Sick of Your Oil Stocks Getting Slaughtered? Try This Instead

Description

It's been terribly hard to pick the right oil stocks in the Canadian oil sector over the past several years. Some of my favourites like Whitecap Resources Inc. (TSX:WCP) have felt continuous pressure as political issues facing pipeline development and the oil sands continue to plague the industry. Even large-cap companies like **Suncor Energy Inc.** (TSX:SU)(NYSE:SU) and steady utility pipelines like **Enbridge Inc.** (TSX:ENB)(NYSE:ENB) have had trouble overcome negative sentiment.

The tough years have made investors nervous about choosing individual stocks. I can remember looking at Whitecap when it was $8 a share thinking it was the deal of the year, only to it see it fall a further 50% a few months later. Luckily for investors, there are other ways to try to ride an oil recovery besides taking a swing at individual stocks.

Exchange Traded Funds (ETFs) are very much like mutual funds except that they trade like stocks and generally have lower Management Expense Ratios (MER). ETFs consist of a basket of stocks that seeks to track a particular index. In Canada, there are many choices of oil ETFs, but two of the best are . Both of these funds are relatively liquid, although they each have their own peculiarities.

The largest differences appear in the names, the fact that ZEO is equal weight and XEG is capped. Essentially, both methods seek to limit the impact of any individual company on the overall performance of the ETF. ZEO tries to keep each holding at a certain percentage of the portfolio.

This way, no matter how large the company, it will only make up around 7-8% of the total. Therefore, even though Suncor is a much bigger company, it will compose 8% of the total portfolio as will Whitecap. XEG uses a model in which it caps its holdings at around 25% of the portfolio, allowing larger companies to have a larger impact on the portfolio's performance. If you prefer larger, blue-chip companies, this might be a better choice for you.

In both cases, the ETF will help you spread exposure over the entire sector without being overexposed to any one company. This applies to dividends as well. The ETF pays out a dividend based on the pool received from each company. While the ETFs' dividends aren't steady, they will probably be steadier than most individual oil companies. At the moment, ZEO pays a dividend of 3.19% and XEG pays a slightly lower one at 2.1%.

But as with any investment decision, there are a few downsides to keep in mind before pulling the trigger on buying an ETF over an individual stock. The biggest downside is the fact that you are buying a basket of stocks which, besides reducing your risk, also limits your upside. If Whitecap triples in value tomorrow and goes back up to $12 a share, you will only experience a small amount of that gain in the ETF.

You also have to pay MER on the ETF, something that you avoid when you hold shares in a company over a long period. These fees aren't significant when compared to most mutual funds, but they still impact your overall returns. ZEO, for example, charges a relatively high ETF MER of 0.61% as does XEG. As an investor, you need to decide whether the diversified relative safety is worth the cost of the MER.

In the end, it comes down to two factors: Your desire to try to hit a home run or your desire to benefit from a general oil recovery. I have to say, after taking a beating on oil over the last few years, the stability, reduction of stock-specific risk, and the somewhat steady dividends are very tempting.

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2. Energy Stocks
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TICKERS GLOBAL

1. TSX:XEG (iShares S&P/TSX Capped Energy Index ETF)

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Date
2025/08/26
Date Created
2019/01/17

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