

Why You Shouldn't Worry About the Price of Oil

Description

It would be an enormous understatement to suggest that the price of oil doesn't matter to Canadian investors. The TSX itself is currently weighted an enormous 26.6% to energy—the largest weighting by a decent margin—with materials coming in at 19.4%.

This is in contrast to the U.S. S&P 500, which is weighted only 8.3% to energy. This means that as a Canadian investor, not only are your investment choices dominated by energy picks, but even if you opt to avoid energy stocks entirely, your returns will likely still be impacted, since poor energy returns weigh on both the overall TSX and the broader Canadian economy.

Given this information, it seems tough not to try to plan your investing activities around oil's potential price movement. Fortunately, there is an alternative. By forgetting about the short-term price of oil, and instead thinking and investing on a long-term horizon in companies with solid economics in all price environments, you can reduce your risk and stop fretting about where oil is headed.

Here's what I mean.

Nobody knows where the short-term price of oil is headed

It can be tempting to try to time the price of oil and make investment decisions based on your conclusion. For example, if the oil price has finally bottomed, then an investment in a company like **Canadian Oil Sands Ltd.**, a company that is deeply leveraged to the price of oil, would be wise. Similarly, if you think oil is going lower, then perhaps you would avoid the energy sector and wait for it to rebound.

The reality is that nobody knows where the short-term price of oil is headed, just as few people predicted the price of oil crashing. Therefore, attempting to time the market is a poor approach.

To illustrate this, there are currently strong arguments from analysts with opposing viewpoints. Some analysts say that oil has bottomed, and others argue that it will go lower.

The bullish analysts claim that the lower Canadian dollar is reducing the impact of low prices, and the fact that oil stocks are now reacting positively to bad news—such as dividend cuts—is a solid sign the bottom has arrived. Bearish analysts, however, cite the fact that oil inventories are currently sitting at an 80-year high and are still skyrocketing higher, with crude supplies jumping by 14.3 million barrels in early February.

There seems to be only one consensus, that oil will likely trend slightly higher over a longer time frame and possibly settle in the \$60 to \$70 dollar range as the economic benefits of low energy prices, combined with supply cutbacks, kick in.

With the short-term price of oil difficult to predict and lower prices potentially a new norm, it is important to invest accordingly.

What you should do

The value of a company is not determined by its earnings during a one- or two-year period, but rather by its potential earnings throughout its entire lifespan. Therefore, it is important to think of a company's prospects over a 10- or 20-year period. With this in mind, 2015's price of oil seems less important; what is more important is that an energy company has solid assets, an economic moat, and the ability to be profitable in all market conditions.

In this regard, **Suncor Energy Inc.**([TSX:SU](#))([NYSE:SU](#)) stands out. Suncor has an extremely high-quality portfolio of long life and low-decline assets relative to its peers, which should enable the company to produce a strong free cash flow for several decades, with low exploration risk. In addition, the company's integrated strategy allows it to achieve Brent prices on over 90% of its production, and as a result, secures it some of the highest netbacks in the industry.

The natural hedge provided by Suncor's refining operations also protects against the volatility of oil prices, since refining margins improve when oil prices drop due the lower input cost.

By shifting focus from the short-term price of oil to investing in companies with solid long-term economics in all price environments, you can stop worrying about the price of oil, while reducing your risk. Warren Buffett would agree, as he recently upped his stake in Suncor, making it his sole energy holding.

CATEGORY

1. Investing

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Date

2025/08/26

Date Created

2015/02/26

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