



Warren Buffett Is Going All-In on Oil: Should You?

Description

Warren Buffett is going all-in on oil stocks.

So far this year, he has bought over 20% of **Occidental Petroleum** and has also acquired a large stake in **Chevron**. Buffett has purchased many things this year, but oil would have to be the number one sector he's piling into. The question is: should you follow Buffett into oil stocks, or are you late to the party?

The value investing philosophy

To understand why [Warren Buffett](#) is buying oil stocks this year, you have to know about the investing philosophy he adheres to: value investing.

Value investing means buying stocks when they're cheap. I don't mean cheap as in "a low price in dollars" but cheap compared to the underlying business. If a stock costs \$100,000 and the business beneath it earns \$50,000 per year, it's cheap. If it costs \$0.02 and the underlying business earns \$0.00000002 (with no growth), it's expensive. It's this ratio of stock price to underlying business performance that Buffett is getting at.

Why would a value investor like oil stocks?

Well, we can use **Suncor Energy** ([TSX:SU](#))([NYSE:SU](#)) stock as a case study. In its [most recent quarter](#), Suncor grew its revenue by 76% and its earnings by 360%. That seems like the kind of high-growth stock that would be insanely expensive, right?

Think again!

Despite all of its phenomenal growth, Suncor Energy is *STILL* dirt cheap, trading at just 6.8 times earnings, 1.2 times sales, and 1.46 times book value ("book value" means the value of a company's assets after you subtract debt). In other words, Suncor's stock price is barely more than the value of what the company owns. Suncor's stock price is only 46% higher than the company's net worth, and

the company delivers enough earnings to buy back all of its own shares in 6.8 years. Sure, oil stocks have rallied this year, but they're still cheap viewed in terms of these ratios.

Is it too late?

Having looked at why Buffett likes oil stocks, we have to ask: is it too late to buy?

If you believe in following Buffett, then the answer is "no." Oil stocks are currently down from their highest prices this year, and Buffett has been buying non-stop all year long. It follows from this that you can buy oil stocks today at prices that Buffett finds cheap.

Does that mean you should?

Not necessarily. Warren Buffett is well known for his willingness to wait extremely long periods of time for investments to pay off. If you aren't extraordinarily patient, you may not enjoy oil stocks as much as he does. I've traded Suncor Energy stock twice this year, both times realizing 10% gains. I made a profit. However, I found all of the oil price volatility, the politics, and all the other such baggage that oil stocks come with too much to handle. I have no plans to get into oil stocks again apart from a few hundred dollars I have invested in Occidental Petroleum.

The point is, Buffett liking oil stocks doesn't mean you won't have a stressful time holding them. Oil is extremely volatile in the best of times. If you don't have a strong stomach, you may be better off looking elsewhere.

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Date

2025/08/17

Date Created

2022/08/18

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