January 2025
Connor Chung || Energy Finance Analyst
Dan Cohn || Energy Finance Analyst

Another Bad Year — and Decade — for Fossil Fuel Stocks

- *Despite industry hopes for the year, fossil fuels significantly underperformed equity markets in 2024.*
- *It's a by-now-familiar story for an industry that has spent much of the last decade dragging down long-term investment portfolios.*
- *With the transient post-Ukraine profit surge firmly in the rearview mirror, the industry's fundamentals continue to demonstrate weakness in today's energy markets.*
- *The traditional fossil fuel business model faces structural risks in a decarbonizing world, and the industry has yet to demonstrate a coherent response.*

As 2024 began, oil majors struck up a confident tune. Higher energy prices had generated strong profits in the wake of the emergence from the Covid-19 pandemic and Russian invasion of Ukraine. To the industry, this moment was here to stay: 2023 had been an "outstanding year," ExxonMobil told its shareholders last February, and by maintaining "existing strategy, building on world-class execution," the company would be well-positioned to meet shareholder expectations moving forward.

And yet the verdict is now in, with the traditional energy sector ending the year near the bottom of equity markets. The S&P 500's fossil fuel components saw a 5.72% return in 2024, compared to the full index's 25.02%. By now, the story is familiar. The fossil fuel sector underperformed the S&P 500 in seven out of the last 10 years, delivering the lowest performance and highest volatility of any of the S&P's sectors over the period. Industry rhetoric aside, oil, gas, and coal have been unreliable and inconsistent contributors to long-term investment portfolios.

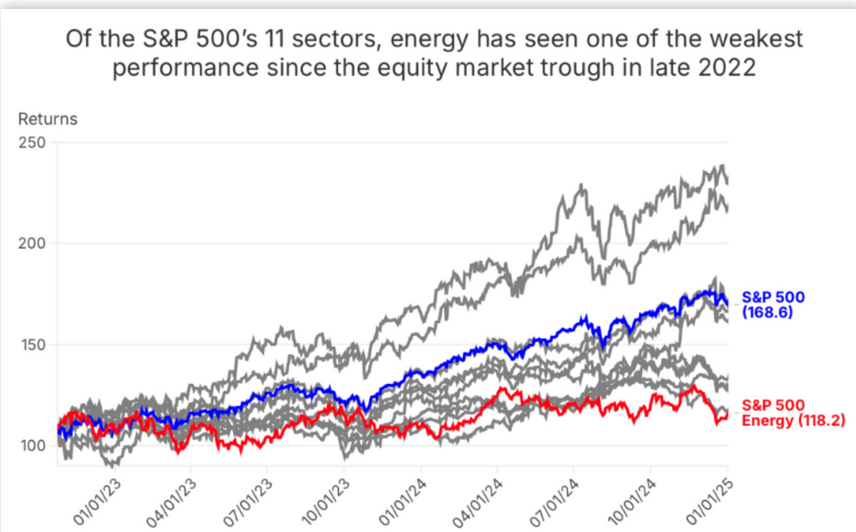
Figure 1

S&P 500 Sector	10-Year Annualized Total Return (%)	10-Year Annualized Volatility (%)
Energy	4.91 (lowest)	29.68 (highest)
Communication Svcs	11.19	18.55
Consumer Discretionary	13.62	20.37
Consumer Staples	8.43	12.8
Financials	11.43	19.87
Health Care	9.14	14.29
Industrials	10.75	18.72
Info. Technology	22.35	19.6
Materials	7.87	19.66
Real Estate	6.58	17.52
Utilities	8.43	15.53

Source: Sector index fact sheets,[1] as of December 2024

This has been true across a range of other timeframes as well.[2] Since the equity market trough of October 2022, for example, energy has seen the smallest comeback of the 11 sectors.

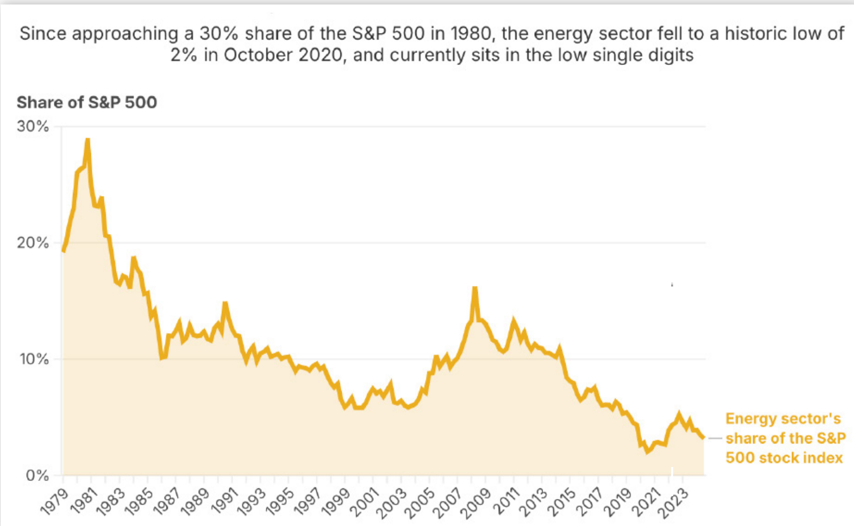
Figure 2: Fossil Fuels Underperform Stock Market Since 2022



Source: S&P. Total return, rebased as to 100 on 10 December 2022

The pattern speaks to a broader market evolution. Fossil fuels were a classic blue-chip bet for decades, promising reliable returns, steady long-term growth, and sound underlying fundamentals.[3] Energy companies could credibly tie their value thesis to economic growth and enjoyed a market position that reflected this. Yet as the global economy has evolved, the industry has seen its once-commanding stature slip. In 1980, the energy sector comprised almost 30% of the S&P 500's total value. At the end of 2024, that figure sat at just 3.2%.

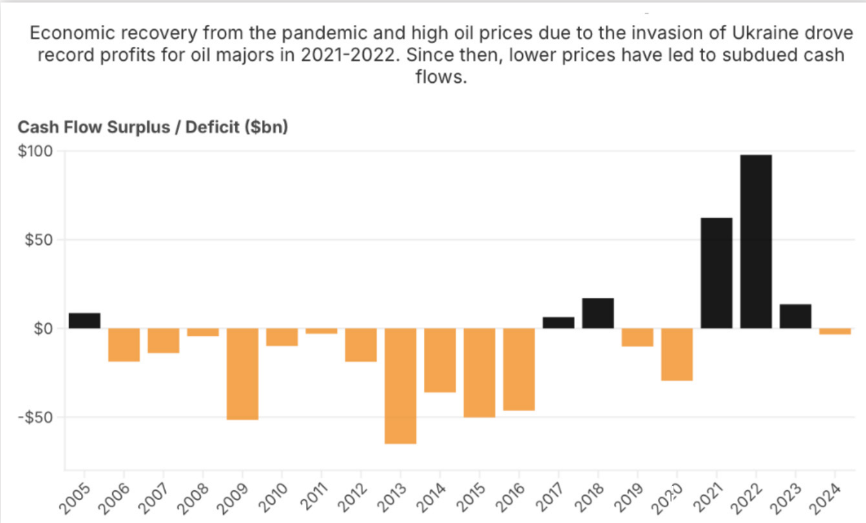
Figure 3: Energy Sector's Share of the S&P 500



Source: S&P Global, Siblis Research, as of December 2024

As the industry's traditional value thesis has eroded—and as the once-major driver of stock market returns becomes an increasingly marginal player in major equity indices—a speculative investment rationale has quietly emerged. Fossil fuel investments are now an implicit bet on geopolitical disruption and near-term destabilization. This was most visible in the wake of the Russian invasion of Ukraine. Before the invasion, fossil fuel majors struggled to generate positive free cash flow after dividends and buybacks at prevailing commodity prices.[4] Prices steadily rose as the global economy emerged from the Covid-19 pandemic. Then supply shocks following Putin's invasion sent energy prices sky-high. Profits surged for several quarters before returning to pre-Covid levels over the course of 2023.[5] But for some investors, the spike was proof that the industry was back.

Figure 4: Oil Majors' Short-Lived Cash Flow Surplus



Source: IEEFA calculations from company reports (XOM, CVX, SHEL, BP, TTE).
Figures are free cash flow minus net distributions to shareholders. Data for 2024 is through Q3

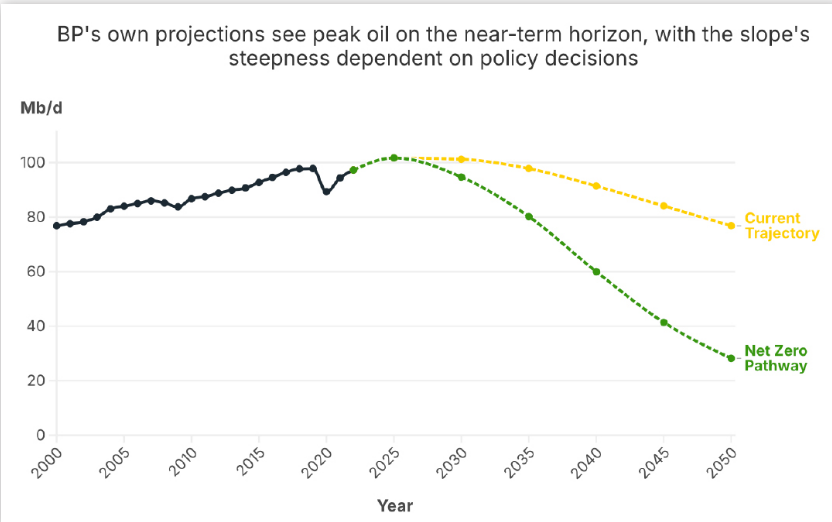
IEEFA warned at the time that elevated energy prices in the short term did not portend a meaningful shift in the industry's long-term fundamentals.[6] By the beginning of 2024, the spike appeared firmly in the rearview mirror.[7] Despite the spiraling conflict in the Middle East, the sector's free cash flow remained weak over the course of the year amid range-bound oil prices and low U.S. gas prices.[8] Oil major returns were down slightly in the third quarter of 2024, and markets will be watching to see how the coming year plays out. Barring unexpected disruptions, the International Energy Agency currently expects that persistent overproduction from some OPEC members, robust non-OPEC supply growth, and relatively modest demand growth (including noticeably lower growth in key markets like China) could have a moderating effect on oil markets this coming year.[9] The U.S. Energy Information Administration's short-term oil price outlook generally agrees.[10]

The volatility of the 2021-22 era may have been a boon for short-term speculators. But an investment rationale tied to unreliable external forces cannot underpin sustainable long-term value creation. The past year's results continue to serve as a reality check on the notion that the sector has returned to the reliable blue-chip days of old.

So, what is shaping market trends? Much of the sector's historical underperformance over the past decade can be understood in the context of oversupply of oil driven by the emergence of fracking, as OPEC-aligned countries and non-OPEC producers competed for global market share.[11] As investors look to the longer run, another factor is indisputably shaping expectations: The energy transition.

As IEEFA has written elsewhere, the world's progress toward net-zero poses substantive threats to demand across all of the fossil fuel sector's traditional markets. Leading credit rating agencies have likewise warned of the compounding risk factors facing the energy sector in a decarbonizing world.[12] Even fossil fuel companies have begun to speak of the looming specter of peak oil demand. The exact path of the energy transition remains uncertain, but as the direction of travel becomes clear, energy companies' traditional business models face a negative outlook.

Figure 5: BP Oil Demand Outlook

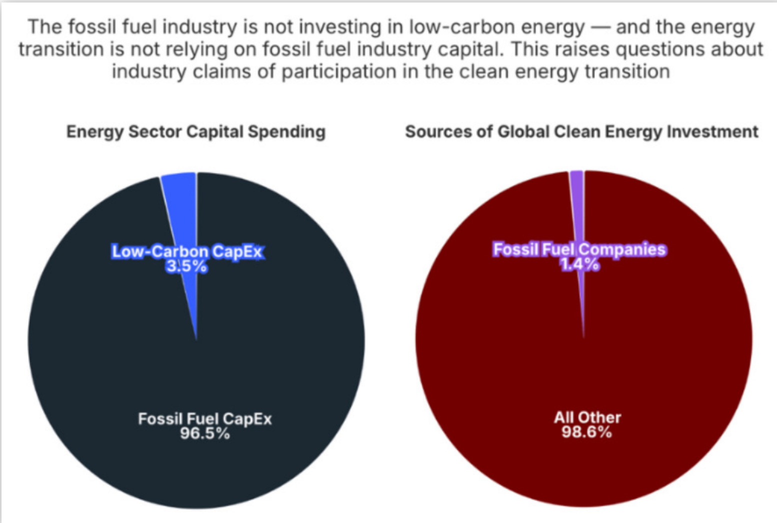


Source: BP 2024 Energy Outlook

To date, the industry has yet to persuade long-term investors that it possesses a cohesive plan for managing the risks of decarbonization. Indeed, from BP weakening its net-zero goals to ExxonMobil suing shareholders concerned about climate change and doubling down on fossil fuel expansion (such as its Guyana megaproject, 2024 saw the prospect of fossil fuel industry-led transition—long a popular hope among major institutional investors—retreat further. Meanwhile, the global energy transition continued apace, with renewable capacity growing at record rates this past year.[13]

Data from the IEA puts this misalignment into further context: The fossil fuel industry devotes less than 4% of its capital expenditure to clean energy, and its clean energy spending accounts for under 1.5% of global clean energy investment. Although there exist a range of different ideas about how oil majors should pursue net-zero alignment, the industry does not seem intent on advancing any of them. The fossil fuel industry is not meaningfully participating in the energy transition, and the energy transition isn't waiting for it to catch up.

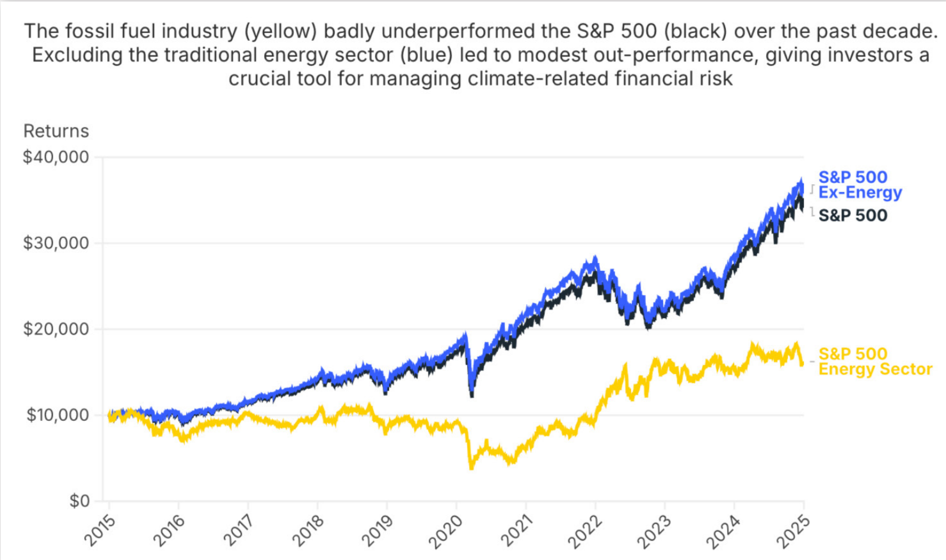
Figure 6: Oil & Gas Industry Clean Energy Investments



Source: IEA World Energy Investment 2024, IEEFA calculations
Note that Low-Carbon CapEx includes spending on CCS, hydrogen

The shift of capital away from coal, oil, and gas and toward climate solutions also continued to pick up steam in 2024. The New York State Common Retirement Fund, for example, decided to shift billions in active and passive holdings from ExxonMobil and some peers, recognizing the continued maturation of lower-carbon investing strategies.[14] The Dutch pension giant PFZW exited the vast majority of its fossil fuel holdings after companies proved unwilling or unable to satisfactorily mitigate climate risk. In doing so, they joined peer fiduciaries around the world who have voiced growing doubts regarding fossil fuel companies' ability to manage shareholder wealth in the long run. As the energy transition continues to progress, such skepticism is unlikely to be dispelled.

Figure 7: Lower-Carbon Indices Outperform



Source: S&P. Gross total return, December 2024
NB. Energy here refers only to the fossil fuel value chain; renewables are categorized otherwise

The energy transition will not always be a smooth or linear process. For short-term investors, there will undoubtedly remain money to be made in conventional energy. Yet the past year continued to demonstrate that equity markets are responding to ongoing structural shifts in the global economy—and that, as the fossil fuel industry faces existential questions about its future, investors are taking note.

Endnotes

1 S&P Global. Sectors – Investment Themes – S&P Dow Jones Indices. Last visited January 23, 2025.

2 IEEFA. Passive investing in a warming world. February 8, 2024.

3 IEEFA. Two economies collide: Competition, conflict, and the financial case for fossil fuel divestment. October 13, 2022.

4 IEEFA. Oil majors live beyond their means – can't pay for dividends, buybacks. January 16, 2020.

5 IEEFA. Oil and gas industry ends 2023 with a weak comeback and a negative outlook. January 12, 2024.

6 IEEFA. Oil and gas profits driven by Ukraine conflict, not financial skill. November 1, 2022.

7 IEEFA. Declining supermajors profits reveal flaws in the oil and gas business model. August 9, 2023.

8 EIA. Brent crude oil prices traded in a narrow range in 2024. January 5, 2025.

9 IEA. Oil Market Report. December 2024.

10 EIA. Short-Term Energy Outlook. January 14, 2025.

11 IEEFA. The financial case for fossil fuel divestment. July 1, 2018.

12 IEEFA. A matter of opinion: Credit rating agencies evolve on climate change, fossil fuel risk. March 14, 2024.

13 IRENA. Record Growth Drives Cost Advantage of Renewable Power. September 24, 2024.

14 IEEFA. New York State Common Retirement Fund takes action to protect New Yorkers from further losses from oil and gas company investments. February 15, 2024.

About IEEFA

The Institute for Energy Economics and Financial Analysis (IEEFA examines issues related to energy markets, trends and policies. The Institute's mission is to accelerate the transition to a diverse, sustainable and profitable energy economy. www.ieefa.org

About the Authors

Connor Chung

Connor Chung is an IEEFA energy finance analyst. He studies how climate change and the energy transition impact financial markets, and how financial institutions are responding to a warming world. He holds an undergraduate degree from Harvard University, and a master's from the University of Cambridge.

Dan Cohn

Dan Cohn is an IEEFA energy finance analyst. His research focuses on protecting institutional investment funds from the volatility associated with global commodity prices and the fossil fuel industry. He is an expert on the U.S. coal mining industry and regulatory framework, with specializations in mine cleanup, financial assurance instruments, and energy transition issues in the Powder River Basin. He has a degree from Washington University in St. Louis.