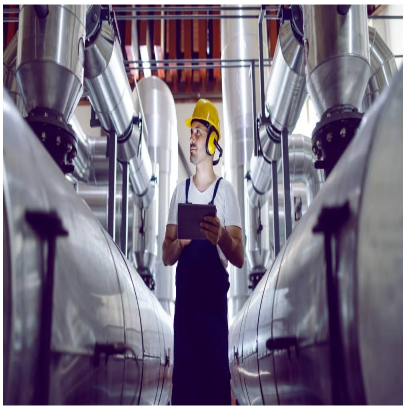

Will TSX Energy Stocks Continue to Outperform Next Year?

Description

The energy sector changed its reputation this year to be one of the treasured sectors from one of the most disliked ones previously. The disdain was evident, mainly among those who had a deep cut in their pockets after a huge fall in 2014 and 2020. However, oil and gas stocks displayed a heroic comeback this year. Canadian energy stocks have returned 80% in the last 12 months. That marks a significant outperformance relative to the **TSX Index's** 25% gain and a 38% gain in the U.S. energy sector.

But will the TSX's outperformance continue? How should investors play the energy markets in the future?

What's next for TSX energy stocks?

The new variant had put brakes on the recovery rally just when things seemed to fall in place after the pandemic. Fears of fresh movement restrictions pulled crude oil prices down from $85 a barrel to $66 a barrel last week. However, energy commodities look to bottom out soon, considering Omicron's less severe than expected impact.

Interestingly, energy demand is forecast to reach its pre-pandemic levels of $100 million barrels per day next year. That's quite a fast recovery compared to once feared amid restrictions. Thus, the demand-supply equation could remain skewed, boosting the oil prices, as supply may remain constrained from the OPEC.

OPEC recently resisted pressure from the top oil-consuming countries to loosen the taps. It aims to increase 400,000 barrels per day every month through next year. JP Morgan Chase claimed that crude oil at $80 a barrel is remarkably cheap. As many other assets are trading close to their all-time highs, oil is nowhere near its historical peak. Importantly, JP Morgan Chase sees crude oil reaching $125 a barrel next year and $150 in 2023.

Higher oil and gas prices could notably boost energy companies' financials next year. Canadian energy companies have doubled their free cash flows after oil and gas prices notably jumped this year. If the trend continues next year as well, energy investors might see continued value unlocking as 2021.

The top way to bet on the energy sector

If you want to play the potential energy rally, consider a relatively safer bet: **iShares S&P/TSX Capped Energy Index ETF** (TSX:XEG). It gives exposure to 14 top energy companies in Canada and replicates the performance of the TSX energy index. It has rallied 75% in the last 12 months. The fund has an expense ratio of 0.61%.

One of the main advantages of investing with ETF is that you don't have to bet on an individual stock. Investors also get a diversified exposure. So, even if one constituent stock underperforms, the overall performance of the ETF likely gets compensated.

XEG has **Suncor Energy** and **Canadian Natural Resources** as its top two constituents. Both collectively form 50% of the fund.

Suncor Energy is the third-biggest energy company in Canada by market cap. Its integrated operations span from oil production and refining to the marketing of petroleum products.

In comparison, Canadian Natural is a $63 billion company with a diversified product portfolio. It produces a balanced mix of natural gas, light and heavy crude oil, and natural gas liquids. Note that XEG ETF has outperformed both these TSX energy stocks in the last 12 months.

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Date
2025/08/14
Date Created
2021/12/07
Author
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