

Wednesday, January 14, 2009

Don't be surprised to see the Saudis embrace "Peak Oil"

My first post of the year. I did mention briefly last year that I had gone long on oil. That position is of course, taking some heat. I started going long at about \$46/barrel oil and it still had lot farther to fall. There is an old adage "The graveyards of Wall St. are littered with the skulls of those who were too early". They were probably margined out the hilt.

Fortunately, I'm not. So I just wait, well actually I've been buying more oil all the way down. I find this a lot different than piling into, say Nortel in 1999 somewhere north of \$1000 and averaging down all the way to, maybe today where they hit .12 on their bankruptcy filing. Oil isn't going to file Chapter 7. There is a finite amount of oil in the world, and we use more and more of it almost literally every day. So softness aside, I see the price going nowhere but up from here. Keep in mind there's a reason I call this channel "This is not investment advice", because it's not. Do your own due diligence, remove cellophane before eating, etc.

But oil is too cheap. David Skarica points out in his newsletter that the gold-to-oil ratio is the highest it's been in decades, and the last two times it approached anywhere near these levels were 1994 and 1998, shortly before multi-year bull runs in the commodity.

In an age where all international currencies seem dead-set on a race-to-the-bottom, I like the idea of using commodity ratios to gauge the relative values of asset classes. All the goldbugs (including me I guess) are positing an eventual return of a 1:1 DOW/Gold ratio, but couldn't tell you if that's at DOW 5000, Gold \$5000/oz or DOW 900, Gold \$900. Without the ratio, it's easy to let monetary inflation or deflation bamboozle you into thinking you're rich when you're really not. With the ratio, a 1:1 DOW/Gold means "life sucks" in the financial markets. That will also be, by the way, as good a signal as any to start looking for a real end to this secular bear market we're in.

So with Skarica's Gold/Oil thesis, he notes that any time it's been 22:1 or higher, oil blasted off on a multi-year run. Right now it's somewhere north of 30:1, what value investors would call "under-valued".

It's so undervalued, in fact, that oil at \$37/barrel or so, many oil producing nations are caught below their cost. I've been reading Jim Roger's Hot Commodities over the holidays and one thing he says is that when the price of any commodity falls below it's cost to produce it, you've pretty well hit the bottom in that commodity, because producers will just close up shop until things pick up. That reduces supply, and that forces the price up.

But we're talking oil here, not cocoa or oranges. If some country decides to stop pumping they may very well earn themselves a dose of "shock-and-awe" from the West (for purely humanitarian reasons, of course). So what is it that value investors call "the catalyzing event" which could presage the turnaround in the price of oil?

Well, from this side of that last oil spike price, all that downplaying of "peak oil" probably looks regrettable to any country who earns most of their revenues from oil exports and vehemently denied there was any truth to all that "peak oil" nonsense. File it in the drawer beside "global warming", and forget about it. The Saudis claim they can increase production all the way to 2035.

Maybe not.

At this stage of the game we've seen OPEC ordained production cuts, an Indo-Pakistani war brewing, Israeli invasion of Gaza and all the usual culprits of world tension do nothing for the price oil. What's left?

Maybe one morning we wake up and Saudis say "You know what? Turns out Matt Simmons was right after all. Our latest study shows our supplies peaked in 2003...it's all downhill from here for us..."

I wonder what the price of oil would do then?

Posted by Mark Jeftovic in This is not investment advice at 20:07

The price of oil will skyrocket.

The top story of the year is that global crude oil production peaked in 2008.

Blog Export: Exile From the Herd, <http://www.privateworld.com/>

The media, governments, world leaders, and public should focus on this issue.

Global crude oil production had been rising briskly until 2004, then plateaued for four years. Because oil producers were extracting at maximum effort to profit from high oil prices, this plateau is a clear indication of Peak Oil.

Then in August and September of 2008 while oil prices were still very high, global crude oil production fell nearly one million barrels per day, clear evidence of Peak Oil (See Rembrandt Koppelaar, Editor of "Oil Watch Monthly," December 2008, page 1) http://www.peakoil.nl/wp-content/uploads/2008/12/2008_december_oilwatch_monthly.pdf.

Peak Oil is now.

Credit for accurate Peak Oil predictions (within a few years) goes to the following (projected year for peak given in parentheses):

Association for the Study of Peak Oil (2007)

Rembrandt Koppelaar, Editor of "Oil Watch Monthly" (2008)

Tony Eriksen, Oil stock analyst; Samuel Foucher, oil analyst; and Stuart Staniford, Physicist [Wikipedia Oil Megaprojects] (2008)

Matthew Simmons, Energy investment banker, (2007)

T. Boone Pickens, Oil and gas investor (2007)

U.S. Army Corps of Engineers (2005)

Kenneth S. Deffeyes, Princeton professor and retired shell geologist (2005)

Sam Sam Bakhtiari, Retired Iranian National Oil Company geologist (2005)

Chris Skrebowski, Editor of "Petroleum Review" (2010)

Sadad Al Hussein, former head of production and exploration, Saudi Aramco (2008)

Energy Watch Group in Germany (2006)

Fredrik Robelius, Oil analyst and author of "Giant Oil Fields" (2008 to 2018)

Oil production will now begin to decline terminally.

Within a year or two, it is likely that oil prices will skyrocket as supply falls below demand. OPEC cuts could exacerbate the gap between supply and demand and drive prices even higher.

Independent studies indicate that global crude oil production will now decline from 74 million barrels per day to 60 million barrels per day by 2015. During the same time, demand will increase. Oil supplies will be even tighter for the U.S. As oil producing nations consume more and more oil domestically they will export less and less. Because demand is high in China, India, the Middle East, and other oil producing nations, once global oil production begins to decline, demand will always be higher than supply. And since the U.S. represents one fourth of global oil demand, whatever oil we conserve will be consumed elsewhere. Thus, conservation in the U.S. will not slow oil depletion rates significantly.

Alternatives will not even begin to fill the gap. There is no plan nor capital for a so-called electric economy. And most alternatives yield electric power, but we need liquid fuels for tractors/combines, 18 wheel trucks, trains, ships, and mining equipment. The independent scientists of the Energy Watch Group conclude in a 2007 report titled: "Peak Oil Could Trigger Meltdown of Society:"

"By 2020, and even more by 2030, global oil supply will be dramatically lower. This will create a supply gap which can hardly be closed by growing contributions from other fossil, nuclear or alternative energy sources in this time frame."

With increasing costs for gasoline and diesel, along with declining taxes and declining gasoline tax revenues, states and local governments will eventually have to cut staff and curtail highway maintenance. Eventually, gasoline stations will close, and state and local highway workers won't be able to get to work. We are facing the collapse of the highways that depend on diesel and gasoline powered trucks for bridge maintenance, culvert cleaning to avoid road washouts, snow plowing, and roadbed and surface repair. When the highways fail, so will the power grid, as highways carry the parts, large transformers, steel for pylons, and high tension cables from great distances. With the highways out, there will be no food coming from far away, and without the power grid virtually nothing modern works, including home heating, pumping of gasoline and diesel, airports, communications, and automated building systems.

Documented here:

<http://www.peakoilassociates.com/POAnalysis.html>

<http://survivingpeakoil.blogspot.com/>

Anonymous on Jan 15 2009, 07:44

Recent deep discoveries of oil indicate that our theories are wrong.

Five miles below sea-level is not the result of pre-historic plants and animals.

http://www.worldnetdaily.com/news/article.asp?ARTICLE_ID=58682

We will never run out of oil... just cheap oil.

Anonymous on Feb 2 2009, 13:25