



## Oil-Mageddon

You know... these continue to be REALLY interesting times... I mean, news with sizable economic impact seems to be *on tap* almost every day – Arab Spring, a dictator-free Libya, Occupy Wall Street... Greece and now Italy, And very recently, a most bizarre addition – a failed attempt by one major oil producing Islamic nation, Iran, to assassinate the ambassador to the U.S. of another major oil producing Islamic nation, Saudi Arabia, right here on U.S. soil.

Here's the plot, and frankly, while it's comically amateurish in its ineptness, it's also extremely scary in its ramifications, including for your way of life and portfolio... so here's what happened: the Iranian government has a covert operations force called the Quds (KODS) Force whose mission is to *conduct sensitive covert operations abroad* (think of them as perhaps a much more sinister version of our CIA). Now, Iran and Saudi Arabia are locked in a vehement tug-of-war for influence over other Islamic nations... so to tilt the scales in its favor, Iran decided to have its Quds Force *take out* the Saudi ambassador to the U.S. – right here in Washington D.C. The comically amateurish part is that, in its search for an assassin, Quds ended up speaking to an undercover U.S. agent thinking he was a member of a violent Mexican drug cartel, and offered him \$1.5 million to assassinate Adel Al-Jubeir, the Saudi Arabian ambassador to the United States. And that's how the plot unraveled, luckily for the Saudi ambassador.

The scary part is that had the Iranians succeeded, Saudi Arabia and Iran would surely have either gone to war, perhaps dragging the U.S. in too, or tensions would have escalated to a point of no return, with each nation on edge and severe jockeying in the Islamic world. This is scary because Iran and Saudi Arabia are major oil producing and exporting nations, and any war between them would have been disastrous for world oil markets.

Here's why: Each time an oil producing nation goes to war, its oil exports shrink... from a combination of the following two main factors – 1) its own demand for oil skyrockets so it exports less than it did before the war; 2) its oil rigs and installations are vital strategic targets and immediately come under attack from the enemy – more so for a nation like Saudi Arabia whose entire economy and influence is based on oil.

In fact, if you look at the most recent example of Libya. Its oil production dropped from 1.6 million barrels per day (BPD) in 2010 before the unrest started, down to 96 million

barrels per day as of September 2011 – that’s a drop of 40%. To put this in perspective: at its peak, Libya’s oil production was less than 2% of the 82 million BPD of global world oil supply; yet, crude oil prices jumped \$10 to \$15 per barrel.

By comparison, Saudi Arabia produces 9.2 million BPD and Iran produces 3.6 million BPD, for a combined 16 percent of world supply. Add to that, the expectation that any war between these two major Islamic nations will severely polarize the Arab world and could easily escalate with other Islamic block oil-producing countries taking sides... and you start to see why this is so scary... because it literally could spike oil prices to unprecedentedly high levels – perhaps driving prices higher by \$100 per barrel or more.

The other scary part is that Iran has set in motion events that Saudi Arabia is unlikely to ignore, and even if Saudi Arabia is restrained by its global allies, Iran – which has seriously lost face over its botched assassination attempt – may plot more seriously to escalate tensions. And that would really spook world markets, jack up the price of oil, severely impact global GDP growth, and perhaps even result in unmanageable inflation because oil is a vital raw material that drives prices on all manner of consumer and non-consumer goods.

And what exacerbates a drop in oil production is that it takes many, many years for production to return to pre-war levels – anywhere from 5 to 15 years. So, in a worst case scenario of war with multiple oil producing Islamic nations involved, oil will likely reach devastating highs and stay there for several years before a return to normalcy.

So, while I love telling stories, my point with this one is that you must prepare yourself for this oil-spike eventuality or possibility. If we are lucky, things will defuse before they get much worse, but the current fire with the Arab Spring may just light other, less desirable flames. If things get worse, I’d like you to protect yourself by...perhaps making sure you have some oil in your portfolio, most easily accomplished by buying a large cap mutual fund, ETF or purchasing one of the major oil companies outright, like Exxon or Chevron. In fact, some of you may remember an earlier piece I did – [Impact of Rising Oil Prices on U.S. Stocks](#) - where too I advocated investing in oil companies as a hedge against rising oil prices... so now you at least know that I am consistent. If you’re more adventurous and sophisticated, you can buy and exchange traded fund that tracks oil prices such as the iPath S&P GSCI Crude Oil TR Index (NYSE: OIL). Everything has its risks and possible rewards, so make sure you understand the pros and cons before making any investment. Speak to your investment advisor on how you can prepare your portfolio for the very real possibility of a crazy spike in oil prices. And if you get in on this and do well, hopefully, you’ll allow me to tell you that you heard it first on my show!