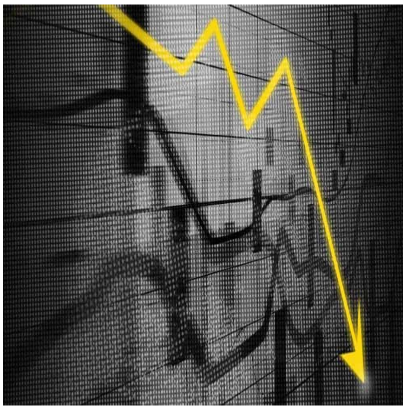

Why Did Oil Stocks Crash so Suddenly?

Description

Energy stock prices collapsed rapidly this month, falling 25% from June 8 to June 23 (as measured by the S&P/TSX Capped Energy Index). It was the first truly major dip this year in an otherwise uninterrupted rise for oil stocks. This year, a combination of global conflict and supply chain issues has sent oil prices into the stratosphere. For the most part, energy stocks have rallied right alongside the commodity their business is based on.

Now, however, the trend seems to be reversing. Oil stocks are down significantly for the month of June, and many people are worried that they will go lower. They could. However, the energy sector is still relatively attractive from a valuation perspective.

Oil prices fell

The most obvious cause of energy stocks falling this month was oil prices. Oil prices fell in June, possibly due to a combination of higher interest rates and the U.S. strategic petroleum reserve release. High interest rates are bad for oil prices, because they tend to reduce demand. Likewise, the SPR release increases supply. Taken together, the two factors create a recipe for lower oil prices.

With that being said, there is little to suggest that oil prices will remain weak all year. The SPR release is a temporary measure, not a permanent one. The interest rate hikes are slated to continue into next year, but who knows if the Fed will go according to its plan? Central banks are institutions run by human beings that can change their minds. If the Fed sees evidence that inflation is easing off, it may stop raising rates earlier than expected. That could give oil the go-ahead to start rising again.

You've also got to keep in mind that oil stocks remain cheap, even if you assume that oil prices will go down from here. Many oil stocks trade at very low multiples, and are likely to surpass analyst estimates even with oil at, say, $100.

Take **Cenovus Energy** (TSX:CVE)(NYSE:CVE) for example. It's a Canadian oil company that grew its operating cash flows by 500% in its most recent quarter. Revenue and earnings grew as well. On the strength of its results, CVE tripled its dividend. Sounds like a true growth stock that should command a premium price tag, right?

The markets don't seem to think so. At today's prices, CVE trades at

- 1.15 times sales;
- 2.5 times book value; and
- 8.5 times operating cash flow.

It's a very cheap stock. Even if oil prices were to drop slightly, the company's earnings would likely be satisfactory. So, there are real reasons for optimism here.

Foolish takeaway

As we've seen, oil prices took a bit of a hit last month. But for enterprising investors, that's just an opportunity to buy. Energy stocks are cheap, and they have great potential to beat earnings estimates when they report for Q2. If you're willing to handle a little volatility, now could be a good time to back up the truck.

CATEGORY

1. Energy Stocks
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