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**Why Is Everyone Losing Sleep Over Oil and Gas Stocks?**

**By BEN STEIN**

ONE of the useful things I have the chance to do when traveling long distances on airplanes is to read the business sections of newspapers and magazines in greater detail than may be merited. Even I, the world champion of sleep, cannot sleep forever (although someday I will). So I have to read in my area, which is business and investment news. Lately, a trend in personal finance articles seems to be about a supposed bubble in the prices of energy stocks.

The theory goes like this: energy stocks are at the high end of their 52-week cycle. Some are at their highest points ever. Oil production and gas production have largely been shut down by recent storms, resulting in high prices of gasoline, heating oil and natural gas. Once production is restored, energy commodity prices will collapse and energy company earnings will collapse, too.

Not only that, but Americans will all soon drive hybrid cars, so no one will want much gasoline any more. Hence - so the rationale for the energy bubble runs - it's time to bail out of energy. The analogy that is often given is the boom and bust of the Internet stocks, which, of course, soared in the late 1990's, then collapsed in 2000 and 2001.

With the greatest respect for my fellow seers, there are a few things desperately wrong with the analogy - and with this whole line of reasoning.

First and foremost, Internet stocks largely had no or negligible earnings. They were valued on hype and rumor. They were not traditional securities with earnings and dividends. They had no value except their trading value. When they did have profits, they often sold at 100 or more times those earnings.

On the contrary, oil and gas stocks have had spectacular earnings. Take a look at those of Exxon, Mobil, BP or Valero. Those stocks' price-to-earnings ratios are far below, not above, the ratios for the S & P 500-stock index as a whole. Take a look at the royalty trusts like those for Prudhoe Bay on the North Slope of Alaska and the Permian Basin in west Texas. The P/E ratios for these trusts - vehicles that energy companies created to transfer interests in their properties directly to their stockholders, who became unit holders in the trusts - are also far lower than even the P/E ratio of the blue-chip Dow Jones industrial average.

And it's important to remember that these ratios are for the last quarter, before the spectacular hurricane-related price increases for the products they sell. It's entirely possible that their earnings will rise, not fall, at least in the short run, as the storm-related prices take some space on their books. (Of course, they will also have costs to repair their facilities, but those costs can be spread out over years.)

Generally speaking, there is a bubble in a security or an asset if its price rises faster than its earnings. Hence the bubble in Internet stocks, which often had no earnings, and perhaps now in residential property, as prices rise faster than imputed rent. But if a security rises quickly in price because its earnings and prospective earnings also rise quickly - where's the bubble?

But some people say energy prices are in a bubble themselves. Maybe yes and maybe no. Certainly, when oil and gas and electricity production resumes along the Gulf Coast, one would expect energy prices to fall. I am positive that they will fall, and indeed they have already started to fall. But let's remember that these are world prices. What has been taken off line in Louisiana and Texas is a lot of United States production but only a small fraction of world production. What has moved the price so much this year is the global imbalance of supply and demand.

Yes, prices reflect storm damage and storm-related scarcity to some extent. No doubt about that. But the prices, which were already rising before the storms, have now retreated to pre-Katrina levels (at least for oil, if not natural gas) and may have already passed through the storm bubble and come out on the other side.

There is a real problem in energy commodities as far as consumers are concerned. We are using energy a lot faster than we find it. As I have written before, price is how we allocate energy products when demand is rising faster than supply, or vice versa. We are seeing the world's people start to suck the oil from the earth at a particularly breathtaking rate.

(I recall a glorious exchange from a Hemingway novel. "How did you go bankrupt?" a man asks his friend. "Two ways," the friend replies. "Gradually and then suddenly.")

Americans are moving at a measured pace from gasoline-powered cars and trucks to hybrids. But the percentage of hybrids is still tiny - and they get hydrogen and electricity from plants fired by coal, oil and natural gas, by the way, which is like cutting off a blanket at one end and sewing it on at the other to make it longer.

When people in China and India take to the roads by the hundreds of millions, it will be good night, nurse. There will be conservation and shifting as prices rise, but the ratio of demand to supply is still rising faster than it was, and it will be decades before major shifts to solar and nuclear energy take effect in a meaningful way. ("Thank you, Sierra Club," the oil companies say with a hearty bow.)

In the meantime, the integrated major oil companies, refiners and royalty trusts own a great deal of a commodity that is rapidly disappearing and is rapidly rising in price. As oil companies drain their reserves faster than they find new ones, their P/E ratios may fall to levels usually associated with royalty trusts, but they will still own a supervaluable asset.

IT used to be that oil prices could be punctured on a moment's notice. Just ask Midland, Tex., which suffered greatly in the oil bust of the 1980's after Saudi Arabia raised its output a few notches. Oil prices are already correcting in the short run. But there is a real question now as to whether the Saudis can raise output in a meaningful way, and no one else seems to have a lot of spare capacity. Add to that the fact that a lot of the world's oil producers don't like us much (a subject for a future column). That is very good news for Midland.

Does this mean that energy stock prices will not correct in the short run? Without question they will correct. Stocks usually correct in the short run after an immense climb.

But are we in a bubble of energy stocks as bubbles are usually defined? No, and the long-term future for entities that own a great deal of a commodity that they bought cheaply - many of the majors have billions of barrels that cost them well under $10 a barrel - and that may stay in desperately short supply looks pretty good to me.

Would I bet the ranch on it? No, but then I don't own a ranch. I may bet a cow, although I don't own a cow, either.

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