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COMMENTARY

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With Nowhere to Store Oil, Prices Plunge

- Contracts to buy oil are expiring and there is a shortage of oil storage tanks.
- We expect oil prices to be subdued for a while as demand isn't expected to pick up.
- We recommend diversifying among sectors and asset classes, not having too much risk in any one single bucket.

Oil prices are plummeting today as a lack of demand for oil combined with a surge in production from Russia and Saudi Arabia has caused supplies to increase to the point storage tanks are near capacity. With stay-at-home orders in effect to combat COVID-19, people have essentially stopped driving and flying and thus have little need for gasoline or jet fuel, which are oil byproducts.

Investors that bought contracts for the right to buy oil in the future are now willing to pay money to get rid of the oil, sending oil prices negative for the first time. For these investors, the future is now, and the major storage facility in the United States located in Cushing, Oklahoma, could be completely full within weeks. The contracts expire tomorrow and with nowhere to store the oil, contract holders need to get rid of it and are even willing to pay others to take it. Oil producers are also willing to pay money for investors to take oil from them in order to delay shutting down oil fields and wells, which can be costly.

While this is unprecedented, the negative prices in oil are referencing these contracts that expire tomorrow. Next month's contracts are still trading at around $20 a barrel and Brent Crude, which is the oil that is traded more internationally, is around $30 a barrel. The negative prices for West Texas Oil contracts that are expiring soon are technical in nature and driven by storage concerns. Next month's contracts could suffer the same fate, however, if stay-at-home orders aren't eased soon.

The oil and gas sector has been an increasing part of the U.S. economy as we became oil-independent. Much of this growth was achieved through new technologies in shale drilling. While these advances have reduced the cost of shale drilling, it is still more expensive than other forms of drilling. Shale producers in the U.S. really need oil prices to be roughly around $40 a barrel to make money. With oil at even $20 a barrel, many producers are likely to go bankrupt, which will not only hurt the U.S. economy, but strain local oil-producing economies even more.

While Russia and Saudi Arabia have cut production, it isn't enough to make up for the loss of demand. We expect oil prices to be subdued at extremely low levels for some time as it will take a while to work through the supply and get people back to driving and flying. There is a lot of uncertainty right now, and oil prices are only one component. We continue to recommend sticking to risk tolerances consistent with your long-term goals and objectives and being diversified among sectors and asset classes. We do think there will be opportunities in this market, but we are looking for more clarity before we get too optimistic. These are challenging times, but your financial professional can help you stay on course.

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A diversified portfolio does not assure a profit or protect against loss in a declining market.

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The **NASDAQ Composite Index** includes all domestic and international based common type stocks listed on The NASDAQ Stock Market. The NASDAQ Composite Index includes over 2,500 companies, spanning all 11 sector groups.