ClearBridge Investments

Risk-Reward Improving for Energy Stocks

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Volatility has returned to the oil markets as a result of the market positioning itself very long oil, lack of inventory drawdowns in the weekly U.S. Department of Energy data and doubts about whether OPEC will extend cuts past June. At $55 per barrel (bbl), U.S. production appears set to grow 800,000 barrels per day in the fourth quarter, which would still result in substantial global inventory reductions as long as OPEC extends its cuts to year end. If OPEC brings oil back into the market in July, inventories are not going to draw down much and oil prices will have to weaken to deter U.S. production growth.

Crude can weaken in the near-term if OPEC does not extend cuts or if U.S. production exceeds growth estimates at current rig count trajectory, implying higher-than-assumed productivity. In the past, $45/bbl oil has been a "pain threshold" for OPEC and is a level at which U.S. activity is likely to be curtailed.

Energy stocks came into the year roughly fairly valued with a handful of exceptions. With share prices having come down, risk-reward in energy has improved. We continue to favor energy stocks with commodity-price-independent value drivers such as internal cost/efficiency-driven margin expansion or resource expansion.

About the Author

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- 12 years of investment industry experience
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