Oil Stocks vs. Gold: Which Is Better for a Recession?

Description

Many economists think that we're about to enter a recession. Canada's most recent GDP reading was pretty strong, but the U.S. recorded negative GDP growth earlier this year. If the U.S. records another quarter of negative GDP growth, then it will enter a technical recession.

Although a recession this year is not guaranteed, there are many experts who think we'll enter one by the first half of 2023. So, it would be wise to prepare for one. Experts can get predictions wrong, but in general, it pays to listen to those who study a topic professionally.

This observation leads to one conclusion: you should build some recession protection into your portfolio. There are many assets out there that some people consider recession resistant, including utilities, discount retailers, and gold. Oil is usually *not* considered one of them, but oil stocks are proving to be the best-performing asset class this year. In this article, I will explore the question of whether you should favour oil stocks or gold as protection against a recession.

Gold works better in theory

In theory, gold is a much better recession asset than oil is. People buy gold when times are tough because it is useful for bartering and because it has a +6,000-year history of use as money. Oil is a commodity that is used when there is demand for its productive uses. Theoretically, oil prices should go down in a recession, unless supply is constrained. This year, supply is, in fact, constrained, thanks to supply chain issues and the war in Ukraine. So, oil is defying its general tendency to go down in weak economic conditions.

Oil is working better in 2022

Because of supply chain issues, oil prices are rising dramatically in 2022. At its highest point this year, oil was going for $123, its highest price in nearly a decade. Although the economy is slowing down, oil supply is being constrained enough that the price is rising anyway.

We can see proof of this by looking at **Cenovus Energy's** (TSX:CVE)(NYSE:CVE) most recent earnings release. In the first quarter, Cenovus delivered the following:

- $1.365 billion in cash from operations, up 499%
- $2.56 billion in adjusted funds low, up 126%
- $1.8 billion in free funds flow, up 209%
- $1.6 billion in net income, up 639%
- $8.4 billion in net debt, down 37%

Virtually every metric improved dramatically. Not only did all cash flow and earnings metrics improve, but debt was reduced, too! It was a solid showing from CVE, which tripled its dividend shortly after the results came out.

Foolish takeaway

Having looked at the different use cases for oil and gold, we can now answer the question of which is the better recession play.

The answer is that it depends on the severity of the recession.

In a true "collapse" scenario, where institutions break down and electricity becomes unavailable, gold is more useful than oil, because you can barter with it. It can be thought of as a kind of disaster insurance. However, you're more likely to get positive long-term returns with oil than with gold, because it has a more meaningful productive use case.

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