

Gasoline Will Not Kill Us All

Do schoolchildren still use those composition books with all the units of weights and measures on the back cover? Aging Baby Boomers remember them well, even if the occasions in life actually to use a peck or a hogshead have been few and far between. One of the more obscure is a mil, which you may or may not know represents one-tenth of a cent. You cannot buy much for a penny, a nickel today is worth what a penny was worth in my childhood, and a dime may soon become obscure.

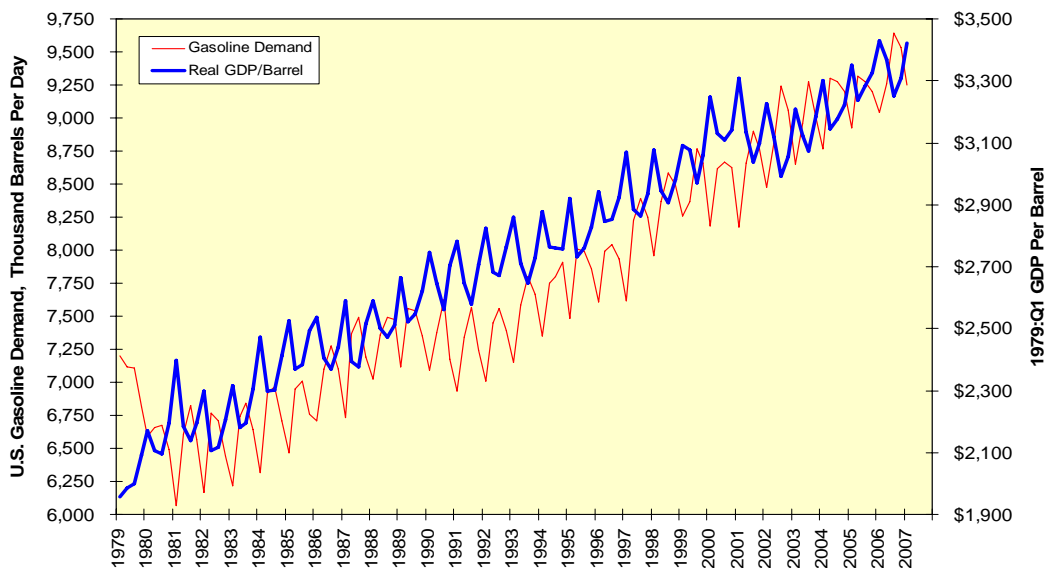
So why do gasoline stations still post prices ending in 0.9 cents per gallon? If I owned a station or two, I would start posting prices ending in 0.7 or 0.8 cents per gallon just to see whether anyone was paying attention.

The answer, of course, derives from that unique niche gasoline occupies in the collective psyche. Prices of everything else go up and down – up, mostly - with little comment even though the productivity of these items may or may not have changed in justification thereof. Well, here is a little surprise for you: The productivity of gasoline has risen faster than its usage since the American Petroleum Institute started to calculate implied gasoline demand on a weekly basis back in 1979.

Role Of The Barrels

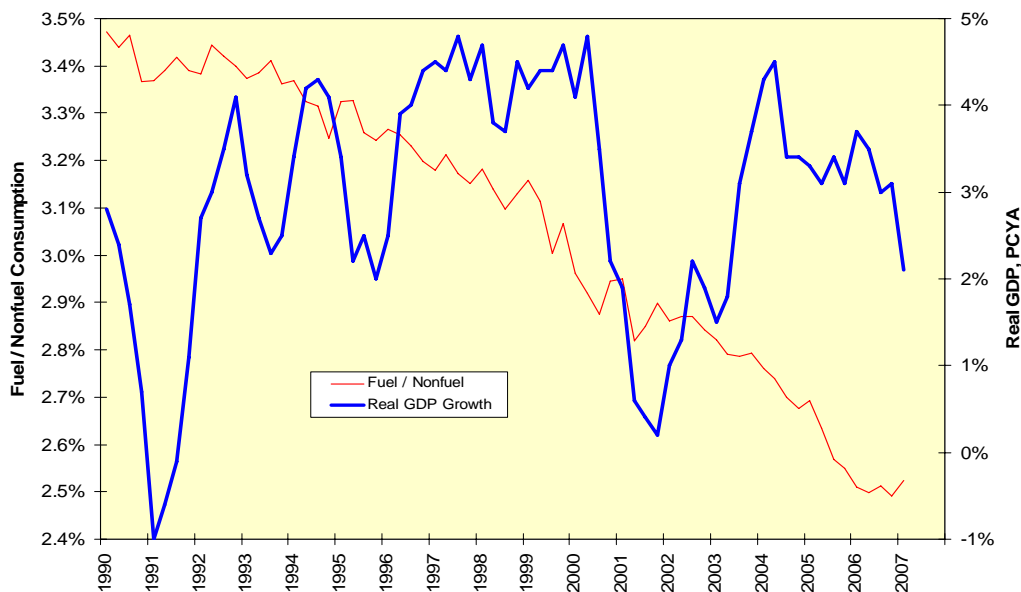
Back then, each 42-gallon barrel of gasoline consumed led to \$1,959 in GDP. Today that same barrel leads to \$3,421 in inflation-adjusted dollars. That is an average annual rate of productivity increase of 2.01%. Total gasoline consumption has increased at an average annual rate of 0.9%, which is less than the average annual population growth of 1.06%. As incredulous as this may seem given all the SUVs and trucks on the road, the American economy has grown quite nicely in spite of rising gasoline consumption. This is how a market is supposed to work: If the incentives to conserve exist, efficiency will rise as a function of both price and technological improvement.

Rising Productivity of U.S. Gasoline Consumption



If this surprises you as intended, here is another little fun fact to impress your friends. The percentage of personal consumption dedicated to gasoline and other fuels has been declining steady since the Commerce Department began keeping track of this category in 1990. The last quarterly reading blipped a little higher, and we can expect the second quarter percentage to increase as well, but the trend is unmistakable. The American consumer, who spent 3.47% of nonfuel expenditures on fuel in the first quarter of 1990, spent 2.52% at the end of the first quarter of 2007. If this is a crisis for the American consumer, the data do not show it at all.

Fuel Is A Declining Percentage of Consumer Spending

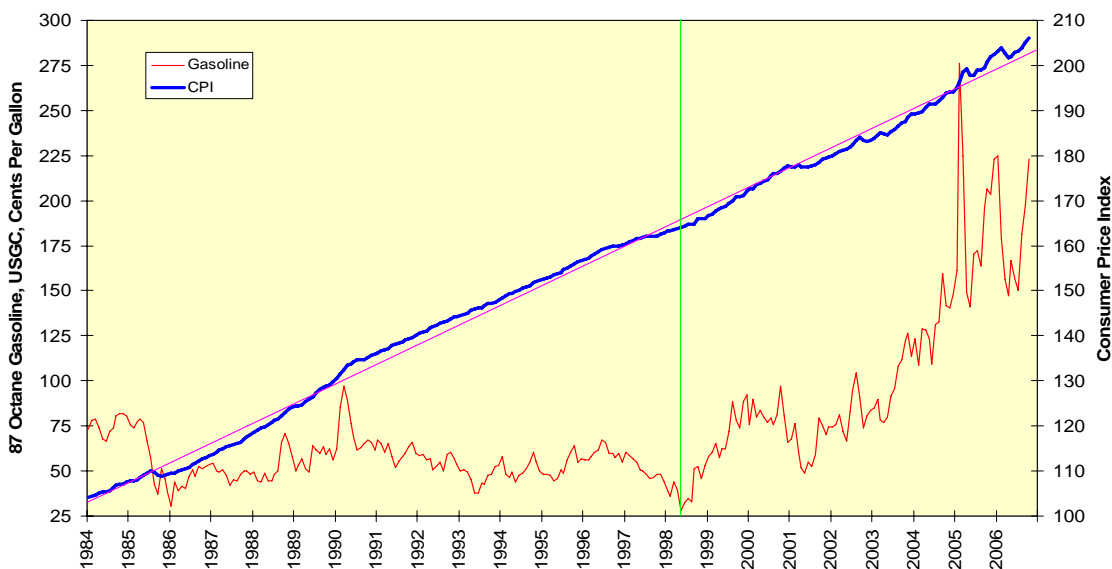


Moreover, if we map this ratio against the year-over-year changes in constant-dollar GDP, we find absolutely no correlation whatsoever.

When A Ruler Is Cooler

Well, you scoff; surely higher gasoline prices are inflationary. Umm, no: Let's map the Consumer Price Index against the wholesale price of 87-octane unleaded gasoline at the U.S. Gulf Coast. This grade of gasoline has largely been replaced by the current RBOB grade, but as RBOB's history is only a year old and as the old and new grades track each other tightly, we will use the old grade for analytical purposes.

Inflation Not A Function Of Gasoline Prices



Note how the nominal price of gasoline was flat-to-lower between 1984 and 1999. When the present bull market started in February 1999, how did inflation change? The answer is it did not. If we regress the CPI against time, we get an r-squared, or percentage of variance explained, of .996. A regression against gasoline produces an r-squared of 0.396. Let's put it another way: If you laid a ruler over a chart of the CPI, you would be two and one-half times as explicatory as the price of gasoline.

Fuel On The Hill

Will any of this change the public's sentiment regarding gasoline prices. Absolutely not; even though we can demonstrate time and time again how higher crude oil prices are neither economic nor financial market poison - please see columns from [March](#) and [last week](#) in this regard - the next bump in the night will convince most there is a monster in the closet, one no doubt wearing an ExxonMobil cap.

If you remain convinced the baddies in the oil industry are out to get you, join them. The total return on the S&P 1500 Oil Refiners index has been 21.19% since the March column was written; this compares very favorably to the 8.77% total return for the S&P 1500 Supercomposite over this same period. The two firms dominating this refining index are Valero and Sunoco. The average annual total return on refiners since the February 1999 low has approached 30%; this compares to a 4.8% average annual total return for the Supercomposite itself.

Is it too late to buy? Given that the current spike in gasoline prices is a direct result of our inadequate refining capacity and that no possibility of rectifying this exists in the short-term, the answer is, "No." The trade is still there, and it might help put a tiger in your portfolio's tank.