



Should You Follow Warren Buffett and Increase Exposure to the Energy Sector?

Description

During **Berkshire Hathaway's** (NYSE:BRK.A)(NYSE:BRK.B) annual general meeting held over the weekend, Warren Buffett disclosed the company increased its stake in energy giant **Chevron** ([NYSE:CVX](#)). At the end of Q1 of 2022, Chevron accounts for 7.7% of Berkshire's investment portfolio, making it the fourth-largest holding.

At the end of 2021, Berkshire Hathaway held US\$4.5 billion worth of Chevron stock and at the end of March 2022, this figure surged to almost US\$30 billion. Chevron stock also rallied by 30% in Q1 due to higher oil prices.

In the last six months, the equity markets have been impacted by a range of macroeconomic issues that include the possibility of multiple interest rate hikes, overvalued tech stocks, surging inflation numbers, higher commodity prices, supply chain disruptions, and the ongoing war between Russia and Ukraine.

The **S&P 500** is already down 13% year to date, while the tech-heavy **Nasdaq Composite** index re-entered bear market territory last week. Comparatively, the energy sector south of the border has gained 35% in the first four months of 2022.

Companies part of the energy sector have experienced a massive uptick in earnings, as crude oil prices recently touched multi-year highs. Due to a significant increase in cash flows, the energy sector in the U.S. offers investors a forward yield of 4.7% compared to the 1.5% yield of the S&P 500.

In addition to Chevron, the Oracle of Omaha also purchased shares of **Occidental Petroleum** worth US\$7 billion, increasing his total position to US\$10 billion in the company.

Berkshire's top holding remains **Apple** followed by financial heavyweights such as **Bank of America** and **American Express**.

Chevron has a dividend yield of 3.63%

Valued at [a market cap](#) of US\$307 billion, Chevron is one of the largest companies in the world. In Q1 of 2022, Chevron [reported earnings](#) of US\$6.3 billion, or US\$3.22 per share. Its adjusted earnings stood at US\$6.5 billion, or US\$3.36 per share.

It was the third consecutive quarter where Chevron reported a free cash flow of US\$6 billion, allowing it to return US\$4 billion to shareholders and further lower its debt.

Chevron offers investors a forward yield of 3.63%, and the company's robust business model, strong balance sheet and low cost of production have allowed it to raise dividends for 36 consecutive years.

Should you invest in energy stocks?

While Warren Buffett has significantly increased exposure to the energy sector, investors should note that the industry is highly cyclical and capital intensive. For example, **iShares S&P/TSX Capped Energy Index ETF** ([TSX:XEG](#)) has gained 95% in the last year, easily crushing the broader indices. However, in the last 10 years, annual returns are below 1%.

Yes, energy stocks are poised to benefit from higher oil prices. However, in order to offset an inflationary environment, central banks are likely to hike interest rates, which, in turn, will result in higher debt payments and lower profit margins.

Further, if recession fears come true, there is a good chance for crude oil prices to trade lower in the upcoming months. Instead of adding oil producers to your portfolio, I believe it makes sense to look at midstream companies such as **Enbridge** and **TC Energy** that are [relatively immune](#) to fluctuations in commodity prices.

CATEGORY

1. Energy Stocks
2. Investing

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2. NYSE:BRKA (Berkshire Hathaway Inc.)
3. NYSE:CVX (Chevron Corporation)
4. TSX:XEG (iShares S&P/TSX Capped Energy Index ETF)

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