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Why Crude Oil Prices Are Guaranteed To Surge Higher

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Summary

- The Energy Information Administration sees oil demand climbing to $94.4 million barrels by the end of the year.
- The squeeze that's coming between supply and demand will cause the price of oil to skyrocket.
- To protect against some of the volatility, I would own a strong dividend payer such as BP.

Crude oil prices are creating havoc around the globe. The low price has crushed American shale-oil producers and a number of countries, such as Russia, are suffering as they struggle to make up for the critical lost income.

Traders have proven to be little help. On one hand, you have traders who believe oil will continue to plummet to $20 a barrel. On the other, you have those of us who believe oil *must* climb to $80 a barrel before it can see any stability.

So who's right? It's the million-dollar question at the moment.

And the events that took place last week answered that for everyone…

Last week we had a slew of earnings announcements from several major oil companies - Chevron (CVX), Royal Dutch Shell (RDS.A) (RDS.B), Exxon (XOM), BP (BP) and Hess (HES) to name a few. In each announcement, billions of dollars were slashed out of spending budgets. Many of these oil companies are basing their cuts on oil settling above $50 a barrel. However, if oil settles lower, we will see further cuts and closures.

Oil reacted, rallying 8% in one day. In fact, black gold climbed more than 20% in the previous four trading days. This came with a bit of volatility, as oil dropped 7% the following day and rebounded by 5% the next.

But the more important factor here is that the markets and oil traders are finally starting to realize that the quickest way for crude oil prices to rise is to lower the price of oil.

This is exactly what Jeff Opdyke, our Investment Director, and I have been saying. Low oil prices will lead to lower production and ultimately higher oil prices.

In fact, OPEC today adjusted its 2015 outlook according to what is playing out - production declining by 400,000 barrels a day and demand rising slightly faster than anticipated on lower fuel prices.

With crude oil prices sitting just above $50 today, oil is a buy right now … and I have just the stock.

Shrinking Supply

Oil is volatile today for one reason only - an excess of supply. But that reason's about to evaporate.

Current oil supply sits just above $94 million barrels, compared to current demand of 93.42 million barrels. It's those 890,000 barrels of oil per day that keep the price of oil lower. While it's minimal compared to the 90-plus million barrels a day that are pumped out, it's enough to send prices lower.

As we see the billions in cuts take place on the supply side, production will shrink, and ultimately end up with supply below demand. That means the price of oil will rise, as traders showed us last week during its buying frenzy as major players in oil cut spending.

What's more, oil demand is not falling as all the Wall Street talking heads would have you believe. Maybe it's not projected to grow at a rapid pace, but the Energy Information Administration sees oil demand climbing to $94.4 million barrels by the end of the year. The squeeze that's coming between supply and demand will cause the price of oil to skyrocket.

In the meantime, expect oil to remain volatile and trade on each news item that comes out - such as the build-up in oil inventories that was announced last Wednesday, which sent the price of oil falling 8%.

But this is why we have been telling you to ignore the noise like pundits calling for $20 oil and a Saudi Prince saying oil will never hit $100 a barrel.

Oil will hit $100 a barrel in less than two years.

The events that took place are the groundwork for the rally, which is why now is an ideal time to add exposure to this volatile sector.

A Strong Dividend Play in Oil

The downside from here is minimal. Oil might make one more leg lower as oil hedges these companies have in place will help maintain elevated production levels into the second half of the year.

The reality of billions in spending cuts, tens of thousands of oil wells already shuttered and hundreds of thousands more to be closed if oil doesn't stabilize and begin to rebound, is that we end up with higher oil prices - much higher.

To protect against some of the volatility, I would own a strong dividend payer such as BP.

After getting beat down from the oil price rout, shares of BP look extremely attractive.

The stock yields a solid 5.8%, which the company made its "first priority" to maintain after slashing billions in spending. It trades at just 14 times earnings and recently was awarded a significantly lower penalty relating to the gulf oil spill.

But on top of the low valuation and strong income it can generate, I really like BP because of its upside potential. As oil rallies, I believe the shares of BP can rally above $50 again, for a conservative estimate.

That implies a 20% increase from here, and a total gain of 26% including the dividend.

This article was written by

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Chad Shoop earned the distinction of Chartered Market Technician (CMT) in 2016. He designed three premium investment services specializing in options trading. For the past decade, Chad has been a featured presenter at Banyan Hill’s annual Total Wealth Symposium. He uses these presentations to guide readers to income opportunities and to acquaint them with his investment services, and he advises on investment panels as well. Chad applies his expertise in technical analysis to all aspects of the stock market to find profitable investment opportunities and to make reliable market predictions. Chad received two bachelor's degrees, with a focus in economics and finance, from the University of North Carolina at Greensboro. "Helping people profit from the stock market has been a humbling experience so far. My extensive research, back testing, and beta testing have allowed me to teach others how to grow their wealth and become financial experts in their own right. I’m glad that I’m able to help my readers grab the reins of their financial futures.

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