ARE OIL PRICES HEADED TOWARD $100 A BARREL?

Jeremy Schwartz — Global Chief Investment Officer
06/08/2021

On June 1, 2021, Jeremy Schwartz, Global Head of Research at WisdomTree and regular host of the Behind the Markets podcast, was joined by Mobeen Tahir, Associate Director of Research at WisdomTree, to host Erik Gilje, professor of finance at the University of Pennsylvania's Wharton School of Business. The topic was oil, and the focus was on Erik's bulli sh view on the commodity stemming from structural supply issues in the U.S. amid an improving demand outlook.

Professor Gilje outlined that over the last decade, almost all new supply of oil has come from North America—i.e., either Canada or the U.S.—while the Organization of the Petroleum Exporting Countries and its partners (OPEC+) have lost market share. The group was forced by the COVID-19 pandemic to reduce 9.7 million barrels of supply in what can be characterized as a dramatic and unprecedented policy coordination.

But OPEC+ may not necessarily be fixated on quickly bringing this supply back online. This is because the group is possibly less worried about losing further market share to U.S. shale producers now than in the past. This marks a major shift in the dynamic between the two and could be the key force that drives oil markets higher.

According to Professor Gilje, U.S. shale production is significantly impaired and this is driven by structural reasons. When West Texas Intermediate (WTI) oil was around $70 per barrel in 2018, there were 874 operating U.S. oil rigs. Today, there are 359. Similarly, the number of fracking crews in operation back then was 485 compared to 226 today. Investment in U.S. shale has fallen meaningfully, and U.S. oil production is likely to decline over the next 1–2 years, according to the professor.

But why might the reduction in investment be structural rather than something fleeting and related to the pandemic? Professor Gilje cited a change in investor preferences and government stance as the two key factors. Investors who have not received dividends from U.S. shale producers in the last decade are now imposing a more stringent cost for their capital. They are not only demanding capital expenditure by the producers, but want them to have positive cash flow. Investors seeking carbon neutrality are also posing more challenging questions to oil producers, which further raises their cost of capital.

The shift in government stance under President Biden is also noteworthy. Biden's freeze on rights of way for hydrocarbons across federal lands limits new pipeline capacity and increases breakeven costs for oil producers.

So even though rig counts have risen slightly in recent weeks, pre-pandemic levels of output are unlikely to be restored given there can be 15%–20% impairment when bringing rigs back online. This means that for production to remain flat, new wells need to be dug—something which seems challenging given the higher cost of capital.

As a result of this evolving dynamic, OPEC+ is unlikely to be rushed into bringing supply back online given the difficulties faced by U.S. producers. They are likely to let prices rise amid an improving demand outlook. Oil prices at $100 per barrel within the next 6–12 months might not be beyond the realm of possibility.

Please listen to the full conversation below.

For standardized performance and the most recent month-end performance click here NOTE, this material is intended for electronic use only. Individuals who intend to print and physically deliver to an investor must print the monthly performance report to accompany this blog.

For more investing insights, check out our Economic & Market Outlook

View the online version of this article here.

IMPORTANT INFORMATION

U.S. investors only: Click here to obtain a WisdomTree ETF prospectus which contains investment objectives, risks, charges, expenses, and other information; read and consider carefully before investing.

There are risks involved with investing, including possible loss of principal. Foreign investing involves currency, political and economic risk. Funds focusing on a single country, sector and/or funds that emphasize investments in smaller companies may experience greater price volatility. Investments in emerging markets, currency, fixed income and alternative investments include additional risks. Please see prospectus for discussion of risks.

Past performance is not indicative of future results. This material contains the opinions of the author, which are subject to change, and should not to be considered or interpreted as a recommendation to participate in any particular trading strategy, or deemed to be an offer or sale of any investment product and it should not be relied on as such. There is no guarantee that any strategies discussed will work under all market conditions. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This material should not be relied upon as research or investment advice regarding any security in particular. The user of this information assumes the entire risk of any use made of the information provided herein. Neither WisdomTree nor its affiliates, nor Foreside Fund Services, LLC, or its affiliates provide tax or legal advice. Investors seeking tax or legal advice should consult their tax or legal advisor. Unless expressly stated otherwise the opinions, interpretations or findings expressed herein do not necessarily represent the views of WisdomTree or any of its affiliates.

The MSCI information may only be used for your internal use, may not be reproduced or re-disseminated in any form and may not be used as a basis for or component of any financial instruments or products or indexes. None of the MSCI information is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. Historical data and analysis should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. The MSCI information is provided on an "as is" basis and the user of this information assumes the entire risk of any use made of this information. MSCI, each of its affiliates and each entity involved in compiling, computing or creating any MSCI information (collectively, the "MSCI Parties") expressly disclaims all warranties. With respect to this information, in no event shall any MSCI Party have any liability for any direct, indirect, special, incidental, punitive, consequential (including loss profits) or any other damages (www.msci.com)

Jonathan Steinberg, Jeremy Schwartz, Rick Harper, Christopher Gannatti, Bradley Krom, Tripp Zimmerman, Michael Barrer, Anita Rausch, Kevin Flanagan, Brendan Loftus, Joseph Tenaglia, Jeff Weniger, Matt Wagner, Alejandro Saltiel, Ryan Krystopowicz, Kara Marciscano, Jianing Wu and Brian Manby are registered representatives of Foreside Fund Services, LLC.

WisdomTree Funds are distributed by Foreside Fund Services, LLC, in the U.S. only.

You cannot invest directly in an index.

DEFINITIONS

Bullish : a position that benefits when asset prices rise.

Commodity : A raw material or primary agricultural product that can be bought and sold.

Dividend : A portion of corporate profits paid out to shareholders.