

Look at the Relative Valuations Before Buying Energy Stocks



Oil prices have dropped by about 40% over the past six months. Not surprisingly, the decline has led to weakness in oil-related stocks. This weakness intensified last week when shares of many energy companies were assigned Black Friday discounts.

Following the big drop, there have been some calls for investors to start buying these stocks. These calls are based on the assumption that oil prices will rebound in the months to come. Having started my finance career in Houston analyzing energy-related companies, I fully realize the potential profits that can be made from taking a contrarian stance. Being greedy when others are fearful does work in the energy sector. (It also works well in all other sectors too). The challenge is knowing when a discount is a true bargain. A very big secondary challenge is ensuring the longer-term reward is large enough to justify the short-term opportunity cost of a continued drop in the stock price and/or a period of underperformance.

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