Why I Prefer Banks to Oil Stocks for 2022’s 2nd Half

Description

In the second half of 2022, the rally in energy stocks is beginning to fade. The price of oil recently dropped below US$90 per barrel, marking a 28.4% decline from the all-time high. In the first half of this year, oil was one of the few sectors giving investors positive returns, but it’s rapidly giving them back.

Personally, I still think oil stocks are undervalued. The price of oil has fallen, but oil companies are likely to deliver strong earnings, even with oil as low as $80. **Suncor Energy** reportedly has a $45 breakeven price, so it will be very profitable at any oil price we’re likely to see this year.

With that said, I’m favouring banks to oil stocks for the second half of the year. Banks are already massively out of favour; oil stocks are only just now coming back down to Earth. I sold all of my Suncor Energy stock a few months ago and increased my exposure to banks shortly afterward. Here’s why.

Oil is volatile and hard to predict

As I’ve written in past articles about oil, there are good reasons to think that the entire year of 2022 will see high oil prices. Sure, we’re going through an economic contraction, but there are still supply-side forces keeping prices high. The war in Ukraine is still ongoing, OPEC is barely raising output, and the U.S. emergency release of oil from its strategic reserve (SPR) will end eventually. Taking all of these factors together, it appears likely that oil could rebound again in the fourth quarter, after the U.S. stops releasing oil from the SPR.

With that said, oil prices are extremely volatile and hard to predict. There are no “underlying cash flows” beneath oil prices that can be used to determine their fair value. You pretty much have to go off pure supply and demand — factors that are usually influenced by politics. For example, Russia’s decision to invade Ukraine this year influenced the spike in oil prices that subsequently occurred. If you’re not politically connected, you won’t be able to predict such events, which means that betting on oil prices is a guessing game.

Compared to oil, banking is relatively predictable. Banks like **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD) tend to make more money when the economy grows, and less when it contracts. During periods of economic growth, people borrow more money, leading to more interest income for banks. The reverse is also true.

Banks can also earn higher interest income from interest rate hikes, like the ones the Bank of Canada is doing now. When central banks raise interest rates, banks raise the interest they charge to customers. If interest rates go up on short- and long-term loans simultaneously, banks earn higher profit margins. So, banks like TD are ideally suited to grow in today's economic conditions.

Banking is out of favour

A second reason I like banking for the second half is that it's already out of favour. Bank stocks rallied in 2021 on their recovery from the COVID-19 pandemic but gave up some of their gains this year, as the economic downturn took a bite out of their earnings. Today, bank stocks are already beaten down, oil stocks are only starting to take a hit. So, banks have a more obvious reason to rise than oil stocks do in the months ahead.

CATEGORY

1. Bank Stocks
2. Investing

TICKERS GLOBAL

1. NYSE:TD (The Toronto-Dominion Bank)
2. TSX:TD (The Toronto-Dominion Bank)

PARTNER-FEEDS

1. Business Insider
2. Koyfin
3. Msn
4. Newscred
5. Quote Media
6. Sharewise
7. Smart News
8. Yahoo CA

PP NOTIFY USER

1. andrewbutton
2. kduncombe

Category

1. Bank Stocks
2. Investing

Date
2025/09/08
Date Created

2022/08/10
Author
andrewbutton