

\$100,000 per Barrel Oil

Written by Leo Wang

Tuesday, 15 June 2010 08:58

Please note that this is only an interesting thought experiment to illustrate the *huge* potential for oil's price escalation.

Assumptions:

1.

Every percentage change of supply (while holding demand constant) or demand (while holding supply constant) results in roughly a 10 to 30 percent change in price. I heard that this tends to be the experience of long time commodities traders. Citation welcomed. But [given that both the price elasticity of demand and supply for oil is very inelastic](#), this assumption sounds reasonable.

2.

Post- [Hubbert peak](#) global oil production decreases at the [Cantarell Field-like rate of 13.1% annual decline](#). While large, due to geographical proximity of Mexico, I think this Mexican oil field should have the highest production transparency, unlike Saudi Arabia. Therefore, actually a good proxy for post-peak oil global petroleum production.

3.

In order to get an approximation for long-term oil price, we will take the average of the highest and lowest oil price over the past 18 months or so as a proxy for the current oil price.

Calculation:

1.

Taking the mid-point of 10 and 30 percent gives us 20% for every percentage change in supply or demand while holding the other factor unchanged.

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2.

The 13.1% annual production decline rate, holding global oil demand constant, would result a price increase of 10.896 *times*! Equation: 1.2 (20% price increase) raised to the 13.1^{th} power = 10.896

3.

Three years into the future, oil price goes up 1293.6 *times*, if price goes up 10.896x every year. Equation: 10.896 raised to the 3rd

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power = 1293.6

4.

Taking the highest and lowest oil price from the beginning of 2008 to now (147.9 and 35.13 respectively), and average them, we get \$91.515 per barrel. Equation: $(147.9 + 35.13) / 2 = 91.515$

5.

Multiply 1293.6 by \$91.515, we get \$118,383.8 per barrel!!

Is it possible? On March 10, 2000, according to [one estimate](#), Nasdaq's p/e ratio reached an incredible 264. At the market close of Friday July 17th

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, 2009; the Nasdaq 100 index ETF,

[PowerShares QQQ Trust I](#)

(or "cubes"), trades at the p/e ratio of 22.8. On March 10, 2000, the Nasdaq composite closes at

[5048.62](#)

. The composite closes at

[1886.61](#)

on 7/17/09. Nasdaq's p/e at the 2000's tech bubble peak is more than 10 times today's p/e ratio! Yet the composite still trades at less than half of its millennial peak value today, almost ten years after...

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Looks like the p/e ratio at the tech stock's market top in March of 2000 reflects future expectation more than two decades, from the time of market top, into the future. My opinion: it's easier for oil to trade at price level reflecting fundamentals only three years into the future.

Again, this is only a thought experiment...

Saturday July 18, 2009 10:40 AM Kaohsiung City, Republic of Taiwan

DISCLOSURE: The information contained in this article should not be misconstrued as an offer to buy or sell securities. Always consult a professional advisor before making an investment. The author holds no positions in any commodities futures. But I am 100% long in oil and energy stocks.