



Energy Sector: Powerhouse or Mirage

Energy has been vital for the production of goods, particularly since the industrial revolution. Such resources obviously have value as they are ultimately a creator of wealth. The energy sector within the stock market has ranged in importance from over 20% of the market capitalization during the 1970s to 13% in 1990 to 6.5% by 2000 back to 14% by the end of 2008 and down all the way to 2.5% today. Energy stocks are up over 34% year-to-date but, during the 10-year period 12/31/2010 through 12/31/2020, the sector declined almost 24%.

There are competing views for the future of energy. Some will say as the world decarbonizes moving toward energy provided from renewable sources, demand will decline, leaving the sector as a runt compared to the rest of the economy. Right now investment by large fund managers is avoiding the sector due to ESG (environmental, social, governance) mandates to avoid this sector's "dirty" or polluting byproduct. Lack of demand by investors makes a difficult case for these stocks.

On the other hand, there is a view that if investment is restricted in a sector, such as less liquidity provided by institutions adhering to ESG principles, then you have less production of that product. Couple that with additional restrictions on production as seen by the current administration canceling pipeline and drilling permits, and you create a world with less supply that creates higher prices and profits for surviving energy producers.

Further complicating issues are some energy companies, particularly European ones that have invested heavily in renewables while cutting budgets for conventional oil production. Some ESG scorecards rank these European producers high; therefore, they are more likely to receive investment from capital markets.

The safest path under current conditions is to maintain an investment position more in-line with the current market capitalization of the industry. In a world where Chevron has an ESG score, on some score cards, equal to Facebook, it is difficult to say how market forces will affect stock values in these changing times.

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