



Should I sell my oil stock when oil hit U\$70?

By CK Wong 2005.08.29

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Introduction

Hurricane Katrina helps the oil price hits U\$70.80 since last oil crisis early this morning. There are a lot of speculations: trading as well as economic impact. I just would like to take a few moments to reflect what has gone through my small investor's mind.

Hurricane and Oil Price

We have been bombarded by the news that the hurricane halts oil and gas production at the Gulf. The oil price has shot through the roof. All the oil related products will be impacted. The question we should ask would be: is this long term or short term? The lost of production is about 1.4M barrel per day. This 1.4M barrel is consumed by the Americans and it is about 12% of the national production but it is only 6.4% of the 20.8 barrels daily consumption (2004 figure [1]). The price has gone up from last Friday's U\$66 to the peak of U\$70.80 in early morning. Is it reasonable? Is it manipulated?

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The 1.4M barrel gap can be filled by increasing the import from other port or Canada. The mechanism to mitigate this type of risk has been established using the reserve. It provides the buffer that balances and secures the supply to reduce the price volatility. The oil price has included the cost of this infrastructure. Apparently this mechanism does not provide the desire effect. The next question would be: why should the reserve be maintained if it does not work? This just shows the American's energy program should be reviewed to adapt to the current energy supply condition.

The sudden surge of U\$4 is a very unreasonable movement because it constitutes a jump of 6% while there is no immediate shortage. It could be manipulated, panic, squeeze on the shortie, or it could be caused by "bad feeling". If the oil platforms at the Gulf are not damaged severely, production should be resumed after the hurricane. Such seasonal production consideration could be discounted in the stock price. In a normal course, specific oil companies' stock should fall depending on the severity of revenue lost. Stock price should not go up. If the reserve mechanism works, the highly volatile oil price should not happen. Such volatility is unhealthy to the economy but it may benefit some specific group of people.

Let's take a look at the price of some American and Canadian oil companies today Aug 28, 2005:

	Open	High	Low	Close	Change	Volume
Exxon [†]	59.240	59.240	58.120	58.420	0.010	17,719,700
Chevron [†]	59.790	60.070	59.010	59.510	0.130	6,886,5000
Royal Dutch B [†]	65.980	66.100	65.320	65.700	0.050	121,300
BP [†]	66.750	66.970	65.850	66.350	0.230	1,898,500
Amerada	126.000	126.000	123.100	124.890	2.790	2,025,100
Occidental	80.250	80.510	79.060	79.830	1.660	2,628,000
PetroCan	93.200	93.290	91.120	91.900	0.280	1,280,100
Shell Canada	38.500	38.500	37.200	37.500	0.500	150,000
CNQ	56.000	56.000	53.550	54.790	1.910	2,756,500
Imperial	117.780	118.200	114.750	115.300	0.250	458,700

[†]These companies have shut-in at the Gulf.

Those have production at the Gulf did not suffer. At the peak of the \$70.8 in the early morning, these Gulf oil companies' share prices rose. This is irrational.

Companies that are not affected by Katrina may make a few more bucks but does it increase the bottom line by a couple of percent of the price in a few days? If it doesn't why the prices increase 2-5%? Oil may not be hedged but they are sold as per supply contract. The contract should have the provision to protect the purchasing price which is standard supply management practice. I don't understand why someone other than trader wants to buy from the spot market. This leads to the other point that the volatility should associate with the future available commodity. However, it is the reverse case.

The market is volatile and emotional. Small investors should ignore these glitches and keep their eye on the big picture.

Should I sell my oil stock when oil price peak?

If the oil price peaks today, you should sell. If the oil price ascends more, we should keep it. As the author of Dow's Theory Letters Richard Russell says "I don't know. The market has its own mind."

As a small investor the worst nightmare is losing the money not because of the company but the commission on frequent trade. Buy on speculation and sell on panic. Frequent trade means you feeding the broker well not your wallet. The day that oil price hits a record high should not be the reason to buy or to sell. It should be guided by your investment objectives.

References

[1] United State Country Analysis Brief by EIA of DOE
<http://www.eia.doe.gov/emeu/cabs/usa.html>