Why Imperial Oil Stock Rose Almost 15% Last Month

Description

Oil stocks have been making investors rich for the last two years. Integrated oil and gas company **Imperial Oil** (TSX:IMO) benefitted from the energy crisis and soaring oil prices. Its stock surged 180% in the last two years. There were concerns that oil stocks reached their cyclical peak in November 2022, and Imperial Oil stock fell 20% in December 2022. But the stock once again turned positive, surging almost 15% in January. What caused this rally? Does the stock have more growth coming this year?

The cyclical nature of oil stocks

Oil is a commodity whose price is determined by global demand and supply. Geopolitical events have played an important role in influencing oil prices as only a few nations have large oil reserves. Last year marked the beginning of the global energy crisis as the reopening of the economy and return of air travel demand boosted oil demand. But the Russia-Ukraine war disrupted the global supply chain as Western countries banned oil and gas imports from Russia. This imbalance in demand and supply sent oil prices as high as US$125/barrel.

Oil companies cannot control oil prices. Instead, they focus on reducing production costs to improve their profits. Imperial Oil used the windfall gains from the global energy crisis to decrease its long-term debt by $1 billion and buy back almost $6.4 billion worth of shares in 2022. This will help the oil giant reduce its fixed costs from interest on the debt. Now for the question of the January stock price rally.

Why did Imperial Oil stock surge 15% in January?

In December 2022, there were concerns that there would be no more upside to oil stocks as interest rate hikes would curb demand to reduce inflation. The fear of a recession sent oil stocks into a bear phase. But 2023 started on an optimistic note as China's economy reopened after COVID lockdowns. China is one of the largest importers of oil and influences oil prices.

Another positive momentum came after the United States released its December inflation figures, which fell to 6.5% from 7.1% in November 2022. An easing in inflation means slower interest rate hikes, which means the economic situation is not as bad as the market anticipated. If the economy is doing better, the oil demand won't drop.

The reopening of China and the strength in the US economy drove oil prices up 10.6% in January. Other oil stocks like **Suncor Energy** and **Cenovus Energy** surged 11.87% and 6.5%, respectively. Imperial Oil outperformed its peers as it reported robust earnings on January 31. Its fourth-quarter profit surged 112% year over year. The company increased its dividend by 29% to $0.44 in early January as it transferred the benefit of windfall gains from high oil prices to shareholders.

Does Imperial Oil stock have more growth coming this year?

Oil markets are volatile even in 2023. Oil companies did not increase their production capacity despite high demand as the energy sector transitions towards renewable energy. Many economists expect oil prices to hover between US$70–US$110 this year. Three factors could influence oil prices, China's economy, the Fed interest rate hike, and the Organization of the Petroleum Exporting Countries (OPEC).

Cyclical stocks like Imperial Oil are not a buy during a rally. You may hold the stock for its dividend yield of 2.45%, but other oil stocks offer a better dividend yield.

If you purchased Imperial Oil stock in 2020 for less than $25/share, now is a good time to sell it and book a 200% capital gain. Instead, you can buy renewable energy stocks like **TransAlta Renewables** while they trade closer to their pandemic lows. They could give you similar growth as oil stocks in the coming two to three years as global economies revive their green initiatives.

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