

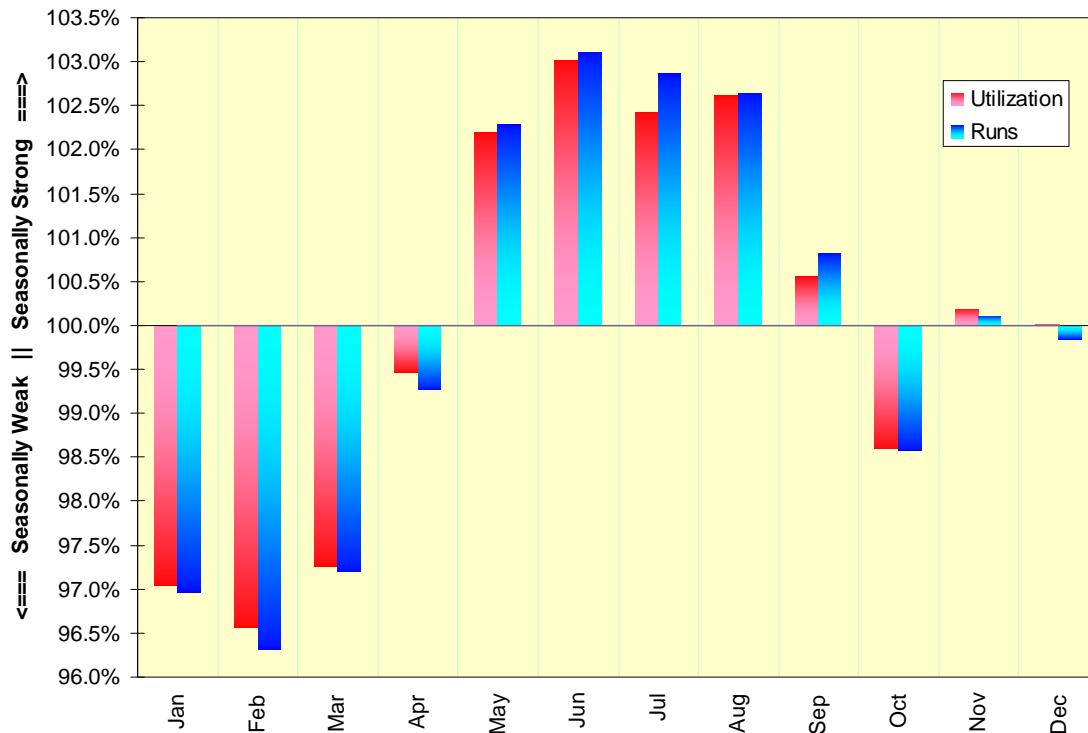
## Refiners' Time Of The Season

Should the venerable *Star-Spangled Banner* be replaced by the Zombies' [Time Of The Season](#), if not for the start of Super Bowls and ordinary baseball games, then certainly for the annual shareholders meeting for Valero, Sunoco, Tesoro and other refiners?

I suggested [a month ago](#) the glut of crude oil in storage at Cushing, Oklahoma, would start to dissipate as refineries came out of their annual maintenance or “turnaround” cycles and that this would lead to a normalization of spreads then distorted to record levels. This has been the case so far. The spread between Louisiana Light Sweet at the U.S. Gulf Coast and West Texas Intermediate crude oil at Cushing has narrowed from \$19 per barrel to a still-wide \$12 per barrel. The simple contango between first- and second-month crude oil futures narrowed from 1.48% to 0.47%.

How was all of this predictable? If we use the American Petroleum Institute’s data on refinery runs and utilization rates going back to January 1979, we can see just how weak the first quarter is every year. Both measures are seasonally strong during the summer months as refineries are trying to maximize both the production of gasoline and diesel fuel while providing enough heating oil to store for the winter.

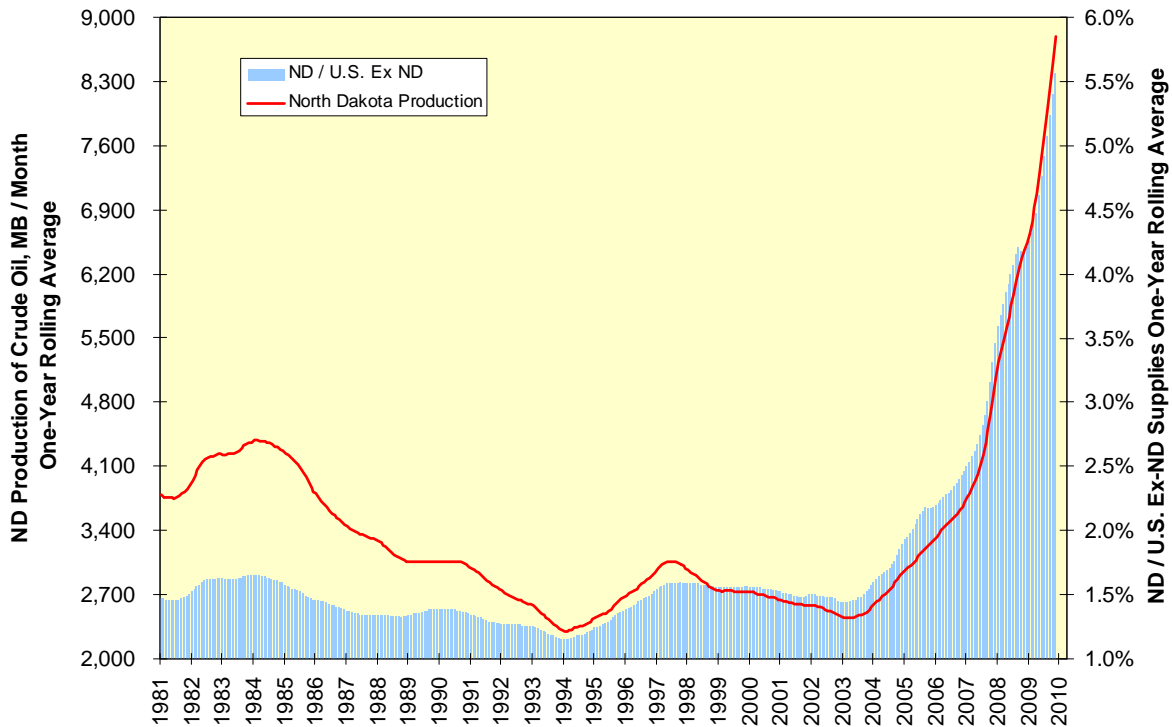
### The Refinery Turnaround Period Is Ending



Now this seasonality has been here for as long as we have been in the Northern Hemisphere. What has been increasingly different in recent years is the refinery slowdown has intersected with rising production from two sources feeding the mid-continent pipeline system. These are Alberta’s oil sands and North Dakota’s Bakken Shale. Please note how I did not say, “new” sources; both Alberta and North Dakota are longtime producers of conventional crude oil, but their absolute production and their production as a share of competing sources have grown.

Let’s isolate North Dakota; it was thirty years ago when the then-new magazine *American Demographics* ran a satire saying the state’s initials stood for “No Demographics.” Today it is a boom-state by virtue of its rising Bakken Shale production. Please note how North Dakota’s production has jumped as a percentage of total U.S. production from other states.

## The Increased Role Of North Dakota Production



As those production streams are fairly constant, they intersect with the annual refining cycle to produce a temporary excess supply than can be stored profitably by virtue of the futures market at Cushing.

Here's the key lesson: Markets work when you let them. The Bakken became economic by virtue of new technology economic at higher prices; we can say the same for Alberta's oil sands. Futures markets allow for inventories to be built and hedged profitably. More important, those same markets allow inventories to be drawn down as markets dictate to supply the U.S. with readily available crude oil. Contrast this with the politically dominated cluster-fest associated with the decision to withdraw crude oil from the money-losing Strategic Petroleum Reserve whenever prices rise.

The next step will be for the industry to build some pipeline capacity out of Cushing toward the U.S. Gulf Coast to alleviate the annual inventory cycle and to move crude oil all the way from Alberta and North Dakota to Gulf Coast refineries. A little quiet out of Washington would not hurt in this regard.