$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.

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

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

, 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.