Oil vs. Banks: Which Value Stocks Are Better?

Description

Oil stocks and bank stocks are among the most popular value stocks in Canada. Two banks, **TD Bank** (TSX:TD)(NYSE:TD) and **Royal Bank**, occupy the two spot spots among Canada's largest public companies. Oil stocks, including **Suncor Energy** (TSX:SU)(NYSE:SU), round out much of the rest of the top 10.

Interestingly, oil stocks and bank stocks are both squarely in the "value" category. Value stocks are those stocks that are considered cheap. A common sign of a value stock is a low price-to-earnings (P/E) ratio — a ratio of stock price to company profit. Both oil stocks and bank stocks have P/E ratios below 10, suggesting that they are deep-value names.

Many Canadian value investors choose to invest in both oil stocks and bank stocks. In general, they have done well. Oil stocks are among the few investments rising in value this year, while bank stocks have done well over the last two years. Either sector is worth investing in. But if you wish to invest in just one, read on, because I am going to spend the next few paragraphs exploring the pros and cons of each.

The case for oil

One positive thing about oil stocks is that they can sometimes deliver truly spectacular returns. From its lowest point in 2021 to its peak this year, Suncor Energy rallied 250%. If you'd invested $10,000 in it at its lowest levels and sold at the highest, your position would be worth $35,000. That's a very good result.

You don't commonly see returns like that from banks. TD Bank had a great year in 2021, but it only rose some 35%. Banks are generally slow and steady gainers, even in good times. Their earnings come mainly from lending, which is an activity that usually grows with the economy. There is no commodity whose price can soar overnight and give windfall profits to banks. That is precisely what can happen to oil stocks when oil prices rise.

The downside is that when oil prices go down, the very opposite happens to oil stocks: they crash.

Companies like Suncor earn their revenue by selling oil and gasoline. When the prices of those goods crash, so do Suncor's profits. So, oil stocks can be very risky.

The case for banks

The case for bank stocks is that they are generally pretty stable and dependable.

Banks like TD tend to grow their sales slowly and steadily as the economy grows. For loans to grow, you need more people borrowing, and increased borrowing comes with higher demand. For this reason, GDP growth — growth in the value of goods/services in the economy — puts an upper limit on bank revenue growth. That sounds like a negative, but it means that banks tend to give a smoother and less "scary" experience than oil stocks do. It might seem odd to hear that just 14 years after the 2008 financial crisis, but remember that that crisis was a once-in-a-century event. There has been no such banking crisis since that time.

Foolish takeaway

Oil stocks and bank stocks have a lot in common, including high dividend yields, cheap valuations, and much more. All in all, you could do well owning both. If you're more risk tolerant, oil stocks might give you a bit more of the "roller coaster"-style experience you seek. If you're more defensive, banks will generally be easier on your nerves.

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3. TSX:SU (Suncor Energy Inc.)
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