The “Supply Shock” That’s Turning the Oil Market on Its Head

After 40 years of empty promises, the prospect of U.S. energy independence has become a reality.

And what started five years ago in the Bakken has set off ripples around the world.

Remember Peak Oil?… It’s dead and buried. Instead of scarcity, the world has arrived at a very different tipping point.

Vast new fields and new drilling techniques developed in the U.S. have created a “supply shock” that is turning the global energy industry on its head.

For the energy markets, it represents a true paradigm shift—the end of the established order.

In many ways, it’s the energy equivalent of the Berlin Wall coming down. Like the end of the Cold War, this “supply shock” is setting off a chain reaction all over the world.

The up-shot for investors is almost inconceivable profits.

The U.S. Boom Has Created an Abundance of Oil

For the U.S., the newfound oil boom represents a dramatic reversal of fortune.

After falling for 30 years, U.S. oil production has skyrocketed since 2010. In fact, if current production trends continue, the United States will overtake Saudi Arabia and Russia as the world’s largest oil producer by 2017, according to both the U.S. Energy Information Administration (EIA) and the International Energy Agency (IEA).
And it all began with the massive growth in the Bakken shale beginning in 2008, when the U.S. Geological Survey (USGS) revealed that the now famous formation held nearly four billion barrels of recoverable oil.

Since then the figure has nearly doubled. The official USGS estimate is now 7.4 billion barrels.

But it wasn’t new discoveries that lead to these massive revisions, it was technology. Thanks to faster and cheaper drilling, well productivity has doubled over the last five years.

Now the Bakken is being eclipsed by an even more productive shale formation in southern Texas known as the Eagle Ford Shale. Often referred to as the Texan Bakken, oil production in the Eagle Ford oil jumped 60% in June from the same month the year before.

According to preliminary data released by the Texas Railroad Commission, the nine fields that make up the majority of Eagle Ford

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<th>Petroleum Production: US, Saudi Arabia, and Europe + Central America + South America January 2003 to March 2013</th>
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<td><strong>Barrels per day (millions)</strong></td>
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Source: EIA, Money Morning Research
yielded 617,884 barrels of crude a day in June.

And inside of a year, the Eagle Ford will likely surpass the Bakken Formation’s production rate of 800,000 barrels per day to become the No. 1 American shale oil producer, helping to fuel a renaissance in Texas crude.

In fact, in March, Texas oil production reached its highest level since 1984. In all, the Lone Star State pumped more than 74 million barrels of crude, which means if Texas were a country; it would be one of the 15 largest oil producers in the world.

To put it into perspective, all you need to do is look at the chart below. The surge in Texas crude has been exponential...

In fact, as of this June, Texas controlled a staggering 48% of the oil and natural gas drilling rigs in operation today across the United States. Meanwhile, Texas holds a 26% share globally.

At the current pace of output gains, Texas’ production will likely surpass three million barrels per day (BPD) by year-end, putting it ahead of Venezuela, Kuwait, Mexico, and Iraq to become the equivalent of the ninth largest oil-production “nation” in the world.

But it’s not just about Texas and North Dakota. There’s the massive

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**Daily Oil Production In Texas**

Source: Money Morning Research
amount of oil buried in the Monterey shale in California. At 15 billion recoverable barrels, the Monterey Shale could be bigger than the Bakken and Eagle Ford combined, according to a new report prepared for the EIA.

The numbers are so large that the loud predictions U.S. oil supply would peak are now a distant memory. As a result, the U.S. will need much less in the way of imports. In fact, U.S. oil imports peaked at 60% in 2005 and will be below 40% this year.

**The “Supply Shock” Puts OPEC in the Crosshairs**

This flood of new oil has created what the International Energy Agency is now calling a “supply shock.” According to the Paris-based agency, this new abundance of shale oil will “be as transformative to the market over the next five years as was the rise of Chinese demand over the last 15.”

That spells trouble for the old order—namely OPEC.

According to the IEA, non-OPEC supplies are expected to grow by six million barrels per day to 59.3 million barrels per day in 2018. About 65% of the growth will come from North American light, tight oil and Canadian oil sands production.

“North America has set off a supply shock that is sending ripples throughout the world,” according IEA Executive Director Maria van der Hoeven.

This rapid increase in North American oil production is expected to outrun the growth in global demand during the next few years, which is forecast to grow at about 900,000 b/d annually—at least in the near term.

This implies that the demand for OPEC oil exports during the next five years is likely to be much weaker than had been expected.

“The technology that unlocked the bonanza in places like North Dakota can and will be applied elsewhere, says van der Hoeven, “potentially leading to a broad reassessment of reserves. But as companies rethink their strategies, and as emerging economies become the leading players in the refining and demand sectors, not everyone will be a winner.”

In fact, the IEA now predicts that OPEC will gain an additional two million b/d increase in its spare capacity during the next few years.
These “supply shock” changes will transform the way the oil market works, causing oil companies to overhaul their global investment strategies, reshaping the way oil is transported, stored and refined.

That will lead to numerous investment opportunities here at home—from the exploration and production companies contributing to the shale oil boom to the builders and operators of pipelines and oil-storage facilities.

But there’s another “supply shock” element the IEA is missing.

While the IEA’s “supply shock” concerns focus primarily on U.S. on-shore shale-oil production, there also the simultaneous revolution in off-shore technology that is enabling the discovery and development of huge fields in the Gulf of Mexico.

Those technologies include improved seismic imaging, the computational power to process the images, and the still-limited application of new stimulation techniques in off-shore fields.

In short, the U.S. led on-shore revolution is now leading to a second wave off-shore, adding even more potential growth to the non-OPEC supply.

The Shale Oil Boom Goes Global

But it’s not just a local story. Not by a long shot.

Now, after years of explosive growth in the U.S. and Canada, the shale oil and gas craze is starting to go global.

Now make no mistake. A head start in a business this critical is huge. But the rest of the world is catching up—and fast.

For investors, that means there will be some genuine opportunities for North American technical, equipment, and production service companies as this wave washes up in areas all over the world.

You see, the first markets may have been U.S. and Canadian, but the biggest shale oil and gas markets are actually abroad. They include massive finds in areas you wouldn’t ordinarily think of.

They are found in places like China, Mexico and Argentina—where a groundbreaking deal was recently inked develop what’s been classified as the world’s second largest shale gas and fourth-largest tight oil deposit.

But to understand just how much bigger this “supply shock” is about to become, you need to see this map. It’s a picture that paints 1000 words…
This well-known map has a few interesting wrinkles to it. First, much of the world (shown here in tan) is not even included in the survey. The areas outside the study include Russia and most of the Middle East.

And we already know there are considerable shale formations in each, leading to the conclusion that much of the world’s available shale gas is not even in the survey.

Second, preliminary calculations have concluded that the top four reserves of shale gas globally are found in China, the U.S., Argentina, and Mexico.

Subsequent EIA calculations have since provided a better indication of what these basins actually look like, leading to this version to the right, put together by Reuters.

As you can see, there are significant shale gas resources to be found in numerous places outside of North America.

And nearly all of them will require similar approaches used in North America, including horizontal drilling and fracking.

**This Industry That Keeps the Oil Flowing**

One of the best ways to invest in this trend is where energy’s big-money cycle actually begins. That’s with oil field service (OFS) companies.
After all, without a rig, a well is nothing more than a dot on a map. That’s why the oil field service (OFS) business always improves before the fortunes of field production companies.

I have periodically recommended to Energy Advantage and Energy Inner Circle members two standouts in this sector - the SPDR S&P Oil & Gas Equipment and Services ETF (NYSEArca:XES) and the Market Vectors Oil Service Holders ETF (NYSE MKT:OIH).

But there’s an even earlier link in this profit chain...

It’s a smaller industry, and may not get much coverage. But the OFS business wouldn’t exist without it... and neither would the all of those oil wells.

That’s why one of my favorite oil and gas plays revolves around drilling equipment.

You can make a fortune investing in companies that manufacture and distribute all the massive equipment each well requires. Pressure pumps, drill bits, down-hole motors...

For instance, take a look at these pumping trucks:

These are just some of the special trucks needed for a frack job. In this case, we’re looking at a medium-sized well site in the Marcellus,
just over the line in northern West Virginia, where I was evaluating the footprint of the drilling pad.

   Fracking work at unconventional sites requires water pushed downhole under heavy pressure.

   That, in turn, requires a large array of pumping trucks and ancillary equipment surrounding the well head, along with compressor stations (to maintain pipeline pressure levels), retention basins (for flowback water) and a range of site specific processing and separation units.

   The picture above shows just a portion of what the pumping footprint at a small frack operation looks like.

   Make no mistake: A working well is a massive display of parts and machinery. And selling this equipment is good money.

   So is servicing it.

   That’s why some of the biggest OFS providers - like Schlumberger Ltd. (NYSE:SLB), Halliburton Co. (NYSE:HAL) and Weatherford International Ltd. (NYSE:WFT)—have been buying up oil and gas equipment makers.

   It’s part of an ongoing move by the big OFS outfits to consolidate access and increase profitability.
With all the M&A going on in the OFS sector, and its reach further “upstream” into the manufacturing and distribution segment, being able to comb through all of these opportunities could be a full-time job.

But it doesn’t have to be.

In fact, there is one company that stands to benefit most directly from what is happening in the equipment sector.

It’s National Oilwell Varco Inc. (NYSE: NOV).

This is one of the primary stand-alone (i.e., has not been acquired by an OFS big boy) providers of oilfield equipment and service. The company provides equipment, components, and supply chain services for the upstream E&P oil and gas industry.

Founded in 1862, the Texas-based company has a worldwide footprint with a market capitalization of $31.8 billion.

Overall, it’s the third-largest servicing company, following Schlumberger and Halliburton. It’s also a favorite of Warren Buffett’s Berkshire Hathaway, perhaps due to its market share.

NOV currently holds about a 60% share in all of its addressable markets and that figure is rising. The company also holds a record backlog for capital equipment orders of nearly $14 billion, up 24% over year-earlier levels.

Of course, this is just one of the many opportunities the “Supply Shock” is going to hand investors.

In future issues of Oil & Energy Investor, I’ll detail the game-changing emergence of the liquefied natural gas export market, the developing “micro-booms” as the shale craze goes global, the money-making advancements in energy technology, and the emergence of new MLP “clones” that kick off incredible income streams.

But that is just the beginning of the opportunities that are headed your way. Over the next five years, the “Supply Shock” is going to change everything you used to know about energy.

When it does, that is going to open up a new bull market in energy shares. You can count on it.

And your subscription to Oil & Energy Investor will give your our best investment research on this massive trend every step of the way.
Dr. Kent Moors is an internationally recognized expert in oil and natural gas policy, risk management, emerging market economic development, and market risk assessment.

He serves as an advisor to the highest levels of the U.S., Russian, Kazakh, Bahamian, Iraqi, and Kurdish governments, to the governors of several U.S. states, and to the premiers of two Canadian provinces. He’s served as a consultant to private companies, financial institutions and law firms in 25 countries, and has appeared more than 1,400 times as a featured radio- and-television commentator. He appears regularly on ABC, BBC, Bloomberg TV, CBS, CNN, NBC, Russian RTV, and the Fox Business Network.

Kent is also a professor in the Graduate Center for Social and Public Policy at Duquesne University, where he directs the Energy Policy Research Group. A prolific writer and lecturer, his six books, more than 750 professional and market publications, and over 250 private/ public sector presentations and workshops have appeared in 44 countries.

He makes specific investment recommendations in his newsletter, the Energy Advantage. For more active investors, he issues shorter-term trades in his Energy Inner Circle. And Kent’s exclusive Micro Energy Trader is a “swing for the fences” service that targets micro-cap energy stocks. Oil & Energy Investor is Kent’s e-letter, where he delivers the latest energy news from his travels around the world in his role as a consultant for major companies and governments.

Kent lives in Pittsburgh, Pa., with his wife Marina (who is also an energy analyst).
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