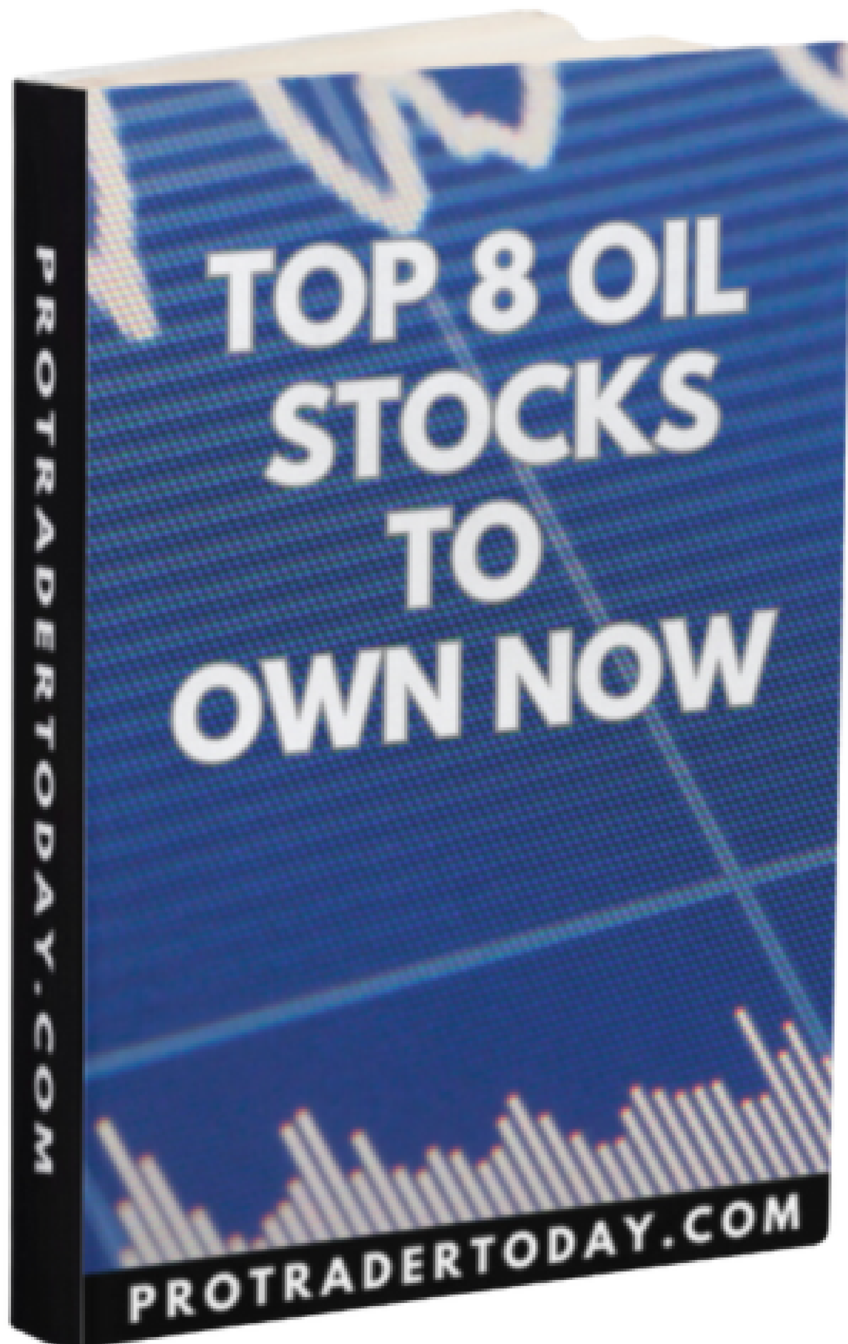

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8 Top Oil Stocks To Own Now

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Dear Reader,

February 19, 2022 is the day that globalization ended.

Of course the cracks in the foundation of the economic order that bound the world's economies together have been deepening for close to a decade…

But Vladimir Putin made it official when he invaded Ukraine: the world is now split in two, and along well-recognized fault lines.

In terms of global GDP, about 40% of the world's economic might sits on one side – Russia, China and India are the big ones, along with Iran, Turkey and North Korea.

Then there's the rest of the world…

It's not a coincidence that the tie that bound and broke the world is energy – chiefly oil and natural gas.

Nor is it a coincidence that, because of its ability to easily and cheaply feed both Europe and China's needs via pipeline, Russia was the epicenter of the split.

Europe, led by Germany, took the obvious and easy way out when it bound its energy dependence over the last two decades to Russia.

And Russia clearly expected Europe to accept the implicit arrangement within the energy bargain – that being the Russian annexation of former Soviet countries – or get cut off from Russian oil and natural gas.

Of course China (with its eye on Taiwan) is backing Putin's play.

All that westbound oil and natural gas traffic can now jam the eastern lane. India's happy to go along for the cheaper ride as well.

But I do wonder just how aware Saudi Arabia is of the precarious position it has put itself in as it attempts to straddle the fence and be a sort of oil double agent in this new world order.

From a political perspective, Saudi Arabia is clearly amongst friends with the likes of Vladmir Putin, Xi Xinping and Kim-Jong Un.

Quite the company to keep.

And Saudi Arabia seems to feel pretty confident that it can continue to play both sides: shipping oil to India and China while at the same time flexing its economic muscle on the West by trying to control oil prices with threats of production cuts.

One thing Saudi Arabia can be counted on for is making some pretty arrogant assumptions.

Deals with the Devil

The Biden Administration has caught a lot of flak for the deal he made with Saudi Crown Prince Mohammed bin Salman Al Saud: immunity for his obvious role in the brutal murder of journalist Jamal Kashoggi in exchange for steady oil production and prices.

The criticism is well deserved.

The Biden Administration has also received plenty of criticism for shortsightedly putting some clamps on U.S. oil production before the U.S. renewable energy economy is truly mature enough to shoulder enough of the burden.

Again, deservedly so.

But it would be a mistake to assume that either of these moves are the first missteps on a long journey down the wrong road. In fact, they can both be walked back pretty fast.

For starters, let's confirm that the death of U.S. oil production has been greatly exaggerated.

U.S. oil production hit its high water mark in November of 2019, right at 13 million barrels a day.

By May 2020, production had dropped to just under 10 million barrels a day as COVID ground the U.S. and global economy to a halt.

But for all the hand-wringing about America's devastated oil industry, production ended 2022 averaging 12 million barrels a day, very much in line with pre-pandemic levels.

And production is expected to finish 2023 at an average of 12.6 million barrels a day – a new all time high for a full year.

There are two great myths about the U.S. oil market. One, that the U.S. can be energy independent. Baloney.

The U.S. uses over 20 million barrels of oil a day.

Open as many pipelines as you want, oil production is not going to jump 40% in any reasonable time frame.

And that's because of the second great myth about U.S. oil companies…

That they will just "drill, baby, drill" if all regulation is removed.

Sure, like most companies, oil companies are motivated by money.

And more oil sales means more money.

But they're not going to simply ignore the fundamentals of supply and demand and how that affects price.

It costs $40 to $50 to get a barrel of oil out of the ground. In 2014, Saudi Arabia tried the "drill, baby, drill" thing and it was a disaster.

Oil prices fell into the $30s and the Saudi's had to pull several hundred billion out of its foreign currency reserves to plug the hole that their misguided policy blew in the country's budget.

U.S. oil companies simply aren't going to shoot themselves in the foot like Saudi Arabia did.

Oil at $70 a barrel with incremental gains in production works just fine, thank you very much.

Now, it could certainly be argued that Europe's new found oil and natural gas needs are a boon for U.S. oil and gas companies.

And it is, especially for natural gas companies.

And I’m sure the Saudi’s feel pretty confident that global oil demand hasn’t dropped, and isn’t likely to drop in the foreseeable future.

The only thing that’s changed is how Europe’s supply needs will be met.

And the Saudis feel just fine raising prices on exports to Europe to “help” Europe meet its supply needs now that Russia is off the board – and at the same time lowering prices to Asia to compete with Russian oil.

Once again, the Saudi’s are very likely overplaying their hand.

Don’t Cry for Me, Argentina (And Brazil, and Guyana and Suriname)

I don’t know if Saudi Arabia simply isn’t aware of how much oil there is in South America, or if they just don’t think South American production can ever be a threat.

But I think South American oil production is just the thing to knock Saudi Arabia down a peg or two.

Here’s a quick look at South America’s oil resources, along with a few stocks that I expect to do very well…

Holding as much as 22 billion barrels of oil, the Vaca Muerta field in Argentina is the second biggest shale oil field in the world after Texas’ Permian Basin.

As you’d expect, Argentina has wildly mismanaged the infrastructure development that the Vaca Muerta field needs to become a truly world-class oil field.

But that is (slowly) changing. And given the new world order for oil, I expect the pace to quicken.

YPF Sociedad Anónima (NYSE: YPF) is by far the biggest producer in the Vaca Muerta field, accounting for just over 50% of production. The stock has run from lows around $9 a share at the start of the year to current prices up around $14.50.

Investors clearly see a bright future for YPF – earnings estimates for next year have jumped more than 10% in the last three months. And the stock is really, really cheap – the forward P/E is just 3.5.

4 years ago, YPF traded between $17 and $20 and had a forward P/E above 10. The fundamentals are there, all that's needed for the stock to regain those former levels is some enthusiasm from investors.

There are a couple other players in the Vaca Muerta, **Pampa Energía (NYSE: PAM)** and **Vista Energy (Nasdaq: VIST)**, that are worth a look, but YPF is cheaper and has the better risk/reward profile.

The Newest Major Oil Discovery

Exxon Mobil (NYSE: XOM) first found oil off the coast of Guyana in 2015. Since then, the amount of recoverable oil has been pegged at 10-11 billion barrels, not including a new find by Exxon back in October.

These discoveries account for one-third of all new oil discoveries since 2015.

Guyana's oil production stands at 360,000 barrels a day now, and is expected to hit one million barrels a day in the next 5 or 6 years. And this is low cost oil: breakeven is reportedly ~$28 a barrel.

Guyana's smaller neighbor, Suriname shares the field (probably why it's called the Guyana-Suriname Basin).

Recoverable oil for Suriname is estimated at 4-5 billion barrels.

But ultimately, the Guyana-Suriname Basin may hold over 30 billion barrels of recoverable oil.

It's mostly oil majors working these fields, like Exxon Mobil and **Hess (NYSE: HES)**.

Still, there are a couple more direct plays for Guyana/Suriname oil.

One may be familiar: it used to be called Apache, but it changed its name to **APA Corp (NYSE: APA)**.

Whatever the name, at $44 a share, APA is basically flat on the year, sitting just below its 52-week at $50. And yet the forward P/E remains quite low, at 8.

The U.K.s **Tullow (TLW.L)** is also active in Guyana, though its operations are still in the "exploration and appraisal" phase.

For the aggressive oil investor, there are two small Canadian companies who've teamed up for a joint venture in Corentyne Block off the coast of Guyana: **CGX (TSX: OYL.V)** has a 32% stake and **Frontera Energy (FEC.TO)** has the remaining 68% stake.

Now, the two companies are in the process of drilling and analyzing results from exploratory wells in the Corentyne Block, which covers 862,000 gross acres. And early indications look extremely good…

The Corentyne Block is estimated to hold 1.7 to 10.7 billion barrels of oil. A veritable bonanza. The best way to play the Corentyne Block is via Frontera Energy.

By virtue of it 77% stake in partner CGX, it commands a dominant 93% controlling interest in the Corentyne Block.

Frontera currently trades around $10, down from its 52-week high at $14.15. It is very cheap, its forward P/E is below 5. And it's market cap is just $866 million.

For a company that may be sitting on 10 billion barrels of oil, Frontera is good bet to move significantly higher.

Big Dividend from Petrobras

Brazil's Tupi field is the world's biggest offshore oil field, with as much as 30 billion barrels of oil. Brazil's **Petrobras (NYSE: PBR)** is the big dog in this field, pumping nearly a million barrels a day.

Petrobras is a state-run oil company that is also a public company.

The Brazilian government owns just over 50% of Petrobras. Government ownership of Petrobras is significant for two reasons: one political, the other financial.

On the political front, management and strategy can be dictated by whomever is in power. And in fact, with a new Brazilian president now taking office, a new Chief Executive Officer (CEO) is taking over at Petrobras.

It would be easy to look at the price performance of Petrobras shares since Brazil's election results and conclude that the incoming president will not be good for Petrobras as a company and/or as an investment. Why else would the shares drop from ~$15 down to $9?

And it’s true: Brazil’s new president Luiz Inácio Lula da Silva does come with the “leftist” label. But Lula is not an unknown commodity at all. He served as president of Brazil from 2003-2010 – and his tenure was pretty darn successful by almost any measure.

In fact, the Tupi field was discovered in 2006 while he was president. And in fact, the Tupi Fields’ name was actually changed from, you guessed it, the Lula Oil Field.

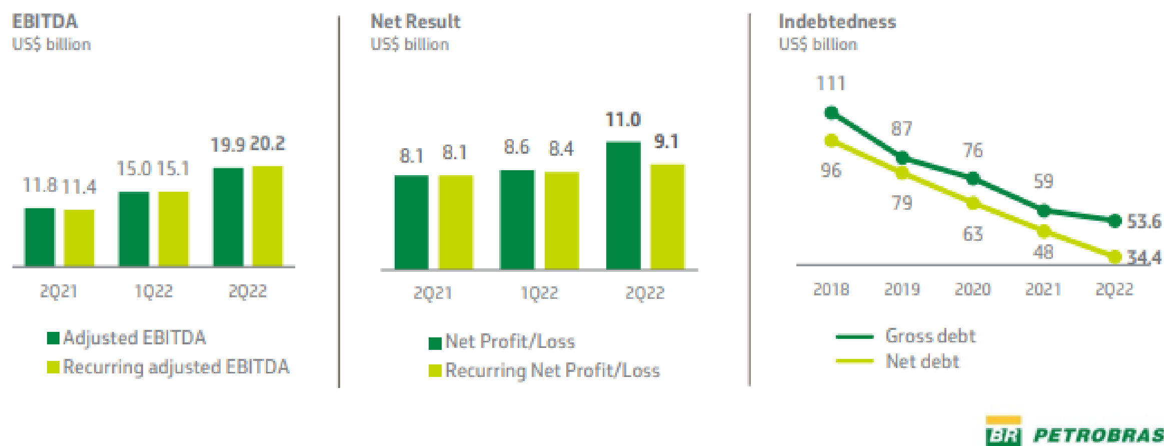
Lula himself called the oil field “the second independence for Brazil.” Any notion that Lula is unfriendly to oil investment is just wrong. Here’s the man himself, with Petrobas employees, during the baptism ceremony of the P-52 Platform oil rig:

And I’d say that’s why PBR shares have rallied steadily since those $9 lows. Currently around $13.50, PBR is very cheap, with the forward P/E under 4.

Now, about the financial aspect of the Brazilian government’s majority ownership of Petrobras…

You may have noticed in the little block of numbers at the start of this section that dividend yield is listed as 26%. That is not a typo. In fact, over the last 12 months, Petrobras has made dividend payments to its shareholders equivalent to 49% of the current stock price. So that 26% actually means the dividend has been cut!

But as you can see from this table, Petrobras does take in enough money to continue making such a high dividend payment, if it so chooses:



Not only that, but Petrobras has been steadily lowering its outstanding debt while making these giant dividend payments.

The question of why Petrobras pays out so much loot every quarter is pretty simple to answer: the dividend is how the Brazilian government gets paid for Brazil's oil resources. Petrobras is like the Brazilian government's piggy bank. It's the source of legitimate funding, as well as corruption. Lula himself served a brief prison sentence for awarding Petrobras service contracts in exchange for political influence and personal gain.

Since the Brazilian government owns the majority of shares, it's reasonable to expect the dividend to remain well above average.

And ironically, while I don't want to say that corruption in Brazil is *good* for Petrobras shareholders, one could certainly argue that continuing corruption is a big reason why this dividend *won't* get cut.

In any event, I rate shares of Petrobras a "strong buy" under $15.

Conclusion

The global energy market is no longer global. It is shrinking into regional pockets where demand and supply will be met.

Europe and especially the U.S. likely have very solid supply partners emerging in South America. The U.S. already doesn't get a lot of Saudi oil, around a million barrels a day. Expect U.S. oil imports from Saudi Arabia to continue to fall as production from South America increases.

Saudi Arabia would love to plug the 20% hole in European supply left by Russia. And Europe's imports of Saudi oil have been rising in the last few months. But how high they will go is a good question. And so is what will happen if Saudi Arabia really starts competing with Russia to supply India and China?

The U.S. and the Western Hemisphere in general is nearly capable of telling the Saudis to pound sand. Europe may not be that far off. But one thing is for sure…

South American oil has a very promising future.

Until next time,

Briton Ryle

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