trump has had on oil prices is his administration's actions on Iranian sanctions. Oil prices had risen about 50% over the past year because of the impending sanctions that were expected to take Iran's oil off the market. Trump convinced Saudi Arabia to pump more oil to compensate for the imminent loss of barrels.

But just ahead of the November 5 deadline, the Trump administration said it would grant waivers to eight countries, including China, to allow them to keep importing Iranian crude oil for now. The waivers allow these countries another 180 days to phase out their purchases of Iranian crude oil. Saudi Arabia was not warned in advance that these sanctions would be given and the kingdom was reportedly angered by the move. The Saudis immediately announced that they would cut oil production in response and are attempting to convince other countries to go along with deeper cuts.

As a result of this perceived betrayal, the Saudis in the future are less likely to trust the Trump administration. The desire to ease these tensions probably accounts for the White House giving Saudi Arabia a pass on the murder in October of journalist and dissident Jamal Khashoggi.

So, sure, President Trump is partially responsible for the reprieve in oil prices. The cost of this has been the loss of a growing market for U.S. oil producers, a weakening of the sanctions against Iran, and an increase in mistrust from Saudi Arabia. Congratulations are hardly in order.

A Growing Opportunity

There is one sector that should benefit from falling oil prices, yet it has fallen along with crude (and the rest of the stock market). The stocks of oil refiners had become quite expensive over the past year, even though they are cash-generating machines. They had risen along with oil prices but, historically, refiners do better when oil prices are falling. That is because it is harder for them to maintain their margins in a rising oil prices market than in one where prices are falling.

Nevertheless, some oil refiners have shed a third of their value since the oil price drop began. The yield of one of the nation's largest refiners, **Valero** (NYSE: VLO) has now risen to above 4%, a level that has not been seen in nearly two years. Prior to the recent correction, Valero had tripled the performance of the S&P 500 over the past five years.

Continuing volatility in the energy market is a concern; a major sell-off could take refiners even lower. But, right now, the refining industry represents a significant disconnect to the rest of the energy sector given the sharp sell-off in oil. Bargain hunters, take notice.

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ABOUT THE AUTHOR

It is 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 has 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 start-up 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.