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Oil is the New Driver of Market Volatility

BY DENNIS C. ROGINSKI

Oil has gotten expensive and has been at the forefront of investor's minds for the last month. Normally the credit crunch, the housing slump, and the sub-prime mortgage problems determine the direction of the markets and the amount of volatility each day. Even though these problems still exist, now its oil's turn to make waves. Except for a few trading days, if the price of oil rises, the stock market drops and visa-versa. People are looking for a scapegoat. They blame the politicians, the oil companies, OPEC, consumers, or speculators for oil's quick price rise. Let's take a look at each.

The first ones who should share the blame are the politicians. Congress chooses what industries to subsidize, determines fuel standards for autos, and decides where oil companies can drill. For years lawmakers have disagreed on windfall profit taxes, additional taxes on energy, actions against OPEC nations, and where oil companies can drill. Plus they continued to ignore the need to revise fuel-efficient standards for the auto industry.

The second ones to shoulder some of the blame are the big oil companies. Exxon Mobil reported a 17% profit increase for the first quarter of this year over last year. Executives claim that these profits are necessary to pay for oil drilling equipment and for finding new oil reserves. But a portion of those profits are being used to get lawmakers to establish legislation that favors oil companies. According to the Center for Responsive Politics, oil companies have spent $640 million on lobbying efforts in Washington.

How about OPEC? Saudi Arabia pumps 9.45 million barrels of oil out of the ground each day. They recently announced an increase in the daily output by 300,000 barrels. This is only a 3% increase and wouldn't make much of a difference. Analysts would like to see an increase of about 10%. Even though this would be a short-term solution, it would give consumers some relief.

Does any blame lie with the consumer? I think so. Americans are in love with their cars. We have chosen to buy suburbans and SUVs instead of small, fuel-efficient vehicles. We should have learned lessons from the early 1970s when gas was in short supply. We should know that a natural resource cannot last forever. We have also chosen to live farther and farther away from where we work. Americans spend an average of 100 hours per year commuting to work. So we should take some of the blame.

How about the speculators? Speculators could be long-term investors but are normally traders who will buy and sell within minutes if there is a profit involved. Because of the stock market's lackluster performance this year, speculators are looking for an asset class that will generate a decent return and so they have turned to the commodities market. With talks of emerging-market countries eventually needing more oil, confidence to buy oil builds because of increased demand for it. Prices in this market fluctuate so fast, fear and greed can drive the price of oil up, and this is what has been happening. Speculators are instrumental in setting the daily price of oil, so they are not off the hook either.