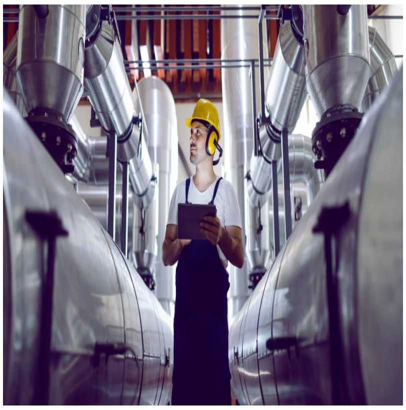

Should You Drop Energy Stocks Before the Recession Kicks in?

Description

Energy stocks have carried the Canadian stock market since 2021, and their strength continues in 2022. The sector's year-to-date gain of 45.89% is higher than its 41.8% overall return last year. Still, some industry experts are wary of a potential plunge of global crude oil prices due to weakening demand.

If the economic situation worsens and tilts towards a recession, it could adversely impact many oil players. Angelo Kourkafas, an investment strategist at Edward Jones, said, "The energy sector is not a sector that investors really want to own in later parts of the economic cycle, especially with heightened risks of a recession." Hence, would it be wise to drop energy stocks before a recession kicks in?

Production cuts

The Organization of Petroleum Exporting Countries (OPEC) and its allies are taking steps to avoid an internal crisis, particularly a significant dip in prices. OPEC+ has announced a reduction in production output by 100,000 barrels per day next month. The cartel knows that excess supply and declining oil demand could trigger a massive price drop.

With more interest rate hikes coming, and if oil demand in China shrinks substantially, expect the bearish sentiment in the market to persist. However, don't expect large-cap Canadian stocks to wilt under the grim scenario. **Suncor Energy** (TSX:SU)(NYSE:SU) and **Cenovus Energy** (TSX:CVE)(NYSE:CVE) have record cash flows in 2022. A capital discipline approach should help both weather the storm.

Overflowing cash hoard

Suncor Energy remains one of the most active and heavily traded stocks on the **TSX**. At $42.11 per share, current investors are ahead 37.23% year-to-date. In Q2 2022, the oil bellwether's net earnings ballooned 360.4% to $3.996 billion versus the same quarter in 2021. Cash flow provided by operating activities increased 103% year-over-year to a mind-blowing $4.235 billion.

Management expects to achieve an additional $400 million of incremental free funds flow by year-end 2022 through the implementation of digital, process, and technology initiatives.

Suncor will also focus on its core business when the sale of its exploration and production assets in Norway plus its wind and solar assets are complete. The $57.33 billion integrated energy company is also open to sell its retail business (Petro-Canada gas stations).

Suncor's dividend yield is now an attractive 4.46%, following the 12% dividend increase in Q1 2022. Management commits to allocating 75% of excess funds to shareholder returns in the second half of 2022 once net debt reduces to $12 billion.

Like Suncor, Cenovus has a considerable cash hoard. Cash flow from operating activities in Q2 2022 climbed 118% to $2.97 billion versus Q2 2021. Net earnings increased 50% year-over-year to $2.43 billion. This energy stock outperforms year-to-date (+58.1%), although the dividend yield is a modest 1.74%.

Cenovus is one of the leading integrated players in the energy sector, and a top oil sands producer in Canada. With refining capabilities, the company also captures significant value in the end-to-end distribution of fuel to consumers.

Its President and CEO, Alex Pourbaix, said the $47 billion oil and natural gas producer is well-positioned for even better performance in the second half of 2022.

Bank machines

Rafi Tahmazian, a senior portfolio manager at Canoe Financial, likens Suncor and Cenovus to a broken bank machine that spits out $100 bills. He adds that investors should benefit from higher dividends and share buybacks because the businesses are very profitable.

CATEGORY

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2. Energy Stocks
3. Investing

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