Should You Avoid Stocks That Rely on Commodity Prices?

Description

There are a lot of different ways that you often hear about diversifying and minimizing your overall risk. The strategies usually circulate around diversifying and holding a balanced portfolio to help offset market-related risks. However, there are some stocks that are inherently riskier than others, and by avoiding these types of investments you can also reduce your risk.

I'm talking about stocks that depend on commodity prices. While in general, stocks will be impacted by commodities and many other factors, some investments are much more sensitive than others; a change in the underlying commodity price could have a big impact on the share price. If you're looking to reduce your risk, consider investing in stocks that aren't dependent on a commodity to be successful.

Oil and gas stocks have been hit hard

The past several years have been rough on the oil and gas industry, and even the companies that have survived the downturn are not getting much confidence from investors. **Enbridge Inc.** (TSX:ENB)(NYSE:ENB) is a great example of a stock that has taken a beating through no fault of its own.

Although the company may have had a disappointing Q4, Enbridge has been able to stay in the black in each of the past five quarters, which is no small feat given the industry conditions. However, the stock has declined more than 12% in the last month, as declining oil prices have dragged down the share price.

Despite all the progress Enbridge has made in the past year, its stock has still lost more than 21% of its value.

To a lesser extent, we've seen **TransCanada Corporation** (TSX:TRP)(NYSE:TRP) see a similar cloud hover over its strong performance. Although the Keystone XL pipeline has made significant progress over the past year, TransCanada's stock has failed to get a boost. In fact, the share price has declined more than 7% in the past 12 months, even as the company has made progress in getting approvals and securing demand for the pipeline.

Unfortunately, a strong degree of pessimism has turned investors off from oil and gas, and even though oil prices are much higher than they were a year ago, that might not last once supply cuts are lifted.

Many other examples exist

It's not just oil prices that have presented risk, but any commodity could potentially create instability for a company and an investment. **Cameco Corp.** (TSX:CCO)(NYSE:CCJ) has been hit hard by low uranium prices, and the company has resorted to having to cut its dividend and production.

Teck Resources Ltd. (TSX:TECK.B)(NYSE:TECK) has been on the other side of the fence, as steel-making coal prices have been on the rise, and that has meant a stronger financial performance for the company. The share price has risen more than 30% in the past year, but the stock still trades at less than nine times earnings, as investors know that a weak commodity price could easily undo the company's strong financials.

Bottom line

Commodity prices are impacted by many different factors, and companies can often be helpless to try and offset their effects, especially when negative. Investors would be safer simply avoiding commodity-dependent stocks.

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3. NYSE:TECK (Teck Resources Limited)
4. NYSE:TRP (Tc Energy)
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Date
2025/08/23
Date Created
2018/02/22
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