Has the Time Come to Sell Energy Stocks?

Description

Energy stocks have begun to fade in a major way after outperforming most other sectors in the first half of 2022. Indeed, energy was one of the major pillars that stood up, as the broader stock markets fell into correction territory (or a bear market in the United States).

With your average TSX energy stock down more than 20% from its highs on the back of a sharp retreat in oil prices, many may be wondering if the recent dip is a chance to buy before another leg up or if this is the start of a sustained move to much lower levels.

With a recession likely on the way in 2023, energy demand could slump considerably. Oil has been fluctuating wildly in the past week, bottoming at around US$95 per barrel before eclipsing the US$100 mark again. Though it’s really hard to gauge where energy is headed next, given the next economic slowdown could prove mild, I’d argue that a continued reversion to the mean is the likeliest scenario for oil, gas, and other falling commodities.

Energy stocks could be at risk of further downside going into year’s end

Though it’s hard to gauge where oil will settle, I’d argue that top TSX energy stocks are at risk of surrendering even more of their past-year gains over the coming weeks and months, as investors come to terms with the recession to come.

Undoubtedly, no equities are 100% safe from downside, especially commodity producers, which can slump as quick as they rise. If you made a gain in energy stocks, it’s only prudent to take at least some profit off the table before oil has a chance to revert to mean levels (around US$60-70 per barrel). Such a plunge could prove detrimental to the producers most sensitive to oil price fluctuations.

In this piece, we'll check out one top energy play I'd trim before oil's slump worsens. Consider **Cenovus Energy** (TSX:CVE)(NYSE:CVE), one of the hottest TSX energy stocks since the 2020 market crash bottom.

Cenovus Energy: A top performer to take profits in?

Cenovus Energy is such a great energy company that it pains me to trim at these levels. Management has really improved upon its operations in recent years. With intriguing extraction innovations that could lead to improving economics, the long-term trend is on Cenovus's side.

Still, Cenovus is highly sensitive to the price of oil. A slide to US$60 per barrel of oil could cause shares of CVE to surrender a huge chunk of the gains enjoyed in its epic rally. Now, I have no idea if oil's recent slip is the beginning of a move to such levels. However, the risk/reward scenario isn't nearly as good as it was a few months ago.

Even after a 25% drop, CVE stock is still up 44% year to date and more than 109% over the past year. That's considerable momentum that's looked to have reversed in recent weeks.

The 24.4 times trailing earnings multiple is also quite rich relative to Cenovus's peers. A premium seems warranted — but just how much of a premium remains the million-dollar question.

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