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An Oily Mess?

Global Markets and Regions

	4th QTR	2014 YTD
US	4.8%	13.4%
Developed Europe	-4.3%	-5.7%
Asia	-1.0%	0.8%
Emerging Markets	-4.4%	-1.8%

US Markets

	3rd QTR	2014 YTD
Dow 30	5.2%	10.0%
Large Cap Cos.	5.3%	13.7%
Mid. Cap Cos.	6.2%	9.3%
Small Cap Cos.	9.9%	5.7%
Bonds	1.6%	5.3%

"Headline News Causes Market Turmoil"! I guess that's why they have headlines. As the New Year unfolds, the price of oil has dropped almost 50% from its peak 2014 price of over $110 a barrel. It's presently under $50 a barrel. I say "presently" as even lower prices appear to be possible. The last time oil was anywhere near this price was back in early 2009. We were in the midst of a financial market meltdown as the world was in the midst of the worst recession since the Great Depression. We're not in a recession anymore, at least not in the United States.

Global consumption has declined. Europe toggles in and out of recession contributing to lower demand, and not just for oil. Japan has delivered practically no economic growth despite unprecedented efforts by their financial authorities to stimulate growth. China and India, new emerging engines of global growth, have slowed considerably from their previous growth trends. The United States, with less than robust growth, but growth none the less, is not adding to energy demand. We're driving less and consumers and industry are becoming increasingly energy efficient. We're spending less on energy; a lot less.

On the other hand, the United States has dramatically added to supply through the miracle of Fracking. Oil production in the US has sky-rocketed in the last several years leading to a global glut of oil. Our trade deficit with the rest of the world has fallen dramatically as we import less and less oil. Natural gas production is another part of the Fracking revolution as natural gas displaces oil as a fuel.

A strong US dollar, driven by our improving fiscal condition and the Federal Reserve ending Quantitative Easing and starting to talk about eventually raising interest rates, has been another factor. Since oil is priced in dollars, this has also added to the downward pressure on oil prices.

Who are the “casualties” in this almost completely unforeseen development? Certainly the major global producers are not happy. Venezuela, Russia, Iran, Saudi Arabia, among others, benefited from high prices as their economies are exclusively based on oil and energy. They are experiencing the oil price decline as a serious disruption. They are slashing investment in drilling and production as well as public expenditures. Looking at the returns from investments based outside the US, this is becoming apparent.

As for the US, anything and everything oil production related from drillers and front end producers to transport and storage to suppliers and equipment manufacturers are having plans and projects disrupted as the lower price of crude changes the rules. The economies of Texas, North Dakota and Pennsylvania appear particularly vulnerable to this type of disruption. Investments in these types of operations have generally been reliable income sources. The uncertainty coming from these developments has, at least in the short term, upset these assumptions.

On the other hand, there are 130 million motorists in the US and fewer than 300,000 people employed in the Energy sector. Another 100 million homeowners will also be facing lower heating bills this winter. I don’t think they will be viewing the decline in energy prices in the same way. We were also discussing the nascent emergence of inflation earlier this year. It looks like the return of inflation as an investment concern will be delayed a while longer. So the dramatic changes from the bursting of the oil price bubble will produce both winners and losers as the effects ripple through the global economy.