A Strong Correlation to Oil Prices Could Make Cenovus (TSX:CVE) a Good Buy Today

Description

Cenovus Energy Inc (TSX:CVE)(NYSE:CVE) and other oil and gas companies are heavily impacted by oil prices. Not only do falling commodity prices impact sales, but they also affect the level of investment in the industry, as many companies have scaled back capital expenditures in recent years to improve their financial positions.

In Cenovus' case, the company's stock price shows a very strong correlation to oil prices:

When looking at West Texas Intermediate (WTI) prices over the past year, there's a correlation of 0.81

with Cenovus' stock price. That's a very strong relationship, and it's not likely a surprise given that investors likely buy and sell the stock based on their expectations of oil prices. It's no coincidence that since the downturn in 2014 began when oil prices began sinking, Cenovus has seen the value of its share price fall by more than 60%.

However, not all oil stocks are this closely correlated to oil prices, which makes Cenovus an even more intriguing buy, particularly for those investors that expect oil prices to rise. We know that OPEC doesn't have much of an appetite for oil prices to remain lower than US$50 a barrel, and so there's a strong chance that there will be support (cuts) in place to make sure that doesn't end up happening, at least, not for a prolonged period of time.

Last year, WTI climbed over US$70 per barrel, and with less production, it could certainly climb back there again. The one caveat in this is, of course, the discount that Western Canada Select (WCS) will trade at. It won't be of much help to Canadian producers if WTI rises and WCS doesn't and it's the reason the Alberta government announced it would be reducing production.

Today, the gap is only US$13 and a big improvement from where it was previously. As long as oil prices rise, it should lead to a lot of bullishness for Cenovus and it's likely the correlation will remain strong.

The downside for investors is that this means that regardless of how well the company performs from one quarter to the next, any positive results might be negated if oil prices aren't strong. Although companies are performing well, investors simply don't want to take a chance investing in oil and gas in general.

While part of it could do with the politics and challenges of getting projects started in Canada, another is certainly the uncertainty around oil prices as well.

Bottom line

Trading at less than its book value at writing, Cenovus is certainly an appealing buy today. Although the company has had many struggles over the past few years, with sales on the rise there is certainly hope that things can turn around.

And if the industry picks up, there could be a lot of room for Cenovus and other oil and gas stocks to rise in value. This is definitely not a suitable option for risk-averse investors, but for those that are willing to take on some uncertainty, the returns could be significant.

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