Weekly Commentary by Professor Jeremy J. Siegel

China Data Turns Softer; U.S. Still Hostage to Foreign Oil

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Stocks settled back this week after hitting a recovery high on Monday. There was not much U.S. data and what there was showed housing slightly on the softer side after a very strong run in the last 3 months. Gasoline prices continued to rise, as regular hit $3.89 a gallon and current futures prices predict another 6 to 8 cent rise. But most of the softness in U.S. stocks was due to data out of China which indicated lower-than-expected growth. Some forecasters predict that GDP growth there has fallen to 7% from 9% recently. This is hardly a "recession," but news from China sets the tone for the European and U.S. markets and greatly impacts commodity prices. Until today, crude oil fell $3 to $4 a barrel on the soft China news. Although falling energy prices benefit the U.S. economy, they do not benefit the major stock averages as much since the energy sector has such a large weight.

It should be noted that both the oil futures and gasoline futures markets display "backwardation," a state where future prices are lower than spot prices. May Brent is selling for $125 a barrel , but May 2013 goes for $115.61, May 2014 for $107, and December 2020 oil at only $92.49. For gasoline, April 2012 wholesale prices are $3.3851, but April 2013 sells for $3.00, and March 2015 for only $2.61 a gallon, 77 cents lower than spot prices.

Part of this backwardation can be explained by future improvement in extracting techniques that will increase the effective supply of energy, much like what happened to natural gas. But some represents the fear of major disruption in the supply of oil caused by a U.S. or Israeli military strike against Iran's nuclear capabilities. Indeed, Intrade.com puts the probability of such a strike occurring this year at near 40%. Certainly if this occurs, oil prices could spike dramatically upward, and no one wants to be on the short side of that trade.

How much of a premium that puts on crude is difficult to determine, but I would not be surprised if it were $20 or higher per barrel. If no strike occurs, crude will drift downward as bulging inventories will put pressure on prices. But no one knows when and if this will happen. Recent oil discoveries have indeed lowered U.S. imports of liquid energy products. But when such imports still amount to 50% (down from 60%-65%) of our total usage, the U.S. is still greatly exposed to the vagaries of foreign demand and supply.
