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Is Now The Time To Buy Energy Stocks?

Morgan Stanley has just gone soft on energy, downgrading the sector from its bullish call earlier this year, following on the heels of Goldman Sachs' recent \$20 per barrel of oil prediction. The oil supply overhang has frightened the herd and they are all running away. Is now the time to buy?



Surfers ride waves in front of an oil rig off Huntington Beach, California on July 31, 2015. Weakness in petroleum-linked equities weighed on US stocks July 31 following poor earnings from ExxonMobil and Chevron and a drop in oil prices. AFP PHOTO / MARK RALSTON (Photo credit should read MARK RALSTON/AFP/Getty Images)

Morgan Stanley's chief U.S. equity strategist Adam Parker noted some reservations about his call, concerned that he may be wrong twice in a row—once in each direction—but noted that there may be a better entry point in six to nine months.

If you have confidence that it is possible to buy at the precise bottom, then maybe hold off. Otherwise, think for a moment about the larger picture and consider whether old energy shares may already be at or near the bottom.

An investment in carbon-based fuel production, and particularly oil, is a bet on the race between Elon Musk and Xi Jinping. Not necessarily personally, but as the face and perhaps currently the primary movers of two trends that will determine the price of oil in the near future and thus heavily impact the equity value of most conventional energy stocks.

This is a race currently being run in slow motion between the development of energy storage—both as the likely leading technology that will sideline carbon energy and as a proxy for another disruptor in the renewable space—and the recovery of the global economy beyond the United States, chiefly in China.

Elon Musk proclaimed that the emissions scandal at Volkswagen means that oil's time must end. Mr. Musk represents the proposition that at some point transportation will be fueled by renewal energy, produced locally and centrally, which will power electric vehicles. The same efficient batteries that are to put carbon energy propelled cars out of business will also store rooftop solar produced energy to power homes and businesses.

Meanwhile, Xi Jinping leads the most populous country on earth and the largest economy by some measures, which, until recently, was driving global economic growth. China's thirst for resources has recently been the main driver of the commodities markets, as outlined in Liz Economy and Michael Levi's book *By All Means Necessary*. When will China emerge from its current doldrums or, as some predict, will India become the new star of the emerging economies, and if so, when?

In this slow motion race between a future of stranded oil reserves and efficient renewable energy (advanced, perhaps, by government action kick-started by the Pope, The UN General Assembly and the upcoming Paris Climate Conference) and the return of the economic engine of the emerging economies, led by China or perhaps a rising India, who is the tortoise and who is the hare?

While this is clearly a place for pessimism, it is a difficult dilemma for the pessimist as there is plenty of material for pessimism about each contestant.

Here's another way to think about it: has global oil demand peaked and now begun a slow decent as long-term slower global economic growth and therefore consumption is overcome by efficiency improvements and an increasing shift to renewables?

Before a disruptive technology can displace carbon energy, not only will it require commercial development but also widespread implementation which will take so much more than a few early adaptors buying Teslas, including replacement of global fleets, production and installation of machinery on a massive scale and development and construction of a vast infrastructure of smart power grids throughout the world, all while concurrently operating existing systems.

Its hard to imagine that the human race has stumbled into a solution to climate change by mismanaging the global economy such that declining carbon use has begun to give way to a rising tide of green energy. Even as one may hope for an ultimate shift from oil, its seems like a fairy tale to believe that this current oil supply overhang is anything more than what it is in fact: a current oversupply brought on by an increase in global production contemporaneously with an economic slowdown in the major growth economies.

But this is what the energy bears are selling just now. That there is no prospect for a recovery in demand in the face of increased production, even as plans for the development of new production are being cut by \$1.5 trillion as recently reported by the Financial Times.

Alas, carbon-based fuel consumption is far from over. Even big bad coal use is expected to dramatically increase, as outlined by Jason Bordoff, Founding Director of the Center on Global Energy Policy at Columbia University in a recent piece in the Wall Street Journal.

What about gas? Morgan Stanley asks whether oil is now behaving more like gas, so plentiful that its price can remain low for extended periods. But increasing gas demand depends upon the installation of expensive pipeline infrastructure while oil can move over rail. The comparison fails.

And bearishness about energy equities in general falsely ties the price of oil to the value of the companies, discounting production efficiencies that are buffering the impact of swings in the commodity price and failing to distinguish between the various players. The \$1.5 trillion of cancelled projects should certainly scare investors away from oil field service providers and companies whose business models rely upon expensive unconventional production or high stakes exploration. Note Shell's abandonment of Burger J in the Arctic off the coast of Alaska.

But basic conventional production from existing wells by companies with manageable debt loads at current commodity prices can and will continue, and while we can cheer for a greener future, based upon the facts currently presented it is a much more likely outcome that the tortoise of global economic growth will make the current oil supply overhang yesterday's news long before the tortoise of alternative energy, however disruptive its form, will overtake it.

Meanwhile, have a look at the one-year stock price chart for Exxon Mobil and ask yourself why we are not seeing buy signals from Wall Street.