Financial Communications

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Market Alert

Oil: Taking the Economy for a Ride?

Headlines trumpeting the potential for $5 a gallon gasoline have ignited fears that the situation could parallel the run-up in prices during 2008.

Higher crude oil and gas prices could derail a robust stock market and depress economic growth.

Whether at a gas station or on the news, consumers can't get away from rising oil and gasoline prices. A barrel of West Texas Intermediate crude reached $108 on February 24, and gasoline averaged $3.73 a gallon nationally on February 29, $.36 higher than one year earlier.[1] Typically, gasoline prices do not spike until the summer months when motorists drive more and demand escalates. Reasons for the recent run-up include geopolitical tensions with Iran, violence in Syria, demand from emerging markets, and signs of an economic recovery in the United States.

But the big question is the impact of hefty prices, or further increases, on the stock market and on the U.S. economy. High energy prices have the potential to depress corporate earnings, reduce household spending, and bring about a spike in inflation. According to one recent analysis, the typical driver uses 60 gallons of regular unleaded gasoline a month and a 50-cent a gallon price hike would cost a typical car-owning consumer an additional $30 a month.[2]

Energy Price Points

Crude oil and gasoline prices have escalated, but prices for other forms of energy, such as natural gas and electricity, have either declined or remained stable.

	2010 Actual	2011 Actual	2012 Projected
Home Heating Oil per Gallon	$3.05	$3.71	$3.84
Electricity per Kilowatt Hour	$0.11	$0.11	$0.11
Regular Grade Gasoline per Gallon	$2.87	$3.53	$3.49
Natural Gas per 1,000 Cubic Feet	$11.74	$10.78	$10.52
Crude Oil per Barrel	$81.95	$94.86	$98.65

Source: U.S. Energy Information Administration (EIA). Crude oil is measured by the price of West Texas Intermediate Crude. Amounts are annual averages. The amount for 2012 is the EIA's projection.

What Investors Can Do

The direction of future oil and gasoline prices remains uncertain, but you may want to consider the following:

- **Anticipate elevated prices for the short term.** S&P Capital IQ believes that oil prices will average close to their current level throughout 2012 because uncertain economic growth prospects are likely to subdue a short-term surge. That said, there always is the potential that prices could go higher if an unforseen event occurs. Be prepared for $4 or maybe even $5 a gallon prices.
- **Avoid overweighting sectors and individual securities that rely heavily on fuel for their operations.[3]** Examples could include trucking, airlines, home delivery companies, and certain utilities, or organizations that use these industries to reach the consumer. Diversify your investments to make sure you are not overly concentrated in these types of investments. Diversification does not ensure against market risk.
- **Realize that commodity-related investments can be volatile.** It is tempting to invest in investments tied to fossil fuel in an attempt to benefit from an expected run-up in prices. But remember that oil can have ups and downs. During 2008, the price of a gallon of oil reached $145 before plunging as the recession took a toll on the oil market.
- **Rely on pooled investments.** If you decide to invest in energy, pooled investments such as mutual funds and exchange-traded funds (ETFs) may lessen the risk associated with an individual security.[4]

Factors that investors cannot anticipate may ultimately influence oil and gasoline prices for better or for worse. In the meantime, an understanding of oil's impact on both corporate America and consumers may aid your planning in a variety of situations.

[1]Sources: Standard & Poor's *U.S. Financial Notes*, February 24, 2012; www.boston.com, "Gas Rises Again Even as Signs Point to Slow Demand," February 29, 2012.

[2]Source: *The New York Times*, "Tensions Raise Specter of Gas at $5 a Gallon," February 29, 2012.

[3]Investments in specialized industry sectors have additional risks. Sector funds may be more volatile than funds that invest across many sectors or industries.

[4]Investing in mutual funds involves risk, including loss of principal. ETF prices change throughout the trading day, and investors may not be able to realize a quoted price. Purchase and sale of ETF shares may involve brokerage trading commissions that are not typically included in expense calculations.