# Taking Stock: Is Big Oil running out of gas?

*by Malcolm_Berko*

Dear Mr. Berko: What do you think will happen to energy prices over the next couple of years and what do you think about investing in oil stocks? I missed the boat five years ago because I didn't have the money to invest. Now I've got about $30,000 that (if you think this is the time) I'd like to put into various oil issues like Exxon, Conoco, BP, Chevron, etc. So I would appreciate your thoughts on the timeliness of investing in oil issues now and what you think the best oil stock investments would be for me. I just want to buy class. I'll be a long-term investor and do not want to speculate. My brother-in-law, who is an analyst for Merrill Lynch believes that oil prices could break below the $50 level this year. That would be great but it would also be bad for oil stocks.

What are your thoughts?

N.W.

Kankee, Ill.

Dear N.W.: The price of a barrel of crude oil resembles the speeding path of a giant Coney Island roller coaster. In mid-July 2006, oil nearly rose to $80 a barrel and pundits, seers, gurus and the suits on the Street thought that the "crude stuff" was going to poke through $100.

The price of oil will always do what its supposed to do but never when it's expected to. As the momentum began to slow, world sentiment became moderately bearish and one could purchase all the crude he wanted at $50 a barrel. In fact, some of the suits were certain crude was headed to the high $30s and low $40s. They were wrong once again. Oil reversed its downward plunge and moved from $50 a barrel to over $60 by February/March of this year.

The suits tell us that oil plunged from nearly $80 to $50 due to an unusually warm November, December and January. They're partially correct. Some say that the price of crude fell 25 percent (to $60) because the Saudis, for political reasons, want to reduce Iran's petrol profits. I think that's tommyrot, but it sounds politically correct to American ears. The International Energy Agency tells us that "oil used by industrialized nations fell 0.6 percent last year, most likely a response to higher prices." While that's true, I strongly doubt that a 0.6 percent drop in demand would cause prices to crash by 25 percent.

I'm convinced that the real reason for the rise and subsequent crash in crude prices is not political, not warm weather nor reduced demand. Rather I believe it may be the ruthless traders at Lehman Brothers, Credit Suisse, Merrill Lynch, Goldman Sachs, UBS, CitiGroup and hedge funds who covertly and possibly in concert, create and thrive on price volatility. Their mastery at dissimulation, chimera, illusions and guile has generated record profits for Goldman, Lehman, Merrill, etc. The process of making money knows no loyalty, no country, no rules and is without conscience.

I believe oil prices will remain at this level for a good part of 2007 and we might even see oil at $50 once again this year. However, I think that $50 oil may be a floor price and I'm not enthusiastic about the stocks in the oil patch in 2007. I believe that we may become accustomed to oil at $70 to $75 a barrel for the next couple of years and perhaps watch the price head higher from there. The reason is simple as Simon: falling reserves and dwindling supplies.

It's acknowledged that Mideast oil reserves are nearly half-empty. Companies searching for oil in Brazil, the Caspian Sea, Mexico, West Africa, the North Sea and even Russia are having enormous problems getting oil out of the ground. While the number of drilling platforms has tripled in the past eight years, production still remains at those levels back then.

Now as prices of that "crude-stuff" fall, the suits in their unassailable brilliance also reduced their earnings projections for Chevron Corp. from $7.94 in 2006 to $6.88 in 2007, Exxon Mobil Corp. from $6.55 to $5.77, BP from $6.18 to $5.63 and ConocoPhillips Co. from $10.22 to $8.26.

So I wouldn't buy individual energy stocks. I think it's a safer bet and possibly better results if you purchased the no-load Vanguard Specialized Energy Fund (VGENX-$69.71). This five-star, $6.4 billion fund has a low turnover and low expense ratio while Exxon Mobil, Chevron and ConocoPhillips (each of which is down this year) represent 17 percent of assets. Total SA, Schlumberger Ltd., Valero Energy Corp., BP Group, BHP Billiton Ltd. and BP PLC represent 15 percent of VGENX's portfolio. VGENX's large-cap, bland portfolio has been managed by Jim Bevilacqua since 1998 and in the past five years it's gained an annualized 26 percent versus 21 percent for the typical energy fund.

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