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Is it time for the sector to clinch its long-awaited comeback?

Energy Stocks Search for Their Spark

Last year offered hope for a beaten-down energy sector, but will 2017 continue the oil and gas rebound?

by Lou Carlozo, Contributor

FROM HIS DESK IN Duluth, Minnesota, Tyler Kocon keeps the kind of detailed charts on the energy industry that would make John D. Rockefeller envious. Then again, if Rockefeller were still alive, he might hold up a huge clove of garlic to ward off the blood-curdling stats and trends some of those charts reflect.

“No subsectors did well in the 2015 environment,” says Kocon, founder of Split Rock Wealth Management, which manages the North American Shale portfolio on the online investing company Covestor. Energy exchange-traded funds lost anywhere between 21 and 36 percent.

“Clearly,” he says, “anything energy related was crushed.”

Then came 2016, when “energy was the best-performing sector of the Standard & Poor’s 500 index as oil prices bottomed and moved higher,” says Andrew Wetzel, senior vice president and portfolio manager at F.L.Putnam Investment Management Co. and based in Wellesley, Massachusetts.

For 2017, the question on every investor’s mind in the energy sector goes like this: Is it time for the sector to clinch its long-

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awaited comeback? Clearly, the political climate is ripe, as energy insiders eagerly await implementation of the "America-first energy plan" Donald Trump promised as a presidential candidate in September.

[See: The 10 Best Energy ETFs for an Eventual Bounce.]

U.S. crude oil ending stocks have spiked since the start of 2017. But as for what that latest mini-gusher might mean, even the smartest experts can't say for sure.

Over the past few years, "a great deal has changed," says Antonio Pietri, president and CEO of AspenTech. "Global trade in chemicals and refined products has skyrocketed. There are real disconnects between where things are produced and consumed. The volatility in energy pricing has been off the charts. Long-term pricing relationships no longer seem to apply."

Yet the investor's fright is the motorist's delight. As recently as 2011, a gallon of regular unleaded gasoline averaged $3.53, according to U.S. Energy Information Administration data. In August of last year, it had slid to $2.27 – down 36 percent to hit levels last seen in 2009. It's only a sliver higher today, as AAA pegs the price of gas at $2.30 as of mid-March.

In his March 10 edition of Stock Traders Daily, editor Thomas H. Kee Jr. writes that even with the current administration's plans to free up energy companies, "something very interesting has happened in the oil space which may make President Trump a little uneasy."

Kee points to two oil-driven ETFs – ProShares Ultra DJ-UBS Crude Oil (ticker: UCO) and the United States Oil Fund LP (USO) – that slipped in value at the start of March. "The reason for oil's recent decline was largely because U.S. stockpiles of oil increased aggressively, but at the same time the United States is importing 4.71 million barrels per day," Kee writes.

"The biggest issue holding the energy sector back over the last two years was the perception by investors of oversupply in the oil market," says Yale Bock, a portfolio manager on Covestor and president of Y H & C Investments in Las Vegas.

Much of this hinges on the production see saw between OPEC and the U.S.

"The OPEC agreement to limit production has helped increase prices, as has the slowing of non-OPEC production," Bock says. "The question of U.S. supply versus OPEC cuts and non-OPEC slowdowns is what needs to be watched."

Elsewhere in the wide world of energy, "prolonged depressed prices across the board simply reflect the lack of strong economic demand, signified by the Chinese slowdown in summer 2015," says K.C. Ma, director of the George Investments Institute at Stetson University in DeLand, Florida.

Don't expect demand to go gangbusters on the home front, either. "Pretty soon, the U.S. will come to grips with the fact that the economy will not grow at 4 to 5 percent annually in next four years," Ma says.

[See: The Best Energy Stocks to Buy for 2017.]

You could also blame the weather. Ma says the warm winter cut into U.S. natural gas demand, with February's monthly consumption figures set to reveal an eight-year low. Looking ahead, "The average spot price for natural gas is expected to drop 12 percent for 2017."

But there could still be cause for optimism. Any move to deregulate natural gas, oil and coal production could put the squeeze on Russian and Asian supplies the U.S. imports.

"If you buy into that investment thesis, you should like Cheniere Energy (LNG) and Exxon Mobil's (XOM) recent announcement of a $20 billion spending program, which includes 11 projects for the U.S. Gulf Coast," Ma says.

Cheniere has picked up 22 percent over the last year and trades at $46 per share, while Exxon Mobil Corp. has remained flat at $18.

“Trump has also promised to integrate more federal acres of land for oil and gas drilling operations, which will significantly improve oil and gas production,” says Michael W. Hinton, chief customer officer at Allegro Development in Dallas. “As demand increases, [exploration and production] companies will be able to sell commodities at higher prices and their operations will increase the need for drilling activities.”

And the administration’s $1.6 trillion proposal to rebuild American infrastructure “comes on top of reducing energy regulations, lowering business taxes and rolling back environmental policies put in by the Obama administration,” Hinton says.

All of this could also lift energy-oriented master limited partnerships.

“Regulation is more important to infrastructure MLPs trying to get pipelines approved, or finish already approved pipelines being held up by protestors,” says Jay Hatfield, president of Infrastructure Capital Advisors in New York. “Energy Transfer Partners, which owns the Dakota Access Pipeline, has already benefited from Trump’s executive order mandating the pipeline be allowed to move forward.”

Yet even if regulations relax as expected, the benefits of clean, efficient production operations “will outweigh any pull to maximize volume at the expense of efficiency due to less stringent regulations,” Wetzel says.

“Companies such as EOG Resources (EOG) and Pioneer Natural Resources (PXD) are more like manufacturing companies as opposed to the wildcatters of years past,” he says. “These companies have dramatically lowered their per-barrel cost of production, improved well productivity and are now profitable at oil prices below $50.”

That makes Kocon bullish on the oil industry in 2017.

[See: Oil ETFs: 8 Ways to Invest in Black Gold.]

“In the event of continued OPEC compliance and greater global demand growth in 2017,” Kocon says, “then one could argue that energy-related stocks are a screaming buy right now.”

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