Top Canadian Energy ETFs of 2023

Description

One of the best-performing TSX market sectors in 2022 was energy. As commodities prices rose due to runaway inflation, energy stocks delivered high returns, outperforming other sectors and the broad market. Investors who over-weighted energy stocks in their portfolios were able to reap these benefits.

However, buying individual energy stocks can be time-consuming. With this approach, investors have to spend time on research, rebalancing their portfolio, and keeping up with earnings reports and corporate events.

A more hands-off, diversified approach using exchange-traded funds (ETFs) that track TSX energy stocks might be a good alternative.

What is an energy ETF?

An energy ETF is a fund that tracks a basket of energy sector stocks. Within the Canadian stock market, this includes companies involved in the production, processing, and sale of energy products and services. Examples include oil, natural gas, and renewable energy companies.

Like energy stocks, energy ETFs can be bought and sold daily with great liquidity on most stock exchanges intra-day. They can also be held in all types of investment accounts, including tax-free savings accounts (TFSA) and registered retirement savings plans (RRSP).

Energy sector ETFs can come in both passive and active forms. The differences are:

- **Passive**: Track an externally provided energy stock index and must follow its rules.
- **Active**: The fund manager picks and chooses energy stocks based on their own investment criteria.

Energy sector ETFs can also be constructed using two approaches: market capitalization weighted versus equally weighted.

- **Market-cap weighted**: Large-cap energy sector stocks are held in greater proportions compared to mid– and small-cap energy sector stocks.
- **Equally weighted**: All energy sector stocks are held in identical proportions regardless of their market capitalization.

Like all ETFs, energy ETFs will charge a management expense ratio (MER). This is the percentage fee deducted annually from your investment for their services. For example, an energy ETF with a MER of 0.25% would incur around $25 in annual fees for a $10,000 investment.

Another benefit of energy ETFs are dividends. Because many Canadian energy stocks are dividend payers, an energy ETF that holds them will also pay dividends. Compared to individual energy stocks that payout quarterly, energy ETFs often pay out dividends monthly. This can be desirable for investors seeking more consistent income.

Top energy ETFs in Canada

The following Canadian energy ETFs have a combination of low fees, broad diversification, and high assets under management.

Energy ETF	Inception Date	MER
iShares S&P/TSX Capped Energy Index ETF (TSX:XEG)	2001-Mar-19	0.60%
BMO Equal Weight Oil & Gas Index ETF (TSX:ZEO)	2009-Oct-20	0.55%
Horizons S&P/TSX Capped Energy Index ETF (TSX:HXE)	2013-Sept-16	0.27%

iShares S&P/TSX Capped Energy Index ETF

XEG provides market-cap weighted exposure to 28 Canadian energy stocks by passively tracking the S&P/TSX Capped Energy Index. About 46% of the ETF is concentrated in its top two holdings: Canadian Natural Resources (TSX:CNQ) and Suncor Energy (TSX:SU).

BMO Equal Weight Oil & Gas Index ETF

ZEO provides equal-weighted exposure to 11 large-cap Canadian energy stocks by passively tracking the Solactive Equal Weight Canada Oil & Gas Index. Each stock is afforded around 9–11% exposure, ensuring a more balanced portfolio.

Horizons S&P/TSX Capped Energy Index ETF

HXE provides market-cap weighted exposure to Canadian energy stocks by passively tracking the S&P/TSX Capped Energy Index (Total Return). The ETF pays no dividends as those are reinvested automatically due to its corporate class structure and total return swaps.

Pros of investing in energy ETFs

Energy ETFs can be an excellent addition to an investment portfolio due to the following reasons:

- **Diversification**: The energy sector is counter-cyclical and can provide diversification benefits if held with popular indexes like the S&P 500.
- **Hedging**: Historically, energy has outperformed during times of increasing inflation due to soaring commodity prices.
- **Liquidity**: Energy sector ETFs are high in liquidity, meaning they're very easy to buy and sell. They benefit from low bid-ask spreads and high daily trading volumes.
- **Simplicity**: Managing a single energy ETF is easier than buying a portfolio of many individual energy stocks and rebalancing them.
- **Dividends**: Energy ETFs often have a high yield thanks to the dividend-paying nature of their underlying holdings.

Cons of investing in energy ETFs

However, energy ETFs might not be a suitable holding for all investors. Reasons for this include:

- **Volatility**: Energy stocks can be volatile and susceptible to fluctuations in commodity prices. Investors who buy an energy ETF must be able to cope with potentially high unrealized losses.
- **Fees**: Energy ETFs often charge a significantly higher MER than regular index ETFs do. Index ETFs can go as low as 0.04% in Canada, whereas the lowest-cost energy ETF charges 0.27%.
- **Poor performance**: There have been prolonged periods where energy stocks have underperformed other sectors and the broad market. Investors who buy energy ETFs must be able to cope with extended underperformance without panic selling.
- **ESG considerations**: Investors who value environmental, social, and governance (ESG) factors may not like energy sector ETFs that hold companies with potentially incongruent practices.

Are energy ETFs right for you?

Whether energy ETFs are a good investment for you depends on your time horizon, investment objectives, and risk tolerance. In general, an allocation to energy ETFs is best suited for long-term, intermediate-level investors who understand the sector well and envision bullish long-term prospects for it.

If your goal is to hedge against unexpected inflation or bet on increasing commodity prices, then an energy ETF might be a good way to overweight energy stocks in your portfolio stock-picking. Keep in mind that this can create additional volatility and increase your expenses.

Canadian investors should also keep in mind that most TSX index ETFs already hold a significant allocation from the energy sector. For instance, the S&P/TSX 60 Index is comprised of 19.2% energy stocks. Investors should be aware of this and not excessively overweight energy ETFs.

TICKERS GLOBAL

1. TSX:CNQ (Canadian Natural Resources Limited)
2. TSX:HXE (Horizons S&p/tsx Capped Energy Index ETF)
3. TSX:SU (Suncor Energy Inc.)
4. TSX:XEG (iShares S&P/TSX Capped Energy Index ETF)
5. TSX:ZEO (BMO Equal Weight Oil & Gas Index ETF)

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