Monday, April 6, 2026
tomorrowsaffairs.com
TA Tomorrow's Affairs
Analysis of today
Assessment of tomorrow

By: Daniel Lacalle

Why wars don't move oil and defence stocks the way investors expect

Investing in oil companies as a “sure bet” when there is a temporary spike in crude is usually a challenging idea.

Doing it during a war, when the destruction of demand can be much greater than the first jump in the commodity price, is even riskier. Recent history in 2008, 2018, 2022, and 2025 proves this.

Investing in oil companies must be based on fundamental analysis that is independent from the spot price of crude and natural gas and focused on value creation at mid-cycle prices.

The key is not to jump on a short-term wave that the oil companies themselves barely capture in their profits.

The SXEP index tracks European oil & gas companies that are highly sensitive to different businesses, expectations, investment cycles, and regulations, and in many cases, they are fundamentally refiners, not pure producers that capture the “spot” price of crude.

Price spikes usually coincide with late-cycle phases or supply shocks, when the risk of a correction in both the sector and the overall market is high.

In those periods, broad indices like the S&P 500, Nasdaq, or Stoxx 600 tend to offer better risk-adjusted returns in the medium term than a long-term entry into oil companies, which in practice is often implemented once the initial shock has already moved the stocks.

Why the oil price misleads investors in oil stocks

The typical argument is: “Oil is going up, so I’ll buy oil stocks.” That intuitive leap confuses spot prices with revenues and cash flow and ignores three important brakes:

- The market discounts the cycle: by the time the retail investor sees oil at a peak on front pages, the strongest stretch of sector re-rating has usually already happened.
- Costs and capex: Higher oil prices also bring regulatory pressure, higher taxes, tougher environmental requirements, and large investment plans, all of which reduce future free cash flow.
- High oil prices hurt companies with a large share of refining or chemicals in their business mix.

If, on top of that, the market perceives the oil jump as temporary, the profit increase is capitalised over a very short time in valuations.

The stock goes up until they report earnings, is a phrase often repeated by analysts that captures the difference between commodity price and profit correlation.

Confusing momentum with opportunity

Oil companies, especially European ones, are highly procyclical and complex and should be treated as such. Basing an investment decision on an external event can easily lead to confusing momentum with opportunity.

That is why investment must be analysed separately from the geopolitical backdrop, while remembering that most of these firms, as concession-based businesses, can suffer expropriations and attacks in periods of political uncertainty.

> Some European energy firms are notorious for investing huge amounts in boom times and divesting at low prices

An oil company is an asset manager that seeks to generate returns at low prices and whose sensitivity to short-term price volatility is quite low. Its appeal should lie in its low cash-flow volatility despite limited margins, not in the opposite.

Value creation or destruction from acquisitions is crucial in companies that are essentially managers of concession assets.

Some European energy firms are notorious for investing huge amounts in boom times and divesting at low prices, with honourable exceptions.

That is why the sector trades at a lower PE and EV/EBITDA multiple than many others. Using oil stocks as an automatic hedge against a few months of higher oil prices is conceptually simple but empirically poor.

Geopolitics, inflation, and oil

This gets even more complex with geopolitical events and wars. Between 2022 and 2025, there were seven major conflicts in the Middle East and Africa with no impact on the oil price.

In real terms, the oil price during the Iran War is below mid-cycle inflation-adjusted highs. Inflation matters, both for the nominal price of the commodity and for exploration, production, and development costs.

Remember that in 2022 the oil and gas price spike deflated in just a couple of months, and four years later commodities have not revisited that peak in either real or nominal terms.

> The US has gone from amplifying geopolitical risk in commodities to becoming a global shock absorber

Why does geopolitical risk affect less and for shorter periods? Ignoring the fact that, since 2007, the United States has gone from being the largest net importer of oil and gas to being independent in gas and the largest oil producer in the world leads to an easy but misguided comparison with past crises.

The US has gone from amplifying geopolitical risk in commodities to becoming a global shock absorber. Added to this is an OPEC that does not want to hurt its customers but rather present itself as the most reliable, competitive, and flexible supplier.

Lessons from 2008 and 2018

In 2008, crude shot above 140 dollars before collapsing with the financial crisis. That peak looked like an ideal scenario for those who thought oil companies were a great haven, but the macro context was lethal for the entire market, including energy.

The SXEP index was dragged down by the global equity crash, with very significant falls when the credit crisis blew up. Oil plunged to around 55 dollars in a short period.

2018 was another example of an oil rally in a context of geopolitical and supply tensions, followed by a market correction.

> For the investor who patiently waits through boom times to buy on a geopolitical shock or oil spike, it often means missing the opportunity in the rest of the market

The SXEP index showed volatile behaviour, with an initial rebound linked to oil, then a correction when the market started discounting the global slowdown.

For the investor who buys oil stocks when oil has already risen and the media talk about an “energy rally," the result is often even worse: little portfolio protection and a lot of stock-specific risk.

For the investor who patiently waits through boom times to buy on a geopolitical shock or oil spike, it often means missing the opportunity in the rest of the market.

That is why professional investors who do not panic over short-term headlines choose very selectively those oil companies that combine

prudent project portfolio management, disciplined investment, high return on capital employed, and cash‑flow growth at the low and midpoints of the cycle, and they do so within a diversified portfolio, not because of the latest front page of a news outlet.

Lessons from 2022–2025

2022 looked like the clearest, most recent case supporting the story – at first sight: war in Ukraine, oil surging, gas exploding, and energy being the star sector in the short term. The error is extrapolating that one‑off year.

If you only look at 2022, the "oil stocks as protection" thesis seems to work. If you look at 2022–2025 as a block, the investor who aggressively rotated into oil missed a large part of the structural rebound in broad equity indices, especially technology and quality, and ended up with returns below inflation.

In 2023, 2024, and 2025, even with wars in Ukraine and Gaza, the picture is worse.

> Investing in the SXEP index – with some honourable individual exceptions – is the empirical definition of "empty calories"

The empirical evidence for the SXEP index (European Oil & Gas) over 2008–2025 is a cumulative return of +128% in dollars, compared with +140% for the Stoxx 600, +530% for the S&P 500 and +1,200% for the Nasdaq 100.

In euro terms, the SXEP index rose much less than oil, the XLE, the S&P 500 or the Nasdaq.

In other words, the "easy trade" of buying oil stocks after the shock cools down while the global benchmarks regain traction and more than compensate for the drawdown in the shock year.

The data, in both euros and dollars, show that investing in the SXEP index – with some honourable individual exceptions – is the empirical definition of "empty calories": an expensive and volatile investment that does not deliver long‑term returns or protection in financial crises.

More than just the commodity price

Oil companies, like gold miners, are much more than the commodity price. Most of these firms have low sensitivity to the oil price – something they themselves constantly repeat in their conference calls during periods of low oil prices.

In addition, they tend to do large acquisitions at elevated valuations during high cash‑flow periods, which is why the market assigns them a significant conglomerate discount.

We should not forget that most oil companies are concessionaires with very diversified businesses, where return on capital barely exceeds the cost of capital, again with some exceptions.

> Individual high-quality names have consistently outperformed the sector indices

For investors attracted by oil, exploration and production (E&P) companies are more appealing because they are less politically constrained, but they are also much more volatile.

The XLE index, which tracks major US oil companies, has done better than the European SXEP index in the period I mentioned (+171%), albeit nowhere near broad indices like the Nasdaq or the S&P 500.

The oil services index, which in theory should have a high correlation with crude, has also underperformed.

The importance of independent analysis and a good understanding of fundamentals become

even clearer: Individual high-quality names have consistently outperformed the sector indices.

Looking beyond the noise

Over a multi-year horizon, for long-term investors, a diversified portfolio in sectors with higher returns on capital and lower capital needs beats a tactical bet taken late in the oil cycle.

The investor who buys oil companies at the peak of geopolitical noise is buying volatility, regulatory risk, and confiscation risk, not extraordinary profits, as S&P Global explains.

If there is a sector that demands detailed analysis and looking beyond the surface, it is the energy sector.

> Being selective and prudent, looking beyond the noise and not confusing headlines with trends is essential when investing in oil companies

A temporary spike in oil prices does not justify an aggressive rotation of the portfolio into oil stocks. A war is a very bad reason to buy companies whose profitability is forged in 30-year investment plans.

In fact, the impact of war on commodities depends largely on expectations about marginal demand and, as we have seen in conflicts since 2022, tends to be very short-lived.

Being selective and prudent, looking beyond the noise and not confusing headlines with trends is essential when investing in oil companies.

Brent's 40% swing

Brent crude has rebounded above 100 dollars per barrel in March 2026 after trading near 70 dollars a month earlier, a swing of more than 40% in a few weeks.

Despite this spike, global oil and gas equities have not matched the move: the S&P 500 Energy sector's 12-month returns remain modest, and in prior conflicts, the average 12-month performance after a war shock has been close to flat once the initial move fades.

Fundamentals matter. Some high-quality oil companies have consistently outperformed their peers due to prudent portfolio management, a focus on returns at mid-cycle prices and cost control.

Meanwhile, most oil equities discount the cycle early, suffer from rising costs and windfall-tax risk, and do not mirror the latest headline on Brent.

Defence stocks: why have some sold off in the middle of war?

Many investors also assume that war equals automatic gains in defence. However, recent months show a different picture:

The S&P 500 Aerospace & Defence industry index is up strongly over the last 12 months (around +30% to +35%), but in the most recent 1–3-month period it has registered short-term pullbacks of around −5% to −7% despite ongoing conflict and rising defence budgets.

This shows that the index mostly discounted the positive news on the military budget early.

Historical analysis across major conflicts (Kuwait 1990, 9/11, Ukraine 2022, and the 2024–2025 Middle East escalations) shows that defence stocks often rally into and shortly after the event but may correct sharply in the first weeks as investors sell the news.

> Quantitative studies of war periods show that the first month after a shock is often the weakest for defence

Several factors explain why defence stocks can fall even as war headlines dominate the news:

From 2022 to 2025, core US defence names like Lockheed Martin, Northrop Grumman, and RTX delivered cumulative gains of roughly 60–85%, significantly outperforming the S&P 500.

When a new escalation hits, such as the Iran war, many investors use the spike in uncertainty to lock in historical profits, generating short-term drawdowns even though the long-term backlog is solid.

Quantitative studies of war periods show that the first month after a shock is often the weakest for defence, with negative or flat returns, while 6- and 12-month windows tend to be positive on average, according to Investor Observer.

When headlines drive crowded trades

When inflation spikes due to war and oil price impacts, investors become nervous about government budgets, allocation to defence, and the sustainability of current backlogs if central banks decide to hike rates.

Defence stocks tend to suffer when investors anticipate higher interest rates and express concerns about weakening sovereign solvency.

Both energy and defence show a similar pattern: the intuitive "war trade" is often late, crowded, and driven by headlines rather than cycle analysis - Daniel Lacalle

Furthermore, sometimes governments announce large defence spending programmes that do not always become real and drive new orders and earnings.

Delays often happen, governments tend to change the structure of their contracts, and political and regulatory risk may affect what seems to be an ideal scenario, leading to uncertainty in revenue projections and investment returns for defence companies.

Some European defence names, in particular, trade with a discount due to governance concerns, state ownership, or fears of windfall-style government interventions like those seen in energy.

Both energy and defence show a similar pattern: the intuitive "war trade" is often late, crowded, and driven by headlines rather than cycle analysis.

These are two sectors in which independent and detailed analysis, with a deep understanding of fundamentals, becomes critical.

Investors that focus on fundamentals and not on news headlines usually outperform the energy and defence sector indices.