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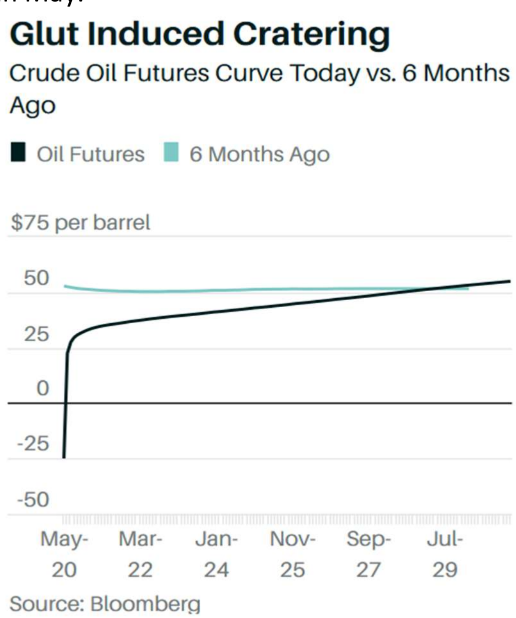
With Super Low Oil Prices, Why am I not Seeing Lower Gas Prices at the Pump?

April 21, 2020

Stocks moved lower as turbulence in the oil patch continued. The Dow Jones Industrial Average fell 632 points, or 2.7% to 23,019 while the S&P 500 dropped 87 points, or 3.1% to close at 2,737. The Nasdaq Composite was lower 298 points or 3.5% to 8,263.

Today was the contract expiration for May delivery of crude oil. With the lack of storage, we spoke about yesterday there is has been a financial, or "paper" squeeze on the traders that have taken long positions in oil but have no place to store it. Today, there was a bounce back in the spot price for May crude deliveries with the price rising to close at $9.06 per barrel from essentially zero on Monday's close. However, the **June** delivery spot prices fell from $21.31 per barrel to $13.98. Why would May crude rise dramatically, and June crude prices fall? Our sense is that it is traders are unwinding old or establishing new "paper" positions, so they don't get squeezed in June like they did in May.



With all this craziness and volatility in the oil market why don't we see the prices at the pump plummeting? Prices will trend down but will not fall precipitously like crude oil prices have.

Obviously, there is a process to get crude from a wellhead to our car gas tank. Oil is pumped at the well and delivered to refineries to create different usable fuels. However, refineries cannot take more than what they can either process or store at one time. When their storage is full, they have to either refine fuel and ship it off, or they must continue storing. The point is that, what they are buying now is probably for delivery several weeks, perhaps even months down the road.

The chart at the left shows the price of oil at future delivery dates. In the immediate term, prices are extremely low, but months into the future, when the refiners will be able to take delivery, the price shoots up past $25 per barrel. So, beyond what they have been able to buy and store presently, they wont benefit from the lower crude prices because they can't take delivery.

The reason the prices dropped in the first place is that there was too much supply and not enough demand and until the demand revives, refiners will be stuck with the excess oil and nowhere to send it. The oil market knows this is a temporary situation and the future prices rise because of an expectation that demand will rise.

Notably, the U.S. Treasury department has stepped into the mix and are evaluating purchasing low priced oil for use in topping of the Strategic Petroleum Reserve (SPR) that was created between 1973-1974 after the oil embargo. The idea then was to have a reserve to soften any supply disruption from the Middle East. Last year, for the first time in history, we were a net exporter of oil, and with the Treasury Department looking into buying low priced crude for the SPR it shows their desire to keep domestic oil production a strategic imperative.