



Energy Stocks Lead the Stock Market Higher

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Apr, 21st, 2010

One of the top performing sectors in 2011 so far has been the one of energy stocks. Many people probably believe that is due to the recent strength of crude oil, but there is more than that. In a final phase of a strong bull market (like the one that started in March 2009) one can expect the commodities and commodity related stocks to outperform the rest of the market. This is what we currently see. This article takes a look at the current prospects before the energy stocks as the historical pattern suggests they are likely to remain strong in the following months till the end of 2011.



The energy stocks have been in uptrend since early 2009 but it was after the September 2010 when they really have become market leaders. In 2009 and the first half of 2010 the main focus was on other sectors: technology stocks, consumer discretionary stocks, real estate and financials. But since the end of 2010 the energy stocks have been one of the hottest sectors in U.S. stock market. That is exactly what the history of sector rotation suggests: usually the oil, and commodity stocks in general, are stronger in the last phase of the bull market and quite often they remain strong even in the very beginning of the bear market. You can take a look at the last top at 2007 when the commodity stocks continued to rise until the middle of 2008 despite the strong bear market of S&P500 that was already in place. Then, of course, as you know, all commodities and commodity-related stocks fell a lot in the fall of 2008.

One of the factors under the strength of energy stocks is the huge increase in the commodities prices including the crude oil. As you can see from the chart below, the uptrend in crude oil remains intact and further gains are likely in the next few months as long as the prices hold the breakout level at 95.0/93.0. Actually it was after this breakout in early February that put the uptrend in crude oil in its acceleration phase.

Weekly chart of Crude Oil:



Source: MetaTrader

As you can see, crude oil was in uptrend since early 2009 but most of the time this uptrend was quite choppy. But in early February 2011 it broke higher out of the channel drawn on the chart and



since then the move up has been almost vertical (similar to the 1st move up from the early 2009 low). It is difficult to forecast upside targets in such strong and speculative market, but a re-test on the 2008 top cannot be ruled out in my view. And as long as the crude oil remains in uptrend, the energy stocks are likely to remain strong.

Daily chart of energy sector ETF (XLE)



Source: www.stockcharts.com

Now, the energy stocks have been in huge uptrend since early September 2010. As you see, the upmove accelerated when the XLE ETF broke above the 56.00 level and this sector was one of the top-performing on Wall Street in the 1st quarter of 2011. At the most recent top in April though there was a bearish divergence between the price and the MACD indicator (see the chart above) and that fact lead to a move down. Of course the broader stock market also retreated in the 1st half of April, so this move lower in oil stocks could not be viewed as a sign of weakness. The XLE has strong support now at 72.50 (where the 100-day exponential moving average comes at the moment) and as long as this support holds, the daily chart remains in strong uptrend. Only a move below this level will cause concerns that the uptrend in energy stocks might have ended already.

And finally, take a look at one interesting sub-sector within the energy sector: the alternative energy stocks. The S&P500 Global Clean Energy ETF (ICLN) broke higher out of sideways consolidation in late March but couldn't sustain its gains and then retreated below the breakout level:



Daily chart of the Global Clean Energy Index Fund (ICLN):



Source: www.stockcharts.com

Still, despite the most recent retreat below the 18.00 key level, this ETF remains in a weak uptrend. And if it can manage to hold above 16.50/16.00 and then move above 18.00 level again, it may join the energy sector in its uptrend. And since these alternative energy stocks have not advanced a lot already, they may have a good upside potential. The next upside targets are near the 20.00 level and then at 24.0 level. But at least at the moment, this group is lagging the XLE ETF and the general market, so one has to be very selective if they decide to invest in them before the ICLN ETF confirms its breakout.

Conclusion

As the bull market from the March 2009 low gets mature, the energy stocks are outperforming the general market. Since their historical pattern suggests they are likely to top out several months after the S&P500 index tops out and since the S&P500 has not topped already, that means the energy sector is likely to remain strong till the end of 2011. And that means one can probably find good investments in this sector. The alternative energy stocks are currently lagging but they may have strong upside potential in the future considering the fact that they have not advanced very far up to now.



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