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U.S. Arctic Oil Drilling Is A Bet On China

The coincidence is poetic: the Obama administration announces that it will approve Arctic drilling by Shell at the same time that China pulls ahead as the world's leading importer of crude oil. These are not totally unconnected events.

A good starting point is a re-read of Liz Economy and Michael Levi's book By All Means Necessary: How China's Resource Quest is Changing the World which outlines the endless thirst for resources of the world's most populous nation. While those who view the world through the lens of defense strategy fret about an arms race in the South China Sea, Economy and Levi make the case that China is increasingly looking to global markets to satisfy its needs.

Arctic drilling is risky and expensive and makes no sense if global oil demand remains at current levels or declines. Traditional existing sources are adequate to meet current demand, with unconventional wells now the swing suppliers.

Ships sit moored at Seattle's Terminal 5, including the Shell support vessel Aiviq, center, where Royal Dutch Shell wants to park two massive Arctic oil drilling rigs, Wednesday, May 6, 2015. (AP Photo/Elaine Thompson)

With plenty of oil flowing already in the United States, Europe in a continued economic slowdown and the BRICs and Next 11 (besides Indonesia) no longer a "thing," who will consume the oil that Arctic drilling will bring to market?

Clearly it's China. Despite disappointing numbers, and despite all the China pessimists, a bet on additional global oil production is a bet that China's growth will continue and that current supply will not satisfy that demand. With the news that China is now the biggest importer, it seems that that bet may not be so crazy.

In my humble opinion, the pessimist/optimist divide on China falls along the lines of those who have spent little or no time in China and those who have spent a lot of time in China, beyond the Forbidden City and Great Wall tours.

China is not only a giant, populous country, it is a political economy, not a private economy, so predictions of a coming bubble burst based upon the Western private market paradigm are useless. In China, the government owns both banks and businesses and can and will manage its "economy" from the top in a way that the United States can only try to do at times of crisis. Not that I am recommending it, just that Westerners often forget this distinction.

That Shell will commence drilling this summer is also a bet on the price of oil, already in a steady recovery from the great 2014/2015 price plunge. Low prices don't justify expensive exploration and production activities so, clearly, Shell is not thinking that prices will return to the lows of the dark day of the winter. Neither, frankly did any of the experts at the time.

Stock picks? This will be a boon for the major oil field services companies. Think about the ones that can work in extreme conditions. Try CHC Helicopter, which is provider of helicopter transportation services to the offshore oil and gas industry. It is the world's largest commercial operator of heavy helicopters, and is in the First Reserve portfolio.

My fund Aquamarine Investment Partners is a real asset fund and does not trade in liquid securities so we do not have positions in these stocks, and I don't invest in individual stocks in my personal portfolio to avoid any possible conflict with our investors.

