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The Great Energy Boom Of 2016

Oil prices have gone up over 60% from their low just a few months ago. That's an astounding result. Some smart traders just got very rich. Why didn't most investors embrace the oil bull market Information overload.

I predicted an energy boom for 2016 in this column on January 7th of this year. (I also predicted a tech bust, but more on that later.) I'm going to claim victory now, even though I expect prices to still climb before year-end, maybe even spike from the Canadian wildfires, and certainly remain volatile. Why was I so sure? Because oil is a commodity that is in great use and it needs to be produced. While its market value can fluctuate with the wind, it costs money to extract the stuff and, ultimately, it needs to sell at or above its cost of extraction.

The world had over-produced crude by the end of 2015 and prices fell below cost for many producers. This couldn't last. There was a massive disinvestment in production, which inevitably led to a rebalancing of prices back nearer to average cost. This was not a hard call.

What happened in late 2015 through early 2016, however, was a negative feedback loop between commodities traders and equity traders. Stocks had become oddly coupled to oil prices due in part to the share of the market held by energy companies but also because of this: equity traders had begun to track falling oil prices as an indicator of a slowing economy at the same time that oil traders were tracking the equity markets as an indicator of slowing future demand. No wonder both oil and equities were falling together.

Many factors influence oil prices, including geopolitical considerations since national oil companies are a big part of the market, and lots of oil is produced in some of the world's more complicated places. So along with the oversupply of product, the market was also flooded with lots of bits of information that obscured the fundamentals of supply and demand and allowed the negative feedback loop to play on. Soon, equity traders will completely stop caring about oil prices, for a while.

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