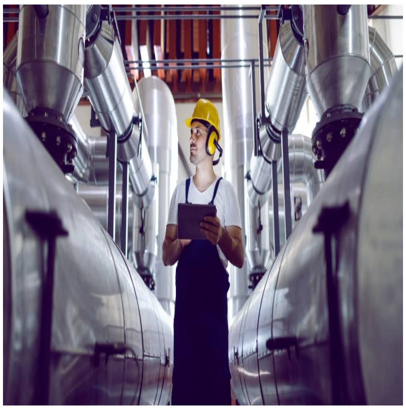

Why Are Oil Stocks Lagging the Price of Oil?

Description

Oil stocks have performed well in 2021, but they've underperformed their underlying commodity. The price of a barrel of West Texas Intermediate crude has surged over 50% year to date. Meanwhile, many of Canada's oil stocks are up just 20-30% over the same period.

If experts are right, and demand for oil continues to surge this year, will oil stocks continue to underperform? Here's a closer look.

Why is oil surging?

The price action of crude often boils down to supply-demand factors. In 2020, much of the economy was locked down suddenly and travel was suspended. Demand for oil evaporated, which is why a barrel of crude was temporarily trading *negative.* This scared off producers, who cut back production and delayed investments in new plants.

In other words, the price action of 2020 caused suppliers to overreact. Now, in 2021, the economy is reopening, and travel is quickly rebounding back to normalcy. In fact, there's pent-up demand for travel and leisure. Demand is sky-high. Meanwhile, suppliers haven't caught up.

Which is why the price of WTI crude surged from $48 to $72 within six months. Some experts now believe the price could cross $100. That's another 39% upside. However, energy stocks have underperformed and could continue to do so.

Stocks underperforming

Suncor Energy (TSX:SU)(NYSE:SU) is up 31.7% year to date. That's better than the rest of the stock market but still not as good as crude oil. That's because people buying the commodity and people buying the stock are betting on different things.

The commodity buyers are betting on near-term demand and trying to protect their businesses from a supply shock. Investors, meanwhile, are betting on long-term profits. It doesn't matter if profits are higher *this year* if it can’t be sustained for the long term.

In other words, it seems stock investors are betting that crude’s surge is temporary. By 2022, households will have depleted excess savings. Meanwhile, suppliers will have ramped up production. The demand gap could be plugged, which means oil prices could normalize.

This is what the market seems to be indicating. But the market could be wrong, in which case a contrarian investor could make tremendous profits. Oil stocks like Suncor could surge much higher in 2022 if crude remains elevated throughout. Energy traders should keep an eye on this trend.

Bottom line

Oil prices are galloping higher and could breach triple digits soon. However, stock investors remain skeptical that this surge will be sustained. The fact that oil stocks have underperformed oil seems to indicate that pent-up demand and supply shortfalls will be resolved soon — perhaps by 2022.

If the market and investors are wrong, oil stocks could outperform in the near term. These energy stocks are still undervalued, based on fundamentals. It’s the perfect opportunity for a contrarian investor with limited downside, because the chances of oil prices collapsing are slim. Good luck!

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