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## **ENERGY MANIAS**

Concerns about the looming oil shortage are intense. It seems that most people from Wall Street to Main Street to those in government are worried about the phenomenon called "Peak Oil".

Unfortunately, there are some laggards who are not sufficiently motivated and a leading expert slams the skeptics and, at the same time, elevates the status of the true believers.

Although energy is mainly a secular matter, the expert writes "*This is a question of almost religious importance which needs the study and determination of every intelligent person.*".

And the key message is "*It is the material energy – the universal aid – the factor in everything we do. With petroleum almost any feat is possible or easy; without it we are thrown into the laborious poverty of early times.*".

Amen to this, but it is important to stress that these quotations have been provided without a date and with one key word changed.

The date was 1865, the important energy source was coal, and the writer was Stanley Jevons – a leading economist. His book – The Coal Question – was thoroughly researched and broadcast his personal concerns that the industrialized world was about to run out of coal and civilization, as they knew it then, was about to collapse.

Now, the concern is that we are running out of oil and great distress will follow.

As with any such concerns before then and right up to now, the intellectual speculation seems mainly driven by soaring prices.

Commodity prices had been increasing for twenty years, and were soaring with the U.S. Civil War and the dollar depreciation that went with it.

The market soon attended to the price problem and even to this day there is no shortage of coal.

This time around, crude oil has the headlines and if we adjust the price by the producer price index it tells an interesting story.

The real price soared to 73 dollars with the 1980 crisis and then plunged to 16 in 1986.

Now, twenty years later, it is again back to 73 and those who insist that their intellect and personal concerns are superior to market forces are again getting the headlines.

This was the case for coal in 1865 and the last time it happened to crude oil was in 1980 when the then U.S. Secretary of Energy stated that market forces didn't apply to crude oil – his exact words were:

***"One thing is for certain, [crude] prices will continue to rise ... traditional criteria of supply and demand don't apply."***

**- Charles W. Duncan, Secretary of Energy – Feb. 25, 1980**

It seems that the higher a mania runs, the higher the intellect that succumbs to it.

If, indeed, oil prices moved solely on dysfunctional Middle East politics, then the chart would show a relentless rise from lower left to upper right – beginning as the Royal Navy converted from coal to oil in the early 1900s.

However, crude's history records major price changes dependent upon the 4 to 5 year business cycle as well as recurring manias in commodities.

Of course, prior to the development of petroleum as a commercial product, distillation of coal and/or whale oil provided illumination, chemical, and cosmetic needs and prices soared with the great inflation in commodities that blew out in the 1860s.

Ironically, it was in the late 1860s that petroleum started on its path to become the giant it is today.

In the long history of the financial markets, it didn't take long before "King Coal" became "King Crude".

The next mania in commodities climaxed in 1920 and crude oil's action became extremely compelling when Mexico briefly cartelled the price. At the time, Mexico was the world's second largest producer (after the U.S.), which amounted to some 25% of global production.

This intervention anticipated OPEC's attempted cartel that flourished during the 1970s and flopped in the 1980s.

But, as noted above, the chart is rarely a straight line and the 1920 high was slammed by the contraction that followed the 1929 stock bubble.

In gold terms, the price of crude fell to about a quarter of its high, which was about the same as the long slump in whale oil prices following the 1873 stock bubble.

Quite likely, petroleum prices will still be subject to the long term trends, with the ups being provided by great asset inflations and the downs provided by the lengthy post-bubble contractions.

Also evident in the price history are fluctuations with the perennial 4 to 5 year business cycle.

On the most recent one, crude prices have rallied from \$17.48 (spot West Texas intermediate) in November, 2001 to the recent high of \$75. It's important to peer through the distortions caused by the policies of deliberate currency depreciation and this can best be done by adjusting the price by the Producer Price Index (PPI).

The "big" high with the 1980 Iranian Crisis was \$73. This sets the 2001 low at \$21.82, from which it has soared to \$75. In 1980, the tout was that crude would get to \$90, which compares with today's touts of \$100.

Obviously, conditions are as speculative as at the 1980 high or, for that matter, at the 1920 high.

With such market compulsions evident again, it's natural to ask the question *Are we there yet?*

In this case, the "there" means the end of yet another speculative trip in energy prices and, for this, it is prudent to observe that every great mania in energy prices has occurred close to the peak of a business cycle. For many, the main explanation to a slump in crude prices would require a cessation of Middle East troubles, which is unlikely.

For the more disinterested, the best explanation would be just another post-bubble business contraction whereby prices for most commodities (including oil) go down.

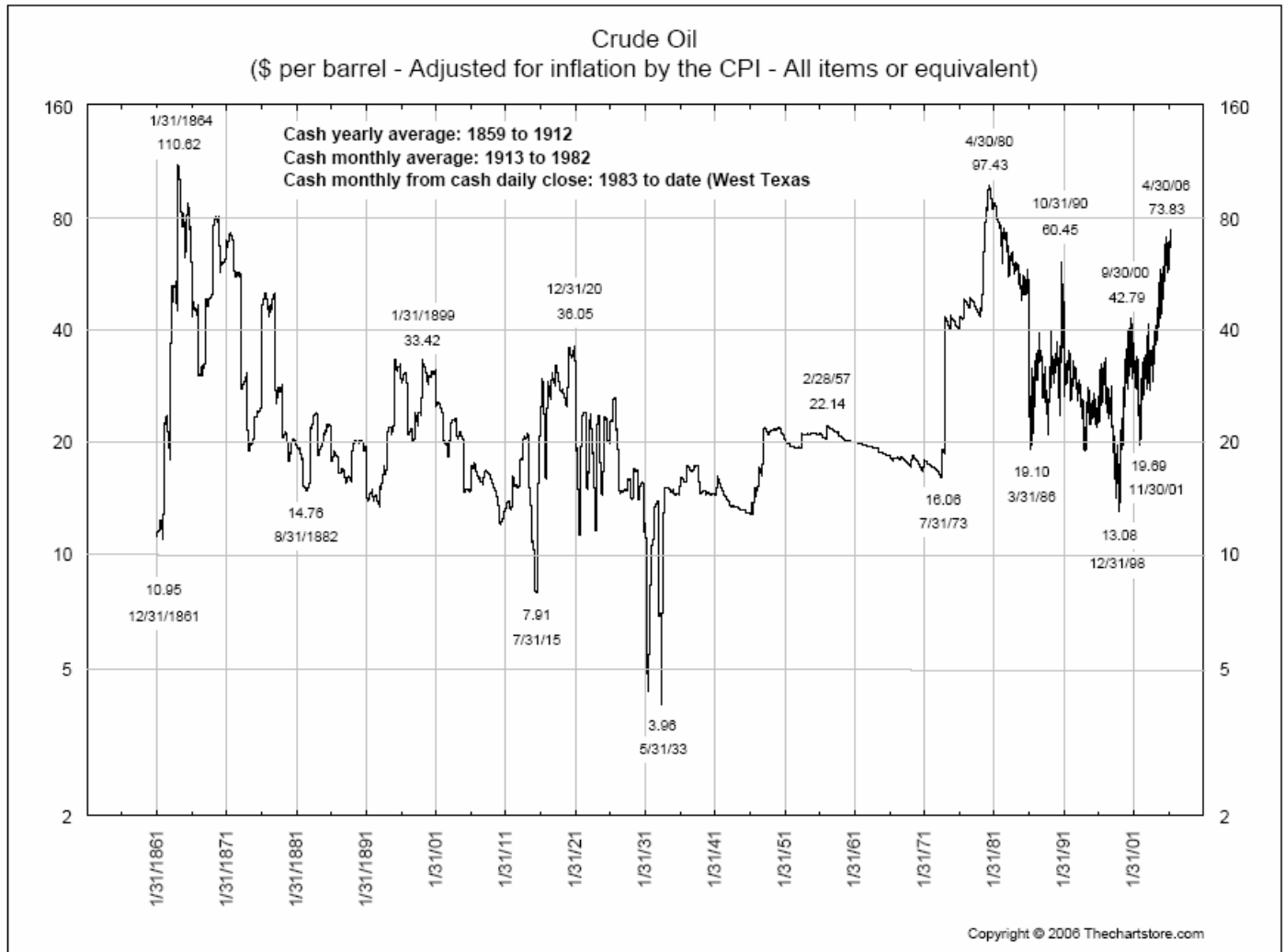
One of the other noticeable aspects of crude oil is the seasonal pattern with a high in the late Spring and a decline into the late June to early July window.

One of the most relentless forces acting on commodity prices is deliberate dollar depreciation and this is subject to influences outside the senior central bank. If the Fed's intentions were supreme, the dollar chart would be a straight line from the upper left to the lower right, but this is not the case as there are times when the Fed just can't depreciate.

Typically, this also occurs during the post-bubble contractions when implacable market forces deny the policies of depreciation.

According to the technical analysis that identified the dollar's low in December, 2004, the dollar index is poised for a rally, in which case an essential part of the compulsion to consider commodities as an asset class to "invest" in will diminish.

Speculative excesses have captured the imagination of pundits, punters, policymakers, and intellectuals in a manner unseen since similar excesses were displayed by the same crowd in 1980 or at any great blowoff in commodities in history.



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