

StockTwits®

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MACRO WEEKLY

A periodical of the StockTwits
Investment Community

OIL SPIKE

The Developing World is Ready
As Oil Heads to Higher Ground

Edited by Gregor Macdonald

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Tadas Viskanta
of Abnormal Returns
Talks To David Gaffen
of ThompsonReuters

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OIL SPIKE

Developing world economies now consume more energy than developed economies. That was inevitable, and is mostly explained by the difference between 5 billion vs 2 billion people. What was not expected is that emerging market oil consumers would be able to handle easily prices above 80/barrel. The result, is that the risk of another oil spike is rising. Will the Winter of 2010-2011 see a big advance above 100?



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A NOTE FROM THE EDITOR

Welcome to StockTwits Macro Weekly, the weekly magazine of the StockTwits investment community. Each issue features a core essay, written by the Editor. Around this, we build in the key news events and observations, from the past week. [To have each issue sent to you, sign up here.](#)

You will also find StockTwits Macro Weekly functions as a live document, that is eminently clickable and is therefore a helpful launching pad to other relevant content. Feedback from readership is welcome, and we are always on the lookout for written contributions from the community: gregor@stocktwits.com

OIL SPIKE— The global industrial collapse of 2008 and the ensuing recession was supposed to give economies plenty of time before having to contend again with high oil prices. Oil's astonishing, 6 month corkscrew from above 140 to a low in the 30's confirmed the time-tested wisdom that recessions always crush the master commodity. In that one motion, five years of resentment towards oil's steady rise was wiped away. By early winter 2009, just about every assertion for oil's decadal rise had been confirmed. That it was the subject of commodity market speculation, that producers had held back production, and that supply was under no constraint at all. Indeed, oil was returning--as anticipated--to its rightful place below 35 dollars a barrel. The break above the long-term, historic ceiling of 40 was surely anomalous, having taken place several years before. Gasoline was headed back toward 1.50 a gallon. And as a result, the US economy would revive.



As it turns out, oil would only spend about 20 trading sessions below 40 dollars a barrel, over a brief eight week period in the winter of 2008-2009. By March of 2009, oil was back above 50. By April, back above 60. And by June, back above 70. Despite the severity of the systemic financial crisis, (which, along with the previous high prices had taken a whole tranche of gasoline consumption offline), key realities in global oil production and supply were unaltered by the man made problems of credit, and debt-deflation. In short, global production of crude oil had already stopped increasing after 2005. Worse, cost inflation to bring on new supply, which started showing up as early as 2002, was exploding higher by 2008. The financial crisis

Indexes

INDU 11491 TNX 3.33 GOLD 1374.34 VIX 16.11 SPX 1243.91 DXY 80.35

StockTwits.TV: Abnormal Returns



Abnormal Returns has had a fantastic year, having built [a beautiful web-site](#) and scoring high marks with a growing readership. Tadas Viskanta has been putting this all together single-handedly, in addition to creating a show on StockTwits.TV. Well done.

The AR show has made a speciality of interviewing the most compelling independent thinkers in the world of financial media, and trading. This week, Tadas invites a discussion with markets editor at Thompson-Reuters David Gaffen to discuss his new book, [Never Buy Another Stock Again: The Investing Portfolio That Will Preserve Your Wealth and Your Sanity](#).

Gaffen offers a refreshing perspective, in that he encourages investors to stop optimizing for ultra-performance. More broadly, Tadas and Gaffen have a fascinating discussion about trends in personal finance journalism. [Watch the show here](#).

[StockTwits.TV](#) can also be taken as an iTunes subscription.

had done little to ameliorate that particular trend either, as offshore rates for big rigs and wages for specialized labor were barely dented. Combined, these twin pressures bulldozed their way through the gauntlet of the world's troubles, and by summer of 2009 were applying new pressure to the global economy. Which brings us to today.

As 2010 comes to a close, with unpayable mountains of debt from Japan to the US and Europe, oil--at 88 dollars for NYMEX and 91 dollars for Brent--offers no solace to these moribund developed world economies. Putting people back to work remains difficult. Meanwhile, as these OECD economies find they cannot afford to add new demand at current prices, Non-OECD economies are having little trouble adding new users at 90 dollars a barrel. Before we explore that particular dynamic, it behooves to review some facts here at the end of the decade. First, global crude oil production in 2010 has failed for a fifth year to exceed [the 2005 annual average of 73.718 mbpd](#) (million barrels per day). Perhaps in 2011, some spare capacity will come online for 6 months or so, and either tag or slightly eclipse the 2005 level. But frankly, most were certain such an increase was due in 2008, when oil prices average 99 dollar for the year. Thus, five years of oscillating global oil production is remains below an increasingly hard ceiling. Second, OECD demand growth which had been strong for decades slowed down significantly starting the past 10 years. That may sound like good news, but, it highlights instead the financial constraint of adding new oil demand. Because of the structurally embedded nature of oil into western economies, this is a limit to growth. Finally, there is the new phenomenon of quickly advancing demand from developing world economies, combined with their lower sensitivity to price. When we take this factor together with five years of stagnant supply, we are at continual risk of price spikes and such a spike is very likely developing right now for the

winter of 2010-2011.

It can be very counter-intuitive to understand that the developing world can handle much higher oil prices--beyond a threshold--than the developed world. To explain this vexing dynamic, however, we need only understand that the typical user of oil in the OECD has been using large amounts of oil for decades. Not only as an individual, but, as embedded into OECD economies with their multiple forms of transport, and shipping of food and goods. Indeed, OECD economies are “wealthier” than Non-OECD economies, right? Well of course, but this is the point. Coming from lower levels of wealth, users in developing economies are newly adopting oil and using smaller quantities as they come on line. In other words, the marginal utility of oil to the new user in Asia is huge whereas the old user of oil in the OECD already received the oil boost to wealth starting 75 years ago. The result? The OECD user is now shackled to a higher quantity of oil consumption to maintain lifestyle. The new user in emerging market is instead liberated by oil. Who could possibly care if oil is at 60, 80, or 120 dollars a barrel in the developed world as part of a lifestyle upgrade from using zero gallons of petrol per month to using 4-8 gallons per month? And besides, most developing world economies are infrastructurally still running on coal. Yet another fact that helps explain the significantly reduced exposure to oil embedded within emerging market economies.

What is likely to trigger an oil spike this Winter, however, is the combination of these structural factors with falling inventories of global oil. [IEA data on OECD inventories](#) has show that only US inventories have remained stubbornly high this year as Asia and Europe inventories fell steadily. But that too started to change roughly 6-8 weeks ago as US inventories joined in with the larger trend, [falling over 20 million barrels](#). The driver appears to be global distillate: a

Mal.gracious



In [the continuing saga that is Yahoo](#), the former cutting-edge internet name flubbed again with users this week. Responding to a leak of pending corporate strategy, Yahoo failed to clarify whether a number of its internet services, in particular the bookmarking site Delicious, would be closed down. Instead, Yahoo spewed forth a stream of robotic verbiage, that rivalled the best of obfuscationist PR traditions. The result? Panic among researchers and readers across the internet who'd come to rely on Delicious for archiving.

Over at Infectious Greed, Paul Kedrosky ran with the story, and produced [a series of Yahoophemisms](#). Of particular note was the phrase: *Off-Strategy Products*. The PR machine clearly stumbled on that one. It recalls the toxic *Off-Balance Sheet*, but this assumes Yahoo! even understands...itself.

By the end of the week Delicious users were calmed to learn [Delicious was not in fact shutting down](#). However malgracious one wonders what Yahoo is thinking here per the overall trend growth in data.

Happy Recovery Village



A trend we've spotted this Autumn is the media's now habitual use of the word Recovery to describe all stories relating to the US economy. The curiosity in all this however is that most of these stories do not describe economic recovery.

In Derek Thompson's Atlantic Magazine slide-deck this week, [The 20 Cities Leading the US Recovery](#), there's no claim of any broad-based recovery in the US, but apparently cities like Baton Rouge and Buffalo are doing well. Really? Buffalo? The Atlantic actually writes the line "Overall, the city-by-city report card...reveals a recovery stuck in neutral." Huh. [At the LAT](#), Alana Semuels writes a story about the recovery which explains...how no recovery in jobs or housing can be expected for at least another year. We detect a pattern.

The trope of a *recovery* among US journalists may be an example of Village Behavior, in which the media understands there's only a marginal recovery taking place in the US at best, but finds itself stuck with the wrong word to describe. Also possible: the media is simply unequipped to write about economic complexity.

demand rush for everything from heating oil (cold weather) to bunker fuel (shipping) and of course diesel--the go-to oil product of the liquid energy universe. Those high-mileage diesel vehicles, so popular in the developing world now, are playing a role. So too are the vagaries of industrial policy in China, where even the most brief reductions in coal-fired power generation can send small factory owners to pull the rip cord starter on their diesel generators. With oil prices at 90 already and the bulk of Winter still ahead of us, the 100 dollar level can be reached easily in any 5 day period. Assuming US inventories come down further as refineries make lots of diesel for export, that's going to make the oil market edgy about supply as it looks towards the end of March, when global refineries need to switch from making distillate to gasoline. The risk of seeing oil at 105-115 is rising. Given that the reflationary stock market rally will mark its two year anniversary come March 2011, the intersection between high stock prices and even higher oil prices will present *intriguing thresholds* as we head into Spring. As a wise man once said: act accordingly.

--Gregor Macdonald, 19 December—Amherst, MA

