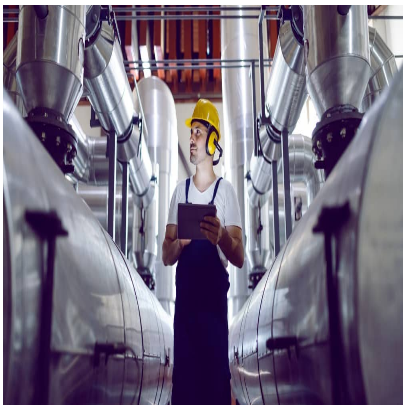

Are Canadian Energy Stocks Now Oversold?

Description

Investors who missed the monster rally in energy stocks off the 2020 lows are wondering if the pullback in recent weeks has driven oil and gas stocks down to the point where they are now undervalued and good to buy.

Oil outlook

WTI oil trades for US$96 per barrel at the time of writing. That's off the 2022 highs above US$120, but it is still a very profitable level for oil producers. Global oil traders were due to take some profits after the spike following the start of the war in Ukraine. Recession fears have added to the negative sentiment, as investors try to figure out if demand growth will slow down. At the same time, new lockdowns in China could reduce the recovery in fuel demand in that country.

These are important points to consider, but analysts and oil executives say that rising demand and tight supplies are expected to remain in place for some time, regardless of anticipated economic slump or extended Chinese COVID-19 restrictions.

Oil companies slashed investment by hundreds of billions of dollars over the past two years. The result is lower supply than normal coming online to meet the sharp rebound in demand that has quickly wiped out excess stockpiles.

Air travel is expected to increase in the coming months as airlines and airports work through their current staffing and processing challenges. Jet fuel demand will soar as a result. At the same time, corporations are slowly calling workers back to the office. This will see a wave of commuters hitting highways again in the fall once kids are back in school. Many people who previously took public transportation will drive to work for the two or three days they need to be in the office. Covid fears persist, and nobody wants to go back to being jammed like a sardine on stuffy buses, street cars, and subways. In fact, traffic could become much heavier in the next two years than it was before the pandemic and stay that way.

All this points to higher oil demand with limited new supply hitting the market until investment increases. For the moment, oil companies are under pressure to meet emissions targets. Unless they get some reprieve from the government, they will be content to simply spend enough to maintain output and reap the high profits from elevated oil prices. Oil at US$100 per barrel could become the new normal.

Are oil stocks oversold?

Oil producers are generating strong margins and profits at current oil prices. They are using the excess cash top reduce debt, buy back stock, and boost payouts to investors. These efforts should all support higher share prices.

Valuations already appeared cheap, even before the pullback. The correction in oil stocks now makes many of the top players attractive for income portfolios or for retirement funds focused on total returns. **Suncor** (TSX:SU)(NYSE:SU) , for example, trades for less than $40 per share at the time of writing and offers a 4.75% dividend yield. This was a $44 stock before the pandemic when oil was US$60 per barrel.

Ongoing volatility should be expected, but investors who have a bullish view on oil prices in the coming two or three years might want to start nibbling on Suncor and its peers at their current levels.

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