

The Roller Coaster Oil Market

There is a public mythology concerning the oil markets that has been fueled by a sharp rise in oil prices in the last few years. That perception is that the oil companies whose job it is to acquire the raw materials to make petroleum products, including gasoline for transportation, are the source of the rising prices. It is easy for the public to pin the blame on big business.

The truth is that those on the inside of the oil business know full well that the oil business is tremendously cyclical. That means that the old adage, "whatever goes up must come down" definitely applies to the oil markets domestically and around the world. The current high prices are more a reflection of problems with refineries and with supply due to tension in the Middle East than it does with the profit objectives of the oil companies involved. In truth, oil companies have to cope with sweeping shifts in supply and demand and it impacts how they plan their economic futures as much or more than it affects the average consumer.

This upswing in the price of gas is not the first time the oil business has seen huge profits and gains in their returns. And anyone who has been in the oil business for a few decades knows full well that the current high profitability economy which is benefiting oil companies tremendously will turn the other direction at some point. Just as there is a shortage due to problems with repairs or temporary shut downs at the nation's refineries, there will come a time when all refineries are producing at full capacity and there will be a glut on the market which will drive prices down.

Similarly just as oil shortages dominate the market and are on the minds of consumers because of Middle East tension, oil supplies can shift dramatically. A new discovery in Asia, The Soviet Union, Europe, South America or off shore in America can suddenly send a glut of supply into the market that will send the price of crude oil plummeting and with it, gas prices worldwide.

This is not just pie in the sky forecasting but an industry trend in the oil business that is supported by years of experience, research and tracking by the businesses most impacted by sudden supply and demand turns in the markets, those big oil companies. The oil business is so used to the roller coaster nature of the market that even though the market is good now for the oil companies, they are already preparing for the next downturn and how they will survive when supply exceeds demand and prices drop leaving them with big adjustments to make in how they do business.

As with any smart manager of a business or investor for that matter,

diversification is the way to prepare a strategy for handling volatile markets like we see in the oil business. And that has been a cornerstone of the strategies that have kept the oil companies able to ride the ups and downs their industry undergoes on these huge swings in supply, demand and profitability. While the oil industry is enjoying unprecedented prosperity now, there is coming a time when they will see their profits drop and they will have to brace for a downturn of unknown length and survive it until the next swing of the pendulum back out.

Even now, you can bet that every big oil company in the world is already investing heavily in diversified business interests that can generate revenue to keep the company afloat when oil revenues are not as lucrative as they are now. Those investments will be in real estate, the stock market and even in far flung unrelated industries such as retail or the entertainment industry. The more diversified a company can get, the more prepared they are to ride out the roller coaster oil market.

And this shrewd business practice is a good signal to those who are investors in the oil industry as well. Just as the companies who are fattening up our portfolios now are strong investments, we should know that the downturn is coming and diversify while times are good. Then we can ride out the next oil slump just as handily as the companies that live or die by the oil markets do year in and year out.