STANDARD &POOR'S

Turmoil in the Middle East: A Look at Oil Prices, Market Fears, and a Fragile Economic Recovery

Given that the United States produces nearly half of its own oil and obtains another sizable chunk from Canada, Mexico, and Venezuela - not from the Middle East - supply disruptions are far less likely to be an issue here at home.

The recent spate of "people's" uprisings across North Africa and the Middle East has sent shock waves through world oil markets and raised fears over what the fast-moving events could mean for the broader global economy.

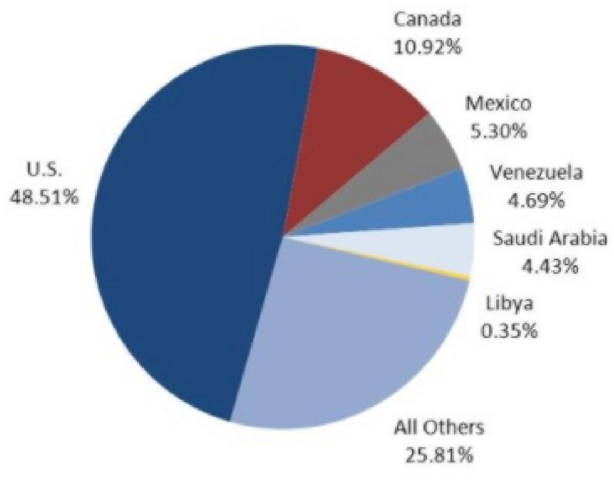
In the wake of a largely uninterrupted 28% rally since late August, the S&P 500 has recently succumbed to aggressive profit taking amid worries over potential oil supply disruptions stemming from escalating Middle Eastern political instability. The sudden overthrow of governments in Tunisia and Egypt and ongoing unrest in Libya, Bahrain, Yemen, Iran, and Algeria have sent oil prices soaring above $100 a barrel, their highest level in more than two years.[1]

And consumers are feeling the pinch at the pumps. According to the U.S. Energy Information Administration, the national average retail price for regular grade gasoline was $3.38 per gallon on February 28, an increase of 19.4 cents per gallon from the previous Monday and the second largest one-week increase since 1990.

The Federal Reserve Responds

In his March 1 testimony before Congress, Federal Reserve Chairman Ben Bernanke remained cool in his assessment of the current situation. "The most likely outcome is that the recent rise in commodity prices will lead to, at most, a temporary and relatively modest increase in U.S. consumer price inflation." He concluded by stating that "the Federal Reserve will continue to monitor these developments closely and is ready to respond as necessary to best support the ongoing recovery."[2]

Sources of U.S. Oil



Source: U.S. Energy Information Administration, *2010 Petroleum Supply Annual*.

Despite the Fed's measured remarks, the uncertainty surrounding current conditions and future expectations is fomenting fears among investors that further oil price spikes could trigger inflation and threaten economic growth both in the United States and abroad.

How much disruption in oil supply will occur is completely speculative at this point, but the widening spread between Brent (European oil prices) and West Texas Intermediate (U.S. oil prices) suggests that the market's main fear is a short-term supply disruption. Given that the United States produces nearly half (48.5%) of its own oil and obtains another sizeable chunk from Canada, Mexico, and Venezuela - not from the Middle East - supply disruptions are far less likely to be an issue here at home.

Takeaways for Investors

While global risk aversion is likely to remain elevated in the near term as investors worry that Libyan unrest may spread to the oil rich Gulf States of Saudi Arabia, the UAE, and Kuwait, according to analysts at Standard & Poor's this is unlikely as the wealthier Gulf States' greater financial resources have precluded the extreme social inequality that has fostered political upheaval elsewhere in the region.

In addition, OPEC's 4.4 million barrels in daily spare production capacity is more than enough to offset any lost Libyan or Egyptian oil production, which totals 2.5 million barrels per day, according to the U.S. Energy Information Administration. In addition, with continuing positive economic and corporate news, Standard & Poor's views current geopolitically driven U.S. equity volatility as an intermediate-term buying opportunity and currently predicts that the S&P 500 will reach 1370 over the next 12 months, which equates to a 7% total return.

Finally, S&P predicts that the U.S. economy will continue to gradually recover and forecasts a 2011 GDP growth of 3.1%, driven by continued gradual improvements in consumer spending, exports, and business investment.

[1]Source: Standard & Poor's, *U.S. Financial Notes*, February 25, 2011.

[2]Source: Board of Governors of the Federal Reserve System , *Semiannual Monetary Policy Report to the Congress*, Committee on Banking, Housing, and Urban Affairs, March 1, 2011.