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FINANCIAL MANAGEMENT



The Impact of Rising Oil Prices on U.S. Stocks

Rising Oil Prices

Over the past two months, oil prices have risen 15% from \$91 at the beginning of the New Year to about \$105 now.

Some of this rise was completely natural - global economic activity has picked-up, demand for oil has increased, and prices have naturally moved up. But as we all know, political disruptions in the Middle East have driven prices even higher.

So what's next for the U.S. stock market?

Probably some good things, but let's face it, we were due for a correction.

Prior to the troubles in Egypt and Libya, the ability of the stock market to march ever higher without taking a breather was starting to concern me. There were far more buyers than sellers in the last few months, perhaps because investors decided to move their money from bonds into stocks and mutual funds. But even then, the bottom line is that the market should not continue ever higher day after day without some profit taking or pause.

Something - a disruption, bad news or a negative surprise - was bound to trip the relentless upward cycle. And this time around, that *something* was the unrest in the Middle East.

Stock Market Impact

Libya is now producing less than half of its normal output and there are fears of more disruptions to come. This is serious and rising oil prices will undoubtedly have adverse consequences for growing economies around the world.

The big question is, will the oil crisis cause a recession and bring the stock market to its knees.

No one really knows. But I believe the stock market will continue its upward trajectory and move higher because business conditions are improving and it would take an awful lot to derail this forward economic momentum.

I am a buyer, and I welcome this sell-off as an opportunity to buy more.

[Other Opinions](#)

Here's what others think:

Barclays says higher oil prices will act as a "tax" on consumers and could slow the economy.

Nomura Securities opines that oil could rise to \$220 per barrel, just as it spiked 130% during the 1990 Gulf War. I think the comparison is overblown. The current turmoil is nowhere as serious as the 1990 invasion of Kuwait by a belligerent Iraq with Iran as a wild card on the sidelines.

Technical analysts at Guppy Traders believe that oil could go to a low of \$98, but could rise to \$108 - \$112 if prices breach \$100, which they already have.

Standard & Poor's thinks any near-term decline in equity prices would be more of a pullback or correction, but not a new bear market. They believe that existing oil inventories could cover a 50-60 day Libyan disruption, and that Saudi Arabia, Kuwait and the United Arab Emirates have the spare capacity to replace a shutdown of output from Algeria and Libya.

Also, S&P forecasts a slowly recovering global economy and a 15% increase in earnings for companies in the S&P 500 index.

[So what do you do?](#)

You could *play* oil prices directly through an exchange traded fund (ETF) that invests in oil futures (ticker symbol: OIL). Fees and other factors may hinder a full 1:1 relationship, so do your homework first.

You could buy shares in oil companies. Blue chips are a safe bet but have already moved higher.

If you want higher returns, consider investing in small to mid size oil drilling companies - their earnings are more closely tied to oil prices than the big companies that are more diversified and may not react as much to rising oil prices.

For income, consider investing in oil and gas pipeline companies' Master Limited Partnerships which payout the bulk of their profits as dividends.

Finally, look at Canadian companies focused on extracting oil from shale. If oil prices rise, their stocks should do well.

So good luck riding this crisis out, I do hope you come out ahead.