3 Reasons to Avoid Oil Stocks

Description

The impact of the oil price war and global pandemic in 2020 was harsh on oil stocks. Industry players, big and small, were not spared when their share prices suffered significant drops. Overall, the sector was the year's worst performer. Many companies had to slash or stop dividend payments to conserve cash and protect the balance sheet.

Fortunately, things turned around in 2021 with the reopening of borders and lifting of travel restrictions. Energy demand returned, although OPEC plus members forged an agreement to limit production output to prop crude prices and avoid a repeat of the 2020 episode.

Fast forward to 2022, and oil stocks continue to ride high due to the favourable pricing environment. Crude prices already breach the US$100 per barrel, and some industry experts predict further rise to US$130 due to geopolitical tensions. No one knows when the energy bull rally will end.

However, there could be three reasons for investors to avoid oil stocks like **Whitecap Resources** (TSX:WCP). If you want to maintain exposure to the energy sector, **Imperial Oil** (TSX:IMO)(NYSE:IMO) could endure the next energy war.

Oil market crash

First, the ban on Russian oil by the West could cause an oil price shock. Russia exports nearly 4.8 to five million barrels a day — a large volume that is hard to replace. Unless the world finds alternative suppliers, inflation could worsen, and prices could soar even more.

Second, OPEC+ can't antagonize fellow member Russia. The organization needs to be intact to manage the market better in the future. Furthermore, increasing production output will not necessarily curb rising oil prices. Historically, when OPEC increase production in times of volatility and uncertainty, the prices go up instead of falling.

The third reason is exclusive to Canada. According to industry insiders, the country's oil and gas industry can step up to fill the supply gap. Mark Scholz, Canadian Association of Energy Contractors president and chief executive said there could be interested investors to take advantage of high prices.

Scholz added, “There’s no guarantee that we would even be able to supply the market with available rigs, based on the labor situation.” The industry is underequipped to meet the soaring global demand.

Stark contrast

Whitecap Resources (+32.84%) and Imperial Oil (+27.39%) are steady performers, given their year-to-date gains. The share price of the former dropped to as low as $0.96 in March 2020, followed by 50% dividend cut. However, the latter lost 26.98% but didn’t stop or slash its dividends.

The situation could repeat for some industry players if an energy crisis erupts today. Whitecap trades at $9.90 per share and pays a 2.73% dividend. Fortunately, the balance sheet of this $6.09 billion oil and gas company is in excellent condition. In 2021, Whitecap generated $544 million in discretionary funds flow.

Imperial Oil lived up to its Dividend Aristocrat status in 2020 to 2022. The $38.65 billion **Exxon Mobil** subsidiary has extended its dividend-growth streak to 26 consecutive years. Also, its dividend track record is now 140 years. At $57.77 per share, the energy stock pays a decent 2.35%.

Investors’ hope

Income investors hope dividend-paying energy stocks can overcome whatever is coming to the sector. They have enough cash flows to prevent dividend cuts and suspensions, like in 2020.

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Date
2025/08/14
Date Created
2022/03/15
Author
cliew