TSX Stocks: A Better and Safe Way to Play the Crude Oil Rally

Description

The crude oil price tumbled into negative territory last month and exhibited how uncertain energy markets can get. However, many market participants now estimate that oil has hit the bottom and is now readying for a big uptrend.

Evidently, Canadian oil and gas companies have been no different. Steep dividend cuts along with reduced capital spending for 2020 have become the norm this year. Thus, TSX energy stocks at large have fallen approximately 50% so far this year.

It's obvious that volatile energy markets in the last few years have made individual stock picking all the more difficult. So, how should investors play the current oil market rally amid its bullish outlook?

How to bet on a basket of TSX energy stocks

Investors can consider adding **iShares S&P/TSX Capped Energy Index ETF** (TSX:XEG) to their portfolios. Just like mutual funds, an ETF is a basket of stocks that can be easily traded on stock exchanges. The XEG ETF (exchange-traded fund) constitutes 22 top energy companies in the country, with which investors can bet on the whole sector. Notably, exposure to an entire sector diminishes a stock-specific risk and will replicate the performance of the sector.

Canadian integrated energy bigwigs **Canadian Natural Resources** (TSX:CNQ)(NYSE:CNQ) and **Suncor Energy** (TSX:SU)(NYSE:SU) are the top constituents in the fund. They form 27% each in XEG.

Thus, one can expect movements in these two top TSX stocks to significantly dominate the oscillations in the ETF. While this may benefit when the two rally, the inverse scenario could notably dampen the portfolio. In other words, it undermines the very purpose of betting on the entire sector.

Luckily, Canadian investors have another ETF to counter this issue. There is another energy-focused ETF called **BMO Equal Weight Oil and Gas Index ETF** (TSX:ZEO). While ZEO holds many of the same TSX energy stocks as XEG, it significantly differs in weighting.

ZEO has an approximately equal weight, whether it's a giant Suncor Energy or a mid-sized pipeline operator **Inter Pipeline**. This fund avoids overexposure to any one TSX energy stock.

Will crude oil peak to $100?

In the last 12 months, ZEO has lost around 40%, while XEG has tumbled around 53%. In the same period, crude oil was even weaker and fell more than 60%.

One significant disadvantage in holding these ETFs is giving up on the upside. If an individual stock doubles in value overnight, the fund could only reflect a marginal gain proportionate to its weight. Another disadvantage is the added costs.

Both these ETFs currently charge an equal management fee and an expense ratio. This should further lower investor returns. While the fees seem marginal, an investor would save this if they intend to bet on an individual stock.

So, what should an investor do? It depends on their outlook. If one wants to take a long-term position betting on the sector, an ETF would be more prudent. The stability and relatively less volatility would be more advantageous as against picking an individual stock over the long term.

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2. TSX:ZEO (BMO Equal Weight Oil & Gas Index ETF)

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Author
vinitkularni20