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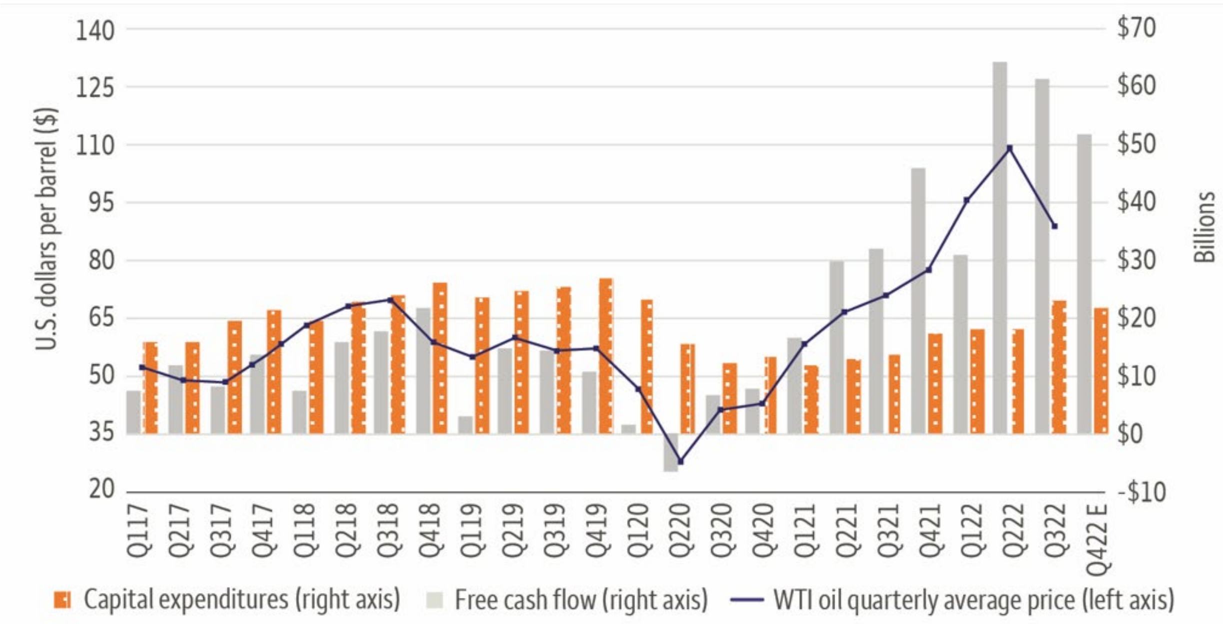
Investment Institute

Chart of the Week

Weekly market analysis on key market indexes | December 20, 2022

Our Energy sector outlook — Revved and ready for 2023



Sources: U.S. Energy Information Administration (EIA), FactSet, Wells Fargo Advisors. Quarterly data: first quarter 2017 through fourth quarter 2022. Data as of November 15, 2022. "E" indicates estimated figures according to FactSet consensus estimates. **Past performance is not a guarantee of future results.**

Higher commodity prices and lower spending have improved cash generation for the Energy sector

Energy has been the best-performing equity sector in 2022. Energy companies have used the recent strength in commodity prices to solidify their balance sheets, while continuing to execute business strategies that prioritize shareholder returns rather than growth.

The chart shows quarterly aggregate capital expenditures compared to free cash flow generation (the amount of cash left over after expense) for the S&P 500 Energy sector. In the fourth quarter of 2022, according to FactSet estimates, the sector is expected to generate $52.5 billion in free cash flow compared to $22.3 billion in capital expenditures. Before 2021, capital expenditures regularly exceeded free cash flows.

What it may mean for investors

We continue to see a favorable environment for Energy going into 2023. Energy has historically performed well during periods of broad inflation, and while there may be concern about the implications of a recession on energy demand, we expect the impact to be largely offset by continued supply constraint.

Within Energy, we remain favorable on integrated oil for broad exposure to the sector. We believe the diversification, flexibility, and scale of integrated oil companies can buffer the impact of the increased volatility and geopolitical uncertainty we expect in 2023.

Ian Mikkelsen, CFA, *Equity Sector Analyst, Global Securities Research 2023 Equity Sector Outlook*: "Balanced and ready" (December 13, 2022).

Risk Considerations

Each asset class has its own risk and return characteristics. The level of risk associated with a particular investment or asset class generally correlates with the level of return the investment or asset class might achieve. **Stock markets**, especially foreign markets, are volatile. Stock values may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors. **Bonds** are subject to market, interest rate, price, credit/default, liquidity, inflation and other risks. Prices tend to be inversely affected by changes in interest rates. **High yield (junk) bonds** have lower credit ratings and are subject to greater risk of default and greater principal risk. The **commodities** markets are considered speculative, carry substantial risks, and have experienced periods of extreme volatility. Investing in a volatile and uncertain commodities market may cause a portfolio to rapidly increase or decrease in value which may result in greater share price volatility.

Definitions

An index is unmanaged and not available for direct investment.

S&P 500 Index is a market capitalization-weighted index composed of 500 widely held common stocks that is generally considered representative of the US stock market.

S&P 500 Energy Index comprises those companies included in the S&P 500 that are classified as members of the GICS® energy sector.

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