Oil Futures ETFs vs Energy Stocks – Which Is Better?

Description

If you've been following the markets lately, you've probably noticed that energy stocks are doing better than most. As of this writing, the TSX energy index is up 16% for the year, while the broader TSX is only up about 1%. So we're seeing some serious outperformance from energy stocks. This fact has got a lot of investors chasing after alpha in the energy sector. Some of the people who got in late were burned, as the energy rally has fizzled out this past week. Nevertheless, energy stocks are still up year to date.

If you're still interested in betting on oil prices, you may have some success buying them today. Sure, oil prices are down, but the fundamentals for strong oil prices are still there. And remember: even after falling, prices are still historically high. First-quarter earnings from Canada's oil producers will likely be very strong.

But before you run out and buy energy stocks, you should be aware that there's another option: *oil futures ETFs.* These ETFs bet on oil prices directly, taking some complexity out of the picture. And because they don't invest in businesses, they don't need to worry about disappointing earnings releases, bankruptcies, or anything of that nature. They're worth looking into. In this article I will explore reasons for investing in oil futures ETFs and energy stocks, so you can decide which is right for you.

The case for oil futures ETFs

The case for oil futures ETFs rests on simplicity. With an oil futures ETF, your investment goes up as long as oil goes up. That's pretty much all there is to it. So, if you're confident that oil prices will go up, you can just buy an ETF and hopefully watch it go up over time.

The downside with such funds is fees. When you invest in an oil futures ETF, you have to pay the fund managers a set fee every year. These fees can go as high as 1%. That takes a big bite out of your return. And it has to be paid whether the fund goes up or down. So, that's one con to watch out for.

The case for energy stocks

The case for energy stocks instead of oil futures ETFs is higher potential returns.

An energy stock like **Suncor Energy Inc** (TSX:SU)(NYSE:SU) has much more than just oil prices to boost its returns. Among other things, it can:

- Sell more oil
- Cut costs
- Raise dividends

Any one of these moves can dramatically increase the price of an oil and gas stock. Energy stocks generally do correlate with oil prices, because the price of oil is such a huge determinant of their earnings. But it's not the only one. If an oil company's management takes specific actions to boost profitability, its stock can go up more than the price of oil does.

So, to answer the question of whether oil stocks or energy futures ETFs are better:

It depends on your needs. Futures ETFs are simpler. Energy stocks have more potential upside. Whichever one you invest in, you can achieve results that meet your goals.

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1. Energy Stocks
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