The Oil Drum
DISCUSSIONS ABOUT ENERGY AND OUR FUTURE

Holding Daniel Yergin and CERA Accountable

Posted by Prof. Goose on January 10, 2008 - 11:15am
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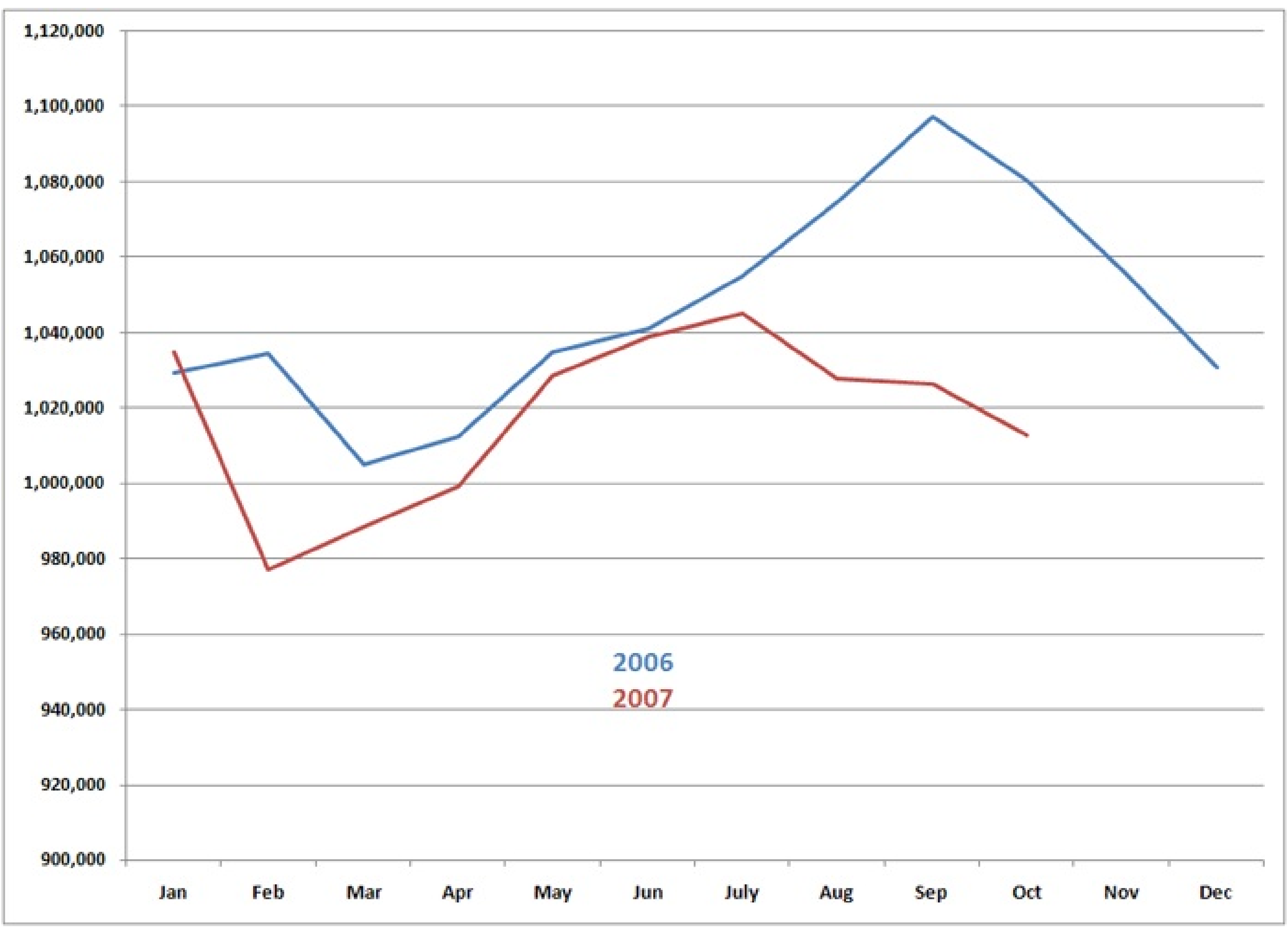
This is a guest post by Glenn Morton, a geophysicist in the oil industry. For Kerr-McGee Oil and Gas Corp., Glenn served as Geophysical Mgr Gulf of Mexico, Geophysical Mgr for the North Sea, Dir. of Technology and as Exploration Director of China. Currently he is an independent consulting geophysicist, and he is known here at TOD affectionately as seismobob.

This post started when I heard Daniel Yergin, the CERA Energy Analyst interviewed by Larry Kudlow on Sept. 14, 2007 on CNBC. Yergin claimed that the high price of oil was not supported by the fundamentals. My jaw fell to the floor. Last year (2006), the price of oil deserved to plummet by 20% (which it did). The amount of oil in storage tanks was very high. But this year, week on week, the oil in storage has dropped, meaning that the fundamentals do support a higher price than last year. The chart is below; note that in 2007 (red curve) the US storage numbers are way way down from what they were in 2006 and we haven't even had a hurricane.



After the interview, Larry Kudlow said something to the effect that Yergin was the authority on oil and he would believe what he said. Over the past week, I have emailed Larry Kudlow's show twice about this silly claim, but, haven't received any response. I decided to look at CERA and Yergin's claims over the past few years and see if their prognosticative powers were as bad as I suspected.

As a note of confession, I must tell the readers that in 2003 when I was Director of Technology for a large independent oil company, I had a discussion with the VP of marketing for my company. I asked him why on earth we paid for CERA's research when their stuff was constantly wrong. He said he knew that they were wrong but that we always wanted to listen to alternative views. With that I agree, but in the press, CERA is constantly proclaimed to be a 'highly respected' research firm. There may be less respect than is proclaimed. I do agree with my friend, the former VP of marketing, that one should always listen to alternative viewpoints.

Respect is earned. That is what I always told my children. By that standard, CERA does not have my respect. Their predictions have been too wrong too often to win my respect. As a personal note, in 2004, I invested in some energy mutual funds. If I had believed CERA and Daniel Yergin's predictions, that would have been an incredibly stupid thing to do. Since 2002 at almost every opportunity, Yergin and CERA have proclaimed that the oil prices were about to fall. If I had believed them, I would have sold out early and often. As a convinced Hubbert Peaker, I am convinced of the opposite.

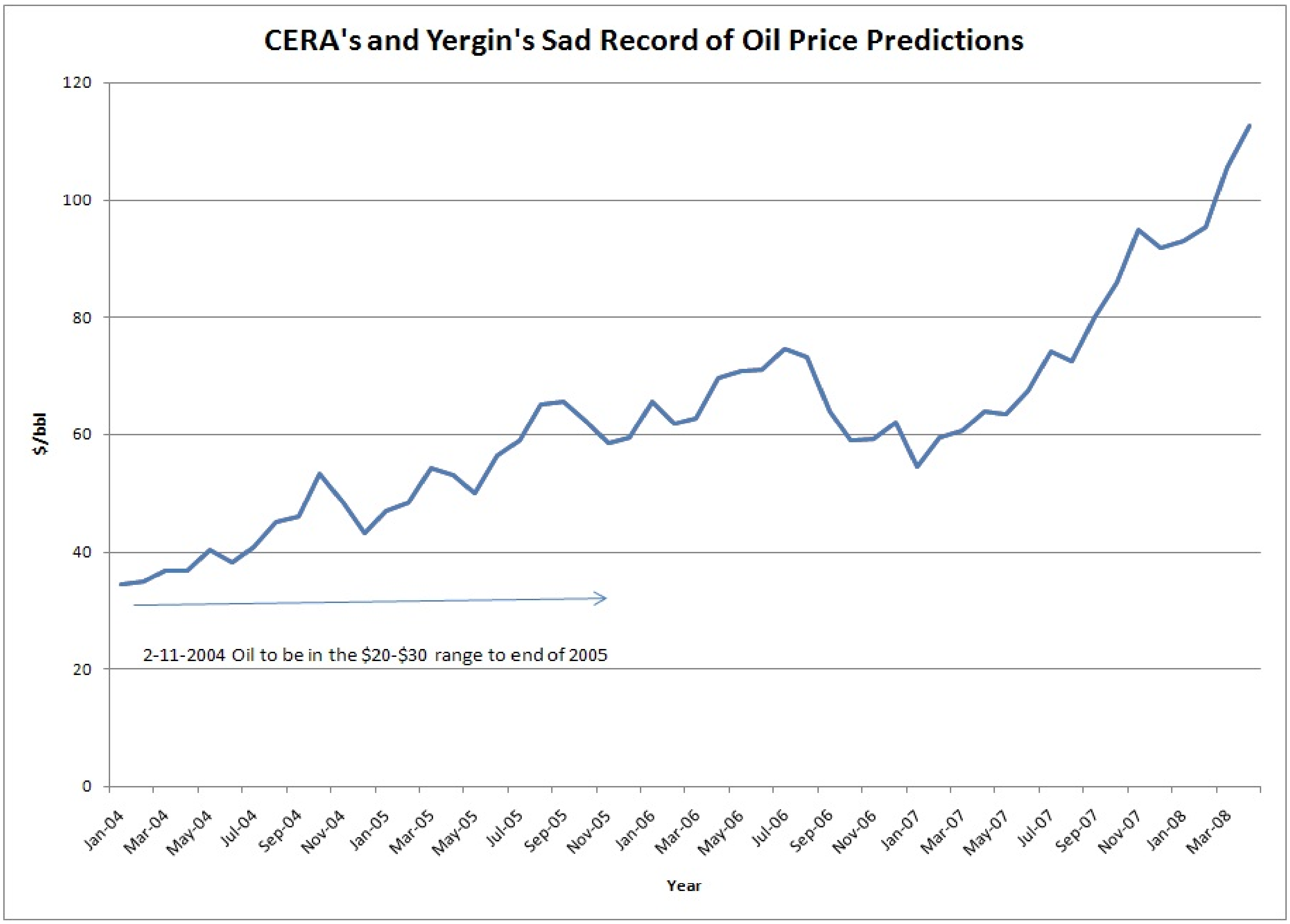
The picture below is of three energy mutual funds compared with the Dow Jones Industrials. I own two of them and invested in them because I didn't believe the utter rubbish that Yergin and cronies were putting out.

The Dow is the orange curve. Since 2004 it has gone up by 35%. The other curves are energy mutual funds. The large drops in the prices of the mutual funds at the end of 2006 are dividends.

Mutual funds, when they give dividends drop in value. But, if the dividend is reinvested, as I did, then one can take the price history after the dividend and lift it up to the top of the drop. This would mean that the green curve should have a total return of an additional 30%, and the red curve an additional 15%. This means that energy mutual funds have gone up 70% to 120 percent while the Dow Jones Industrials has only gone up 35%. And according to my calculations, allowing the dividends to be reinvested, the total return is over 200%. That gets an oil investment over the past 2 years into serious money territory.

Yergin's predictions, if followed, would have cost someone the opportunity to make a fortune. One of my sons decided to invest in energy mutual funds in January 2007. He is a happy camper. I hope he doesn't ever believe Yergin's or CERA's predictions. Looking at those energy mutual funds (don't ask me which they are, I don't give stock advice, nor am I a qualified broker. Don't blame me for your bad investments), one gets the feeling that there must be a serious reason they are going up. There is: it is called scarcity.

The price of oil has increased similarly. The price of oil has more than doubled, from $34 in January of 2004 to over $81 in Sept. 2007; that is more than a 100% increase. Here is the chart of oil price over that time period.



Yergin, and CERA believe that peak oil is garbage. They said as much.

> "Peak Oil theory is garbage as far as we're concerned", said Robert W. Esser, a geologist by training and CERA's senior consultant/director of global oil and gas resources, according to Business Week online national correspondent Mark Morrison (Sept 7).

> http://energybulletin.net/20418.html

One of the reasons they give for rejecting peak oil is this:

> "Peakists' projections of the date a peak would be reached continue to come and go, the most recent targeted around Thanksgiving Day 2005, give or take a few weeks." http://www.cera.com/aspx/cda/public1/news/pressReleases/pressReleaseDetails.aspx?CID=8444

In other words, past predictions have been wrong, therefore peak oil is wrong. What abysmal logic. But, it is interesting to me that the present peak in black crude oil production was May, 2005, and the current peak in world liquids production is July, 2006. See http://home.entouch.net/dmd/oilpeakispast.htm

That aside, let us hold CERA to their standards, if past predictions are wrong, then present predictions are wrong and see how they live up to their own standard.

We are going to plot CERA's and Yergin's statements on top of the oil price curve. A Google search of news archives brought forth the following snippets, which can be garnered free from the search. I have simply copied the search results. The source is first, the price and owner of the report is second followed by the date. Beneath it is the quote, which I put in quotations. The search results are put in italics to differentiate it from what I have to say afterwards.

February 2002

> Technology may help combat volatile oil prices, study suggests....
> $6.95 - Oil and Gas Investor - AccessMyLibrary.com - Feb 1, 2002

> "oil prices are projected to average $20 a barrel in 2002, compared with approximately $26 in 2001, CERA president Joseph Stanislaw said."

What was the reality? Well in 2001, according to the BP Statistical World Review of Energy, the price of WTI averaged $25.93. CERA predicted $20, but BP says the actual number was $26.16--totally in the wrong direction. The price went UP, not down as CERA said.

February 2003

> US commercial oil stocks reach low
> Subscription - Financial Times - Feb 20, 2003

> "Cambridge Energy research Associates (Cera), the Boston-based consulting group, expects world oil prices to drop after any war to the low to mid $20 range."

The reality was that the average price in 2003 was $31.07 and the price never did fall into the low $20's range after the Iraq war.

February 2004

> As Demand Rises, Oil Firms Focus on Finding New Reserves, Expanding...
> $6.95 - Dallas Morning News - AccessMyLibrary.com - Feb 11, 2004

> "Oil prices are expected to remain in the upper $20 to low $30 per barrel range through 2005, CERA Analysts said Tuesday. "

The reality was that the price ended up at $65 at the end of 2005. Wrong again.

June 2005

> Putting a cap on oil supply worries.
> Subscription - Dallas Morning News - HighBeam Research - Jun 22, 2005

> "The growth in oil supplies could force prices well below $40 a barrel as early as 2007, The CERA report said."

This is a full paragraph report on the same claim

"In a June report, CERA said it believed that between now and 2010 there will be a substantial increase in worldwide oil production capacity, providing a supply cushion of 6 million to 7.5 million barrels per day that could cause oil prices to "slip well below $40 a barrel as 2007-08 nears." Peter Enav, "Uncertain Saudi Supplies Hold Key to China's Growing Thirst for Oil," Pittsburgh's Post-Gazette, http://www.post-gazette.com/pg/05236/558766.stm

This year, started at oil in the mid $50s but as everyone knows, we are now at $80/bbl. Cera's perfect record continues.

It was this prediction, which caused Jeff Brown to declare "Daniel Yergin Day," when, contrary to Yergin's prediction of $38/bbl, the price reached twice that value in little more than a year! http://graphoilogy.blogspot.com/2006/07/daniel-yergin-day-july-13-2006.html

2006

As near as I can tell, CERA and Yergin took 2006 off and didn't predict future prices. Indeed, the few comments made in 2006 seemed to indicate that Yergin and CERA were beginning to get the idea that the fundamentals of supply and demand were favorable for higher prices. Yergin was quoted as saying:

> "The world oil market is in the grip of a slow-motion supply shock, in which a $70 to $75 barrel price reflects an aggregate disruption of over 2 million barrels a day," Daniel Yergin, the chairman of Cambridge Energy Research Associates, said in remarks this week at a Washington energy conference.

> http://www.signonsandiego.com/uniontrib/20060427/news_1b27oilecon.html

But, it appears that he was right, but for the wrong reasons. On July 15, 2006 he ascribed the rise in price to geopolitical tensions:

> [CRUDE TOPS $78 PER BARREL ON M-EAST, NIGERIA SUPPLY WORRIES]

> Subscription - All Africa - HighBeam Research - Jul 15, 2006

> "the oil price has become a register of geopolitical tensions and fears," said Daniel Yergin, who heads Cambridge energy Research Associates."

According to this theory, I presume, if Rodney King had his way, and we could all just get along, oil prices would plummet. If this is the true explanation for the rise in oil price over the past 5 years, the world must be becoming more geopolitically tense and fearful.

June 2007

But as we enter 2007, Yergin and CERA are back pounding the drum that oil prices will fall. This is what I heard Yergin imply on Larry Kudlow's program. It reflects what he said in print earlier in the year. In June, 2007, a Yergin interview reported this:

"ISTANBUL, June 27 (Reuters) - World oil prices will drop to the low $60 range by the beginning of next year as long as the security premium in the world oil market does not rise, said Daniel Yergin, chairman of Cambridge Energy Research Associates."
http://uk.reuters.com/article/oilRpt/idUKL2727647820070627?pageNumber=2

At the time of that prediction, oil was $67.84/bbl. Today, it is hovering at $82. The one thing I know personally. If Yergin and CERA ever predict the price of oil is going through the roof, I will sell all my oil investments. It will be a harbinger of doom for the price of oil.

September 2007

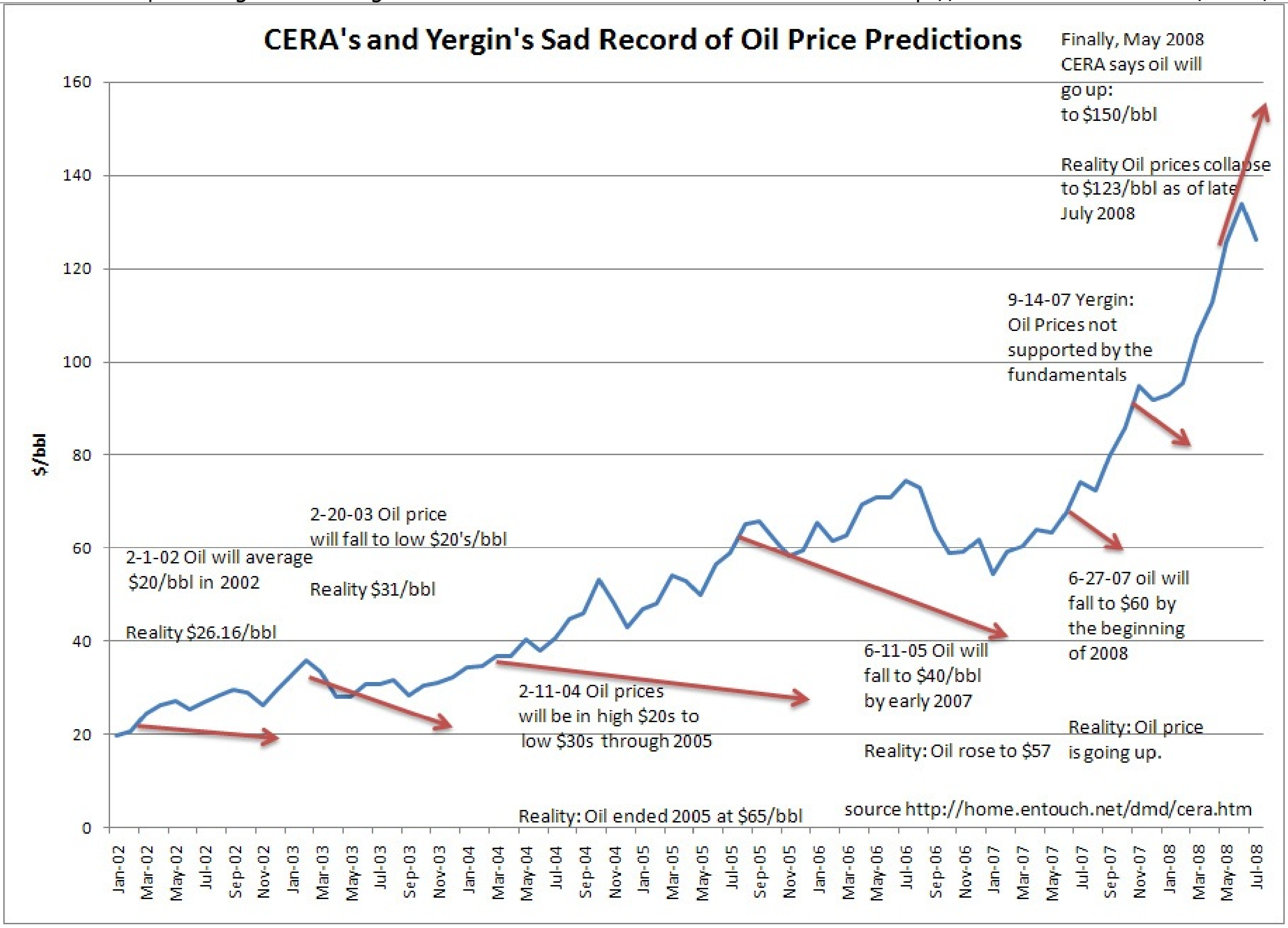
I watched a video from CNBC where Yergin made these points:

- $80 is not supported by the fundamentals unless there is a war with Iran or a hurricane.
- $85 or higher this year
- Next year we will see a build up of supply

http://www.cnbc.com/id/15840232?video=519883687? source=CNBC|MW|video4

We will watch to see if this prediction happens.

For graphical enjoyment, we will show these predictions against the price of oil for the past 5 years.



It would seem to me that CERA's numerous predictions of the fall of the price of oil have been false every time. The chart above speaks volumes about their inability to foresee even the near-term future. Maybe their view of the world energy situation is flawed, leading them to be overly optimistic about the future price of oil.[sarcastic mode on] nah that couldn't be! They are the CNBC oil analysts![sarcastic mode off] Like many in the peak oil community, I use Yergin and CERA as a contra-indicator for how I should invest. So far, it is working quite well.