

November '05 - Oil

Oil. Black Gold. Texas Tea. You all know the song... unfortunately, we are not Jed. His lucky shot, while shooting at some food proved to be quite rewarding for the Clampetts. At \$60-\$70/bbl they would have enjoyed oil's recent price increase... Exxon sure has. According to CNBC, Exxon's 3rd quarter revenue was the highest ever recorded at \$100,700,000,000 dollars. That's \$100.7 billion, which breaks down to be \$1.1 billion/day, \$46 million/hour, and \$760,000/minute. Can the U.S. Treasury print money that fast?

The question I've been getting from clients is, "should we be investing in more energy related stock funds?" Let's take a closer look at the data.

No doubt we have all heard the impact higher oil prices have on the consumer. When consumers pay more at the pump, they have less money to spend on other things like iPods and Televisions. The data* actually shows energy has declined from approximately 8% of consumers disposable income, in the early 1980's, to less than 5% today - making it easier for consumers to stomach higher gas prices. If we factor inflation into the price of oil, the 1981 peak of \$40/bbl, when the 1st Iraq war began, would be over \$90/bbl in today's dollars. The impact on the consumer is less than it was 25 years ago. Thus, consumer spending should not be affected as much as we have heard in the news.

Next, let us review how world oil demand has changed since oil's recent surge in prices. World demand increased from 79.9 million bbl/day in May, 2003, to 82.4 million bbl/day as of the 2nd quarter of '05 - a 3.1% increase. Yet prices have gone up from \$29.56/bbl in 2003 to as much as \$70/bbl today. A 136% increase in price while supply and demand have risen more or less in balance the last two years. Many point to continued rapid growth in China and India's economies as the reason for the spike in prices. They argue world demand will eventually outpace supply causing oil shortages and high future prices.

In an interview with George Wenzel, Vice-President of a major mutual fund company**, he stated their industry respected research team reported China and India are developing hydro-power to meet future energy needs. If this is the case, future world demand may not materialize to the extent many are predicting. The research team believes we could see \$100/bbl or \$40/bbl in the next twelve months. Why? Speculators are driving the price.

Most of us have heard about a speculative bubble in housing. What about oil? The role of speculators in driving the price of oil has me concerned. While I am bullish on oil in the long-term, in the short-term, there seems to be a bit of a speculative frenzy in the market. In my life of studying the markets, I have learned everyone can't win. In fact, when everyone is betting on one side, it is usually best to stand aside. Many mutual funds are already overweight (meaning they have a higher percentage of assets in oil related businesses than usual) so most of us currently have a relatively high exposure to the oil sector. Could oil go up from here? Absolutely. But it could also go down. If you have a well diversified portfolio, it is my assessment, your best move is to stay the course and let the professional money managers determine how much oil to have in your investments. That is why we pay them.

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