MARKET OBSERVATIONS
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SCHLINDWEIN ASSOCIATES
INVESTMENT COUNSEL

Drill

No commodity has garnered as much attention as oil in recent years. Oil is the lifeblood of all economies. Its use is both praised and disparaged. For many, its use stands in the way of cleaner energy utilization and the pursuit of climate change. For a variety of reasons including relative cost and regulation, other forms of energy, i.e., wind, solar, hydro and nuclear have not reached the output goals of their advocates. As a result, production and consumption of oil only have grown in recent years. A review of some key oil measures can provide perspective for economic growth and investment returns ahead.

PERSPECTIVE

The long-term trend in U.S. oil field production is shown in Chart I. The meaningful role of oil in the U.S. economy began over a century ago. For fifty years, production trended higher at a rather steady pace. The rise of OPEC as a force determining oil production and pricing brought a marked downtrend in U.S. production that lasted about four decades. Production accelerated following the Great Recession and reached a new all-time monthly high in March 2018. Over seventeen months through 2024, five new monthly production highs were reached. This outcome occurred even as the controlling political party in the U.S. was advocating production cuts and pursuing policies to that end.

Recent trends in the global production and consumption of all liquid fuels are shown in Table I. For the total period shown, consumption fell short of production, but the balance shifted almost on a year-by-year basis. The U.S. share of production rose from 19% to 22% while its share of consumption remained flat at 20%. Consumption growth surged in both China and India, and their expected economic growth suggests this trend will continue. While an end to hostilities in the Ukraine and the Middle East may bring higher production to both OPEC and Russia, U.S. production likely remains elevated as the November election has brought a new focus to energy policy with the tagline, “Drill, baby, drill!”

Investing in oil can be accomplished either directly through the commodity itself or through companies whose primary business is the exploration, production and/or sale of oil. Chart II compares rates of returns for each investment approach. The tight relationship (78% correlation) between the prices of oil and oil stocks is quite visible. The other 22% indicates that oil companies add value through their activities. The average 12-month return from oil stocks has been a full 1% higher than the return from oil itself. At the same time, oil price volatility is about 42% higher than that of oil alone. A difference arises from oil stock dividends which add some stability to oil stock returns. The IYE ETF has a dividend yield of 2.9%. 42% of its assets are invested in Exxon Mobil, Chevron and ConocoPhillips.

CHART I

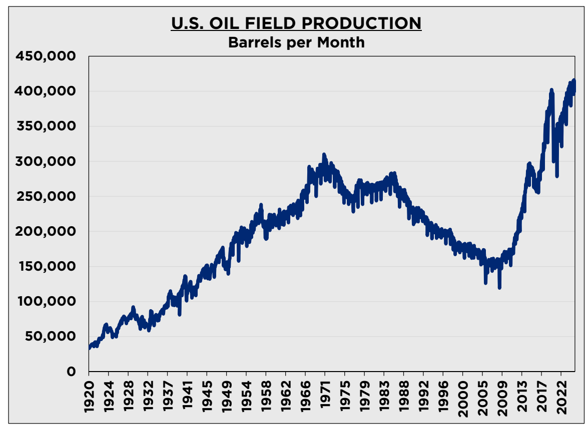
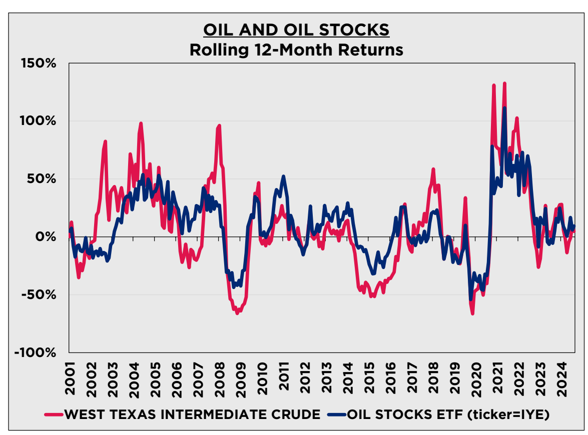


TABLE I

PRODUCTION & CONSUMPTION OF LIQUID FUELS
Millions of Barrels Per Day

PRODUCTION	2019	2020	2021	2022	2023	2024	2025	'19 - '25
U.S.	19.5	18.6	19.0	20.4	22.0	22.7	23.1	18.5%
OPEC	33.1	29.4	30.4	32.9	32.2	32.2	32.6	-1.5%
RUSSIA	11.5	10.5	10.8	11.0	10.9	10.5	10.5	-8.7%
GLOBAL	100.2	93.8	95.7	100.2	102.1	102.6	104.4	4.2%
CONSUMPTION								
U.S.	20.5	18.2	19.9	20.0	20.3	20.3	20.5	0.0%
CHINA	14.0	14.1	15.1	15.1	16.2	16.3	16.5	17.9%
INDIA	4.9	4.5	4.7	5.1	5.3	5.5	5.8	18.4%
GLOBAL	100.6	91.0	96.7	99.5	101.8	102.8	104.1	3.5%

CHART II



INVESTMENT IMPLICATIONS

The use of oil and investing in oil-related stocks raises a range of strongly held opinions. The carbon footprints left from oil exploration, production and use are among the highest concerns for those advocating less oil activity. At the same time, the potential impact of an aggressive reduction timeline for oil activity has a wide range of undesirable outcomes. The pullback in consumer demand for electric vehicles is one such outcome. The challenge is two-fold, reducing the use of oil in electricity generation while increasing the overall level of generation to support broad EV use. Time will tell as drilling continues.