# How to Overweight Your Portfolio for an Oil Comeback (and Avoid Gambler's Ruin)

## Description

In many ways, picking individual stocks is the antithesis of indexing. A single global exchange-traded fund (ETF) like the **Vanguard FTSE All-World ex Canada Index ETF** (TSX:VXC) owns more than 3,000 individual stocks, providing exposure to all economic sectors.



Once in a blue moon, one particular sector appears to be selling at bargain prices relative to the broad indices. Right now, that sector appears to be energy. The price of oil has been cut in half the past six months, but pundits like Gluskin Sheff's chief economist David Rosenberg are now declaring the bottom is in. "I am getting a very strong sense that we are in a bottoming process" (for the price of oil), he wrote in the *Financial Post* early in March.

Does that mean it's time to go bottom-fishing for individual oil stocks like giant **Exxon**, or more speculative domestic junior exploration plays? Or is it already too late? Some pundits still caution it's too early: even *Mad Money's* Jim Cramer is taking a wait-and-see attitude on oil stocks.

Needless to say, betting the farm on any single energy stock is a strategy fraught with risk: sure, get the timing right and you may have great cocktail party bragging rights for years to come. But if you're tempted to wade in now, consider a concept called Gambler's Ruin, long attributed to Rotman Business School professor of finance Eric Kirzner. Gambler's Ruin refers to picking the right sector – in this case, energy – but choosing the wrong individual stock within that sector (for example, Enron back in the day or in telecommunications, Nortel Networks).

Here's where sector ETFs come into play, particularly Canadian oil ETFs. Keep in mind that many indexing purists, like Justin Bender at PWL Capital, prefer broad-based "plain vanilla" ETFs like those offered by Vanguard or iShares. There's a belief in such circles that whatever energy exposure you need is ample in these broad-based funds: oil and gas accounts for 7% of the global Vanguard ETF mentioned above. And because of home-country bias, Canadian investors have even more exposureto energy just through ETFs providing broad exposure to the Canadian equity market: oil and gasmakes up about 21% of the broad index, as represented by the **Vanguard FTSE Canada All-Cap Index ETF** ( TSX:VCN).

If you think that's sufficient exposure to energy, stop reading now.

Still with us? Presumably you think now is one of those rare times when it may be worth overweighting a beaten-down sector. If so, you still want to avoid Gambler's Ruin and I'd suggest finding an ETF that takes an "equal-weighted" approach to the sector. That means an ETF that owns roughly the same amount of money in each security.

An example from my own portfolio is the **BMO S&P/TSX Equal Weight Oil & Gas Index ETF** ( TSX:ZEO). As of late January, there were 15 holdings in this fund, all but one of them accounting for between 6% and 8% of the fund. All Canada's oil majors are there: **EnCana**, **Enbridge**, **TransCanada**, **Imperial Oil** (a unit of Exxon), and **Canadian Oil Sands**. **Talisman Energy** is 13.5%, which presumably reflects a recent price run-up that will be cut back the next time the fund rebalances.



I owned this ETF long before the price of oil crashed and once it did, added a bit more to the position. (Full disclosure: I also did so with the **Market Vectors Oil Services ETF** (NYSE:OIH), which holds global oil services giants like **Halliburton** and **Schlumberger**, but according to market weight rather than equal weight.)

To be sure, there are several more esoteric energy ETFs in Canada, like the **iShares Oil Sands Index ETF** (TSX:CLO) and even leveraged reverse plays on crude oil from firms like Horizons ETFs. I won't even disclose the ticker on that last one, for fear of inflicting Gambler's Ruin on anyone who happens to read this piece.

Most of us can stick to the energy exposure the broad funds provide and if you must indulge in overweighting, I'd stick with the equal-weighted approach.

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**Date**
2025/07/21
**Date Created**
2015/03/05

**Author**
jchevreau