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Oil Freefall

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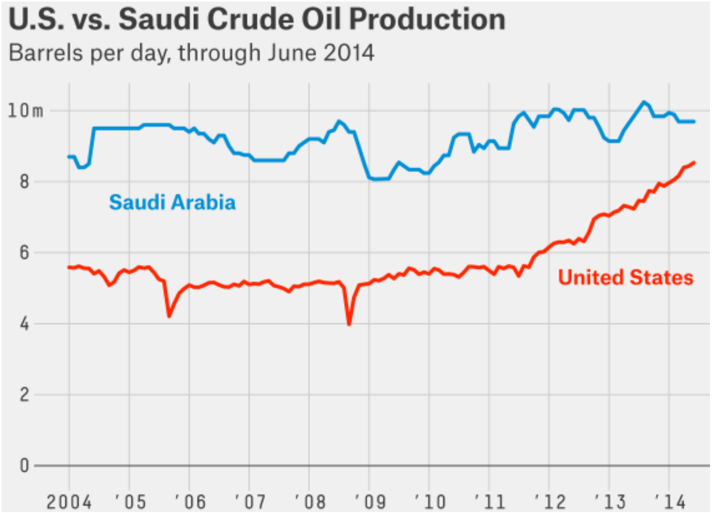
Since June 20th, when oil peaked at $107.95 a barrel, West Texas Intermediate (WTI) has plummeted, resulting in the price of oil dropping to a low of $44.20. That's more than a 59% drop over the past 6 months. Drastic moves in the price of oil are not an anomaly; in fact it's happened 6 times since 1980: 1987, 1991, 1999, 2002, 2009, and 2014.[1] So what is causing this free fall in the price of oil? Two words: supply and demand. Currently, the world is producing about 1.8 million barrels of oil in excess of the current demand.[2]

From the supply side, the shale boom in the U.S. is a key contributor to this glut in oil. With prices of crude hovering around $100 per barrel and new drilling techniques making extraction more cost efficient, it became profitable for companies to drill for oil in hard-to-drill places, specifically in shale areas throughout North Dakota and Texas and in the thick oil sands throughout Alberta, Canada. Since 2008, the U.S. has added 4 million barrels per day of crude to the global market, significant as a percentage, since global crude production is around 93 million barrels per day. Up until this year, the growth in U.S. production was almost completely offset by the reduction of 3 million barrels per day in production out of areas like Iran, Libya, and Iraq.



From the demand side, a slowing global economy has led to lower demand for oil in Asia and Europe, especially with the anticipated decline of growth rates in countries like China and Germany. In 2014, China's GDP grew +7.4%, the slowest since 1990. More broadly, oil demand has simply been flat. Governments and individuals have become much more cognizant of the impact of fossil fuels on the environment, and are seeking to reduce their carbon footprint on the Earth. Gasoline consumption has fallen in the U.S. as car manufacturers have not only begun making cars that are much more fuel-efficient, but also vehicles that run without the need of gasoline at all, for example Tesla.

Interestingly, four out of the five times crude oil has dropped by 50% or more in a six month window, the S&P 500 has been up six months later, averaging +3.7% for that period. All five times, WTI rebounded in the subsequent six month period, averaging a +52% recovery.[2] Not to mention, the average price per gallon for consumers across America is trickling down to $2.00, with several states already seeing lower prices. The average price per gallon in the U.S. sits at $2.12, down 46 cents in the past month, and down $1.01 from this time last year.[3] That means the U.S. consumer is saving around $750 at the pump per year, which is a potential boost to the economy as that cash goes right back into Americans wallets.

[1] CNBC.com "Here's what happens to stocks when oil drops 50%"
[2] Bloomberg.com "Oil Recovery Seen by Gulf Producers as Slump Spurs Demand"
[3] USAToday.com "National gas prices to soon fall below $2"