# The Best ETF to Play Oil’s Continuing Volatility

## Description

Investors who made a proxy bet on higher oil prices in 2016 by buying the **iShares S&P/TSX Capped Energy Index Fund** (TSX:XEG) on December 31, 2015, have been generously rewarded with a 24% year-to-date gain for their unwavering optimism.



Bravo. But don’t get too confident. Volatility in oil prices is expected to remain high as the bulls and bears fight it out for directional supremacy. In hindsight, the easy money is waiting for those who were confident enough to take a calculated risk earlier this year that oil prices had indeed bottomed and a recovery, no matter how slow its progress, was underway.

I couldn’t have made that bet, but many did. The question now is whether or not these same investors can stomach the next leg up. Some will take profits, others will trim positions, while the diehards will hold fast, knowing that ultimately higher energy prices are in the cards.

I’m not clairvoyant, so I honestly can’t help you make a decision on what to do with your XEG holdings. However, what I can do is suggest a better way to play oil’s continuing volatility. All you need to do is exchange one ETF for another. The best part: the ETF I’m recommending will also save you a sliver on your annual management expenses.  It’s not a huge amount, mind you, but it’s something nonetheless.

**Horizons S&P/TSX 60 Equal Weight Index ETF** (TSX:HEW) is the fund I believe energy investors can successfully use to hedge their bets in the coming months.

How so?

The **iShares S&P/TSX 60 Index Fund** (TSX:XIU) is an ETF that tracks the index of the same name. It has 60 holdings, including 13 in the energy sector.  Horizons holds the same 60 stocks, including those in the energy sector.

However, Horizons rebalances four times a year: March, June, September, and December, while the XIU rarely does. This means that every quarter the holdings in the equal-weight version of theS&P/TSX 60 Index are reset to a weighting of approximately 1.66%. This allows for profits to be takenon winners, while losers are able to fight another day.

What does this mean for energy investors? It means you get to maintain your exposure to energy stocks regardless of what happens to the 13 individual stocks that represent the energy sector. Big or small, their performance is of equal value.

For example, **Suncor Energy Inc.** (TSX:SU)(NYSE:SU) currently is the fifth-largest holding in the XIU at a weighting of 4.27%. In Horizons, it's not even in the top 25 holdings. That's because Suncor's stock hasn't done much since the June rebalancing compared to other stocks such as **Teck Resources Ltd.** (TSX:TCK.B)(NYSE:TCK), the number one holding as of August 24 at 2.21%, about 32% higher than at its rebalancing in June.

Theoretically, if all 13 energy stocks in the cap-weighted version of the S&P/TSX 60 Index were to lose half of their value in a quarter, energy stocks would be reduced to about 10% of the index's portfolio from its current weighting of about 21%. Although I doubt this would ever happen, it points out an obvious weakness in float-adjusted, cap-weighted indexes.



On the other hand, if that were to happen to Horizons, energy stocks would see their weighting rebalanced back to 21.5% (13 times 1.66%) at the end of the quarter in question instead of remaining at 10% like the XIU.

For investors keen on energy stocks but unsure of their near-term direction given oil's ongoing volatility, you might want to consider Horizons's equal-weighted version of the S&P/TSX 60. It gives you exposure to energy stocks while reducing the risk associated with the cap-weighted version of the index.

**CATEGORY**

1. Energy Stocks
2. Investing

**TICKERS GLOBAL**

1. NYSE:SU (Suncor Energy Inc.)
2. NYSE:TECK (Teck Resources Limited)
3. TSX:SU (Suncor Energy Inc.)
4. TSX:TECK.B (Teck Resources Limited)
5. TSX:XEG (iShares S&P/TSX Capped Energy Index ETF)
6. TSX:XIU (iShares S&P/TSX 60 Index ETF)

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