

Oil Bubble

What Goes Up, Must Come Down

By Kevin Bourke

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It seems that oil hits new highs every day. What's next?

--Sam from Montecito

Sam, I have strong opinions about oil, and the future of energy in general. A hundred or so years from now, students will read in their history books about the "petroleum age," a time when the world economy hinged upon oil. The petroleum age will be seen as a golden era, one where the lifestyle of billions of people was enhanced, and technology took a quantum leap forward.

Students of history will view these as good times for civilization in general.

But today, when you fill up the tank in your vehicle, this golden era doesn't feel all that golden. We've all seen the cartoon where the consumer is filling out a loan application before filling up their car with gasoline.



Money Talks

So, what is going on with oil today? Simply put, in my opinion, we are witnessing an oil bubble. In fact, if you were to chart the price of oil over the past 10 years, then compare that with a chart displaying the Nasdaq for the 10 years prior to its peak, there is an uncanny similarity.

And we all know how Nasdaq fared.

There is a massive move among investors today toward commodities. For example, earlier this year, CALPERS increased its commodity allocation from \$450 million to \$7.2 billion. Many of the dollars chasing commodities are being funneled into oil investments, driving up the price of oil. That many dollars chasing an investment will certainly have an impact on pricing.

The decline of the dollar in recent years is also counted among the many reasons the price of oil has risen.

But consider some interesting observations. On May 23, 2008, the Department of Transportation reported that Americans drove 11 billion fewer miles in March than they had one year earlier. This 4.3 percent decline was the first decline since the 1979 oil shock, and the sharpest decline ever.

There is evidence that inventories of crude oil have been building to above average levels, and demand has slowed among emerging nations.

So the old law of supply and demand says that if demand slows, supply builds, and prices decline.

Today, demand is slowing, supply is building, and prices are going up. What gives?

What does that sound like to you?

To me, it sounds like every other bubble we've experienced. Washington has taken some measures to slow the rise in oil. But so far, nothing has had an impact.

What will it take?

Eventually demand should drive the price in any market, oil or otherwise. So when the price of oil starts to reflect actual demand, in theory it simply must come down. Government action in the form of interest rate hikes or some type of legislation could help bring down prices.

Regardless of what causes it, I believe that we will see the price of gasoline decline significantly in the future. I believe it might happen in 2008, but more likely sometime next year.

In the meantime, use this opportunity to become more efficient. Ride your bike. Buy a fuel efficient vehicle. Plan your day more carefully so that you can accomplish more with less driving. Do your part to encourage conservation.

Your wallet, and the planet, will thank you.

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