Rodney's Take

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Update on John Del Vecchio's Risk-O-Meter: it remains in cash, where it has been for most of the year, avoiding all of the current market noise. As for his Micro-Cap Millions strategy, we're now seeing more stories about small caps likely leading the way when the markets turn higher, because these stocks tend to be focused on domestic markets and the U.S. should emerge from the current downturn faster than other nations.

Oil's Unsettled December

When Russia invaded Ukraine, the countries of the EU made bold announcements about reducing Russian oil imports, but then turned many a blind eye to the Russian oil and related products that they have purchased in the months since. Not only did they compile a long list of exemptions, but they also purchased the tanker-full Russian oil and related products that everyone knew were first imported by other nations and then blended to hide their Russian origins. The end result has been that Russia just moved more of its oil exports through intermediaries. Although the proclaimed rejection of Russian oil didn't change the global market in terms of end use, the switch did cause tanker charter rates to jump, as Russian oil and related products took longer routes from extraction points to the end users. It turns out that obfuscation has a cost, even when it doesn't work.

The EU officially imports about 1.2 million barrels of Russian oil per day (bpd), down from about 1.9 million bpd before the invasion, a drop of about 670k bpd. Now, the December 5 deadline for the EU to end all seaborne Russian oil imports is fast approaching, although the deadline for ending Russian oil product imports doesn't arrive until February. The countries of the economic block have just a few short weeks to figure out how to replace their Russian oil imports with oil from other sources. Recent history tells us how this will or, rather, won't work.

While EU countries ostensibly will stop buying Russian oil that day, there is no plan to reduce their consumption by a commensurate amount, and therein lies the issue. Instead, the Europeans will go to great lengths to highlight new oil suppliers without discussing that those suppliers sent oil elsewhere before December 5. The old clients of the new suppliers will have to find their own new suppliers. Somewhere along the way, the old clients will buy oil from Russia, and some of it will find its way to Europe. Think of the energy markets as a global game of musical chairs, except that everyone gets a seat. The Europeans get to sit in the chair of moral high ground while still using oil, while the Russians get the chair filled with consistent energy profits as they continue to sell the stuff to whomever will buy it.

The only way to do this differently would be for almost all global oil buyers to shun Russian oil and for global demand to fall by the amount of Russian exports or for producers to increase production to make up for the lost Russian supply. As we've seen in recent moves by OPEC+, none of this seems likely.

To make things more confusing, the Group of 7 (G-7) just voted to put a price cap on Russian oil, which doesn't allow companies based in the G-7 nations to provide services such as shipping and insurance to Russian oil shipments priced above a set rate. The nations of the EU would like to adopt the same price cap limit and potentially scrap their drop-dead December embargo date, but that would require a unanimous vote. Hungary and Cyprus already have said they don't support a price cap, which should make this a moot issue.

With the Europeans forcing importers to shuffle their suppliers to meet their embargo deadline and the G-7 trying to enforce a price cap, there's no telling what disruptions will occur in the energy markets in the weeks ahead, but we probably won't have to wait until December to find out. Shippers, insurers, importers, and exporters sign contracts weeks and months in advance. Today, they are scrambling to figure out the rules they will have to follow in just a few short weeks, but unfortunately the rules don't exist.

The confluence of the looming EU import ban and G-7 price cap and worries over how those two things might or might not work together are creating a lot of uncertainty in the oil market as we get closer to December. Let's hope that the Europeans are better prepared for their embargo than they seem and that the G-7 has a clear sense of how its price cap will work. Otherwise, we might find oil shipments stranded at sea or stuck at export terminals, which will leave consumers with dwindling energy supplies, a situation that always leads to higher prices.

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Got a question or comment? You can contact us at info@hsdent.com.