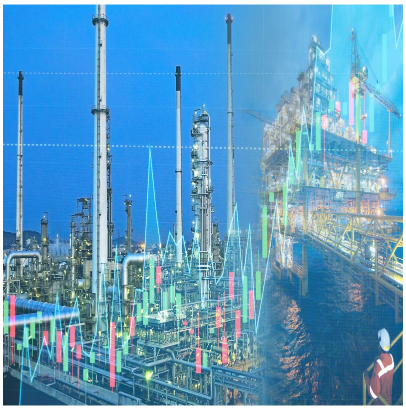

3 Reasons Why TSX Energy Stocks Could Keep Rallying

Description

Oil and gas stocks are still showing unwavering strength, even when the broad market sentiment is not that optimistic. Energy names are sitting on multi-year highs this year, outperforming indices by a wide margin. TSX energy stocks have gained 60% in 2022, while U.S. energy names have returned 47%.

Interestingly, one of the most celebrated investors of our time, Warren Buffett, is aggressively investing in energy stocks of late. While Buffett is famed for his deep value investing, he has been doubling down on oil and gas stocks — this time at their record-high levels.

During the first quarter, his investing conglomerate bought 118 million shares of **Occidental Petroleum** and more than nine million shares of **Chevron**. While some might argue that the Oracle of Omaha is late to the party, the oil and gas rally seems far from over. The global energy market's chronic supply squeeze and recently aggravated geopolitical tensions will likely keep supporting higher oil and gas prices for longer.

Here are some top reasons oil and gas stocks could continue to outperform.

Oil and gas prices to remain elevated

Russia accounts for almost 10% of global oil production. The U.S. and Europe have been discussing an embargo on Russian energy for quite some time now. Given the E.U.'s huge reliance on Russian energy, a full-fledged ban seems hard. However, some part of Russian oil could go away from the global energy equation, ultimately pushing the prices further higher.

Although inflationary pressures and slowing economic growth could dent the oil demand, the global demand-supply equation could remain skewed for the foreseeable period.

According to the Oil Market Report of May 2022 by the International Energy Agency, global crude oil demand is expected to average 99.4 million barrels per day relative to the current supply of 98.1 mb/d.

Financial growth

Higher oil prices will directly positively impact energy producers' earnings. Since the pandemic, this has been the trend, where we have seen massive earnings and margin expansion. Note that Canadian oil and producers doubled or tripled their earnings during Q1 2022, as crude breached the US$135-a-barrel level.

Though oil has fallen from those levels, it has averaged at a much higher rate in the second quarter. So, energy companies will most likely see another quarter of superior financial growth.

Investors can expect much faster deleveraging and even stronger balance sheets at the end of Q2 2022. This should further speed dividend hikes and share buybacks.

For example, **Vermilion Energy** had over $2 billion in net debt at the end of 2020, which has now come down to $1.4 billion. The company has also reinstated its dividends.

Discounted valuation

Despite the rally, TSX energy stocks look immensely undervalued. More and more institutional investors, though late, will come onboard seeking value. According to the *Financial Post*, Eric Nuttall of Ninepoint Partners said that the current macro setup is massively bullish, yet energy stocks remain woefully undervalued.

TSX energy stocks have doubled since last year and are still trading around 10 times earnings on average. Strong earnings-growth potential and discounted valuations will likely drive them higher.

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