Time to Take Profits in TSX Energy Stocks?

Description

TSX energy stocks have been in a world of pain over the past few weeks, with WTI (West Texas Intermediate) nosediving below US$100 per barrel on Tuesday. Indeed, the oil slump may be viewed as a buying opportunity by some. Many TSX energy stocks are still quite discounted relative to the magnitude of cash flows that will continue to flow in over coming quarters. Still, oil is a wildly volatile asset.

While it's not quite as volatile as cryptocurrencies, exogenous factors tend to propel oil stocks sharply and without notice. Though it's tough to gauge where oil will head next, I think that recession fears will ultimately act as a major overhang on the price of oil and other commodities. Further, oil is still up considerably from 2020. Indeed, the higher an asset rises, the more room it has to fall as momentum reverses course. We saw that with speculative growth stocks in the run-up in 2021. And in mid-2022, we're starting to see a reversal of fortune for energy plays.

Though Russian sanctions are unlikely to go anywhere anytime soon, a huge drop in demand could weigh heavily on energy stocks across the board. When it comes to commodities, I'd much rather be a buyer on strength than on weakness, especially after a magnificent rally to historic highs.

Could an oil collapse be on the horizon? Citi seems to think so

As we inch closer to a recession, I find it harder to believe that oil can stay above the US$100 per barrel mark. Recently, **Citigroup** noted that oil could be in for a massive collapse to US$65 per barrel, with a US$45 per barrel possible by the end of 2023. Now, that's a sizeable decline. Although many TSX energy stocks have baked in a potential pullback, such a severe decline could take a lot of steam out of the hot energy plays today, sending them back to lows we haven't seen since mid- to late 2020.

If a recession proves more severe, I wouldn't rule out sub-US$45 oil in 2023. While many Canadian energy firms are well positioned to deal with US$50-65 oil, things will get very challenging at below US$50 for certain energy giants.

So, if you made a quick buck off energy stocks, it seems wise to take some profits off the table before the energy collapse worsens in the face of an economic slowdown. Sure, Warren Buffett is a raging bull on energy stocks, with aggressive buying in the first half. However, even the Oracle of Omaha can be wrong some of the time.

Where to take profits in hot TSX energy stocks

Canadian Natural Resources (TSX:CNQ)(NYSE:CNQ) strikes me as a TSX energy stock that could have considerable downside, as the tides go out on the oil patch. The stock looks very cheap at 8.4 times trailing earnings after a 7% plunge in Tuesday's session. Still, the stock isn't as cheap as it seems, assuming oil plunges to US$45 per barrel by the end of 2023, as Citi projects.

Could CNQ stock be a value trap? Perhaps. In any case, the 4.48% dividend yield may not be enough to compensate for the downside risks that could accompany a steep oil price implosion that could be to come.

Not to take away from CNQ's managers. They're doing a fine job of optimizing operations. But at the end of the day, it's all about where oil is headed. That alone makes it tough to recommend energy plays here, even after the latest pullback into bear market territory.

Personally, I think CNQ stock could touch $45 per share by year-end, especially if further signs of a recession materialize.

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Date
2025/08/18
Date Created
2022/07/06
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