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## MARKETS

# Energy Stocks, Long a Market Drag, Lead the Way to Start 2019

Sector is S&P 500's best performer of year as oil rallies, investors bet shares are undervalued



A U.K. oil-drilling unit in the North Sea operated by Transocean Ltd., whose stock has surged 23% this month. PHOTO: MATTHEW LLOYD/BLOOMBERG NEWS

*By Jessica Menton*

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Shares of energy companies have surged out of the gate this year, climbing alongside a rally in oil prices after a bruising end to 2018.

Energy stocks in the S&P 500 are the best-performing group in the index over the first seven trading days of the year, rising 8.8%.

U.S. oil prices, meanwhile, have climbed for nine straight sessions, buoyed by easing supply concerns and expectations that Saudi Arabia will cut exports. The prices are up 16% in 2019 to \$52.59 a barrel, extending their rally from a Dec. 24 low to 24%.

That lockstep rebound is a welcome relief to investors after energy stocks largely missed out on a robust rally in oil in the first nine months of last year, when prices topped \$75 a barrel.

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“It’s a battle on where oil prices are headed right now,” said Patrick Kaser, managing director and portfolio manager at Brandywine Global, which has roughly \$6.5 billion in assets under management.

“Skeptics on energy stocks are making a huge bet that oil prices will fall lower than where they are now. Energy stocks are expensive if you’re willing to make the bet that oil prices stay below \$50,” Mr. Kaser said. “But energy stocks are really, really cheap if you think prices go to the low 60s.”

January’s resurgence follows the worst quarter in a decade for energy stocks, which slumped 24% in the final three months of 2018, when the fears of oversupply and worries about slowing demand in a weakening global economy pushed oil prices down nearly 40%. The stocks’ gain this month has outpaced a 3.6% increase in the broad S&P 500 index.

Shares of offshore drillers have been among the best performers in January. Rowan Co s. and Transocean Ltd. have jumped 27% and 23%, respectively, while Tidewater Inc. has gained 13%. All three stocks are still down more than 34% over the past three months.

Charles Lemonides, portfolio manager of ValueWorks, a money manager with \$200 million in assets under management, said he has been buying shares of those companies because of their cheaper valuations.

“The move lower in oil prices was overdone,” Mr. Lemonides said. “Energy companies are still going to be pretty profitable around oil’s current level.”

Profits at energy companies in the S&P 500 are expected to outperform all other sectors again in the fourth quarter, according to FactSet. Their earnings are projected to increase 72% from the same period a year earlier, compared with a rise of 8.5% for all other companies in the index.

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Although valuations in the energy sector have come down in recent months, they are back above that of the broader index after the stocks’ recent rally.

The energy group is trading at 16.3 times projected earnings over the next 12 months, down from 16.9 at the end of September. The S&P 500, meanwhile, is trading at 15 times projected earnings, down from 16.8, according to FactSet.

Nancy Tengler, chief investment strategist of Tengler Wealth Management, which has \$400 million in assets under management, said she has also been scooping up cheaper energy stocks.

The firm took a stake in Marathon Petroleum Corp. recently, she said.

The oil refiner's shares have tumbled 21% over the past three months, despite a rally of 7.8% to start 2019.

"A lot of people say that valuations aren't necessarily predicated on returns, but it works for us," Ms. Tengler said.

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**Write to Jessica Menton at [Jessica.Menton@wsj.com](mailto:Jessica.Menton@wsj.com)**

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