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An argument for why natural gas can only go higher

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With a Republican controlled Congress and Washington gridlock upon us, we need to refocus on the only remaining energy sector sure to benefit: natural gas.

It's time to increase exposure to this still unbelievably cheap fuel and the stocks tied to it. Everything points to this being a relative bottom for both.

It is because of the long run of horrid fundamentals for natural gas and the headwinds for those companies that we need to look at overweighting our investment in the stuff right now.

Industrial demand for gas has been in a steady secular decline since 2002, reaching its lowest levels last year of just over 16 billion cubic feet per day (Bcf/d).

Supply, however, has continued to enormously outstrip this weakened demand. The Energy Information Administration reported a 1.2 Bcf/d sequential increase in production this August, continuing the increases mostly from shale plays. Rig counts that impact production in the Gulf of Mexico continue to slowly trend higher from their disaster year in 2009 and the lag from those increases almost guarantees greater offshore supply, even if exploration and production companies looked to cut back production tomorrow.

Prices for the commodity have reflected this extremely bearish outlook both for demand and supply, hovering around \$4 per thousand cubic feet (mcf) since March and reaching a positively dirt cheap low of \$3.30 less than a month ago.

And yet there seems to be the flickering of clear signs that these market forces are beginning to cause all the changes needed for a turnaround.

There is a trend for dedicated natural gas companies that have begun to "throw in the towel" and concentrate on crude oil if the option exists. The Canadian giant Encana Corp. ([ECA-T29.26----](#)%) has been renegotiating leases and deferring completions in the Haynesville shale area, and Anadarko Petroleum Corp. ([APC-N63.63----](#)%) reported on its earning call that it expects 70 per cent of its onshore capital expenditures next year to be committed to crude oil, and not natural gas.

For the huge integrated companies, the trend is similar, as production reports for the third quarter have all come in below expectations, including Conoco-Phillips ([COP-N61.92----](#)%), Chevron Corp. ([CVX-N83.94----](#)%) and Exxon Mobil Corp. ([XOM-N70.54----](#)%). There are the beginnings, therefore, of a production draw.

Politically, a Republican-controlled Congress will also demand at least some Republican initiatives, which on energy would have to include a more favorable outlook on domestic natural gas incentives at least for truck engines.

And the commodity itself clearly seems unable to go any lower. Quietly in the last two weeks, natural gas ([NG-FT4.230.061.54%](#)) futures on the NYMEX have been recovering steadily, now trading just a hair's breadth away from \$4/Mmbtu.

I strongly and sharply disagree with most of the analysts expectations for continued depressed pricing for gas during 2011. When the first real turnarounds of demand begin to show themselves, the price will quickly (and illogically) completely outstrip the admittedly huge inventories of gas in storage. It may not make sense, but I've seen it too many times in the past to expect anything different this time around.

Yes, I believe natural gas can easily trade \$7/mcf in 2011 - all while the fundamental supply picture is still looking bearish and the demand picture is only slowly improving. If that should happen, the stocks I am about to suggest are right now looking very cheap indeed.

Devon Energy Corp. ([DVN-N73.20----](#)%) has been retaining decent margins by concentrating on natural gas liquids (NGL's) during this period of depressed commodity pricing and is poised to take immediate advantage of an increasing price.

Cimarex Energy ([XEC-N82.02----](#)%) is a smaller, but equally well-run company that has stellar assets in the Oklahoma Cana shale play.

Both of these stocks will benefit tremendously from any turnaround in the natural gas fundamentals that appear today - low demand, high supply and a depressed commodity

price. But on the heels of a midterm election and some improving industrial indications, there's only one way natural gas can logically go: up.

At the time of publication, Dicker had positions in Devon, Conoco-Phillips and Cimarex.

Dan Dicker has been a floor trader at the New York Mercantile Exchange with more than 20 years' experience. He is a licensed commodities trade adviser. Dan's recognized energy market expertise includes active trading in crude oil, natural gas, unleaded gasoline and heating oil futures contracts; fundamental analysis including supply and demand statistics (DOE, EIA), CFTC trade reportage, volume and open interest; technical analysis including trend analysis, stochastics, Bollinger Bands, Elliot Wave theory, bar and tick charting and Japanese candlesticks; and trading expertise in outright, intermarket and intramarket spreads and cracks.

Dan also designed and supervised the introduction of the new Nymex PJM electricity futures contract, launched in April 2003, which cleared more than 600,000 contracts last year alone. Its launch has been the basis of Nymex's resurgence in the clearing of power market contracts over the last three years.

Dan Dicker has appeared as an energy analyst since 2002 with all the major financial news networks. He has lent his expertise in hundreds of live radio and television broadcasts as an analyst of the oil markets on CNBC, Bloomberg US and UK and CNNfn. Dan is the author of many energy articles published in Nymex and other trade journals.

Dan obtained a bachelor of arts degree from the State University of New York at Stony Brook in 1982.