Oil Rally of 697% Surpassed Dot-Com Craze in Speculators' Mania

By Michael Patterson and Elizabeth Stanton

Enlarge/Details

June 13 (Bloomberg) -- The rally that drove oil to a record $139.12 a barrel last week surpassed the gains in Internet stocks that preceded the dot-com crash in 2000.

Crude rose 697 percent since trading at $17.45 a barrel on the New York Mercantile Exchange in November 2001, and reached 28 record highs this year. The last time a similar pattern was seen in equities was eight years ago, when Internet-related stocks sent the **Nasdaq Composite Index** up 640 percent to its highest level ever, according to data compiled by Bloomberg and Bespoke Investment Group LLC.

The Nasdaq tumbled 78 percent from its March 2000 peak, erasing about $6 trillion of market value, as investors concluded that prices weren't supported by profits at companies such as **Broadcom Corp.** and **Amazon.com Inc.** Billionaire investor George Soros and **Stephen Schork**, president of Schork Group Inc., say oil is ready to tumble because prices aren't justified by supply and demand.

``There's nothing different between this mania, the dot-com mania, the real estate mania, the Dow Jones mania of the 1920s, the South Sea bubble and the Dutch tulip-bulb mania,'' said Schork, whose Villanova, Pennsylvania-based firm advises the Organization of Petroleum Exporting Countries, Wall Street firms and oil companies on the outlook for energy prices. ``History repeats itself over and over and over again.''

Oil climbed on growing demand from China and India, whose economies expanded the past seven years at an average annual pace of 10.2 percent and 7.3 percent, respectively. Supply disruptions in Nigeria and Iraq and declining production in Russia also boosted prices. Investors added about $250 billion to commodity index trading strategies since 2003, according to **Mike Masters**, president and founder of Masters Capital Management, a St. Croix- based hedge fund.

Money Flow

Money is flowing into oil as the global economy slows. The worst U.S. housing slump since the 1930s and more than $390 billion of writedowns and credit losses at banks will slow global growth to 2.7 percent this year from 3.7 percent in 2007, according to the World Bank.

The U.S. economy's expansion may slow to 1.3 percent this year from 2.2 percent in 2007, dragging down oil demand by 240,000 barrels a day, according to economists surveyed by Bloomberg and Energy Department data. In China, the second- biggest fuel consumer after the U.S., economic growth may fall to 10.1 percent from 11.9 percent, the Bloomberg survey shows.

Supply, Demand

``I don't know if you can classify it as a bubble or not,'' said Masters. ``But there is no question that investor demand is having an effect on price. Very little of it has to do with physical supply and demand of crude oil.'' Masters testified at a Senate hearing in May on the role of speculators in commodities markets.

Gains in oil are the result of a ``bubble'' caused by speculation from index funds and a tight balance between supply and demand, **Soros** said in testimony before the Senate Committee on Commerce, Science and Transportation on June 3. ``The bubble is superimposed on an upward trend in oil prices that has a strong foundation in reality,'' he said.

Commodity index traders account for about 40 percent of the open interest, or outstanding contracts, in the 12 agricultural commodities for which the **Commodity Futures Trading Commission** reports data, according to Chicago-based Bianco Research LLC.

Crude futures more than doubled in the past year and surged $10.75 a barrel on June 6, the biggest rise on record and the largest in percentage terms since June 1996. **Robert Aliber**, a professor of economics emeritus at the University of Chicago Graduate School of Business, says the risk of a ``correction'' has increased because prices climbed so fast.

`Momentum Players'

``You've got speculation in a lot of commodities and that seems to be driving up the price,'' Aliber, co-author of ``Manias, Panics, and Crashes: A History of Financial Crises,'' said in an interview from Hanover, New Hampshire. ``Movements are dominated by momentum players who predict price changes from Wednesday to Friday on the basis of the price change from Monday to Wednesday.''

Burton Malkiel, a Princeton University economics professor and author of ``A Random Walk Down Wall Street,'' says the rise in oil may be justified because supplies are limited and demand in developing economies is increasing. That distinguishes oil from the market for **technology stocks** in the 1990s, where supply ``could be expanded infinitely'' and new stock issues helped push down prices, he said.

``The picture is fundamentally different than the Internet picture,'' Malkiel said in an interview from Princeton, New Jersey. ``I'm not saying we're running out of oil, but we're clearly supply-constrained. Five and 10 years from now, the price is going to be higher than $134.''

Nasdaq's Rally

The Nasdaq reached a record intraday high of 5,132.52 on March 10, 2000, in a rally that started in June 1994. Investors plowed $199 billion into mutual funds dedicated to U.S. equities during the 10-month stretch leading up to the peak, including $36.5 billion in February of that year, data from **TrimTabs Investment Research** in Sausalito, California show.

The flood helped boost the price-to-earnings ratio on shares of Irvine, California-based **Broadcom** to 617 in March 2000, according to Bloomberg data. Shares of the semiconductor maker, which surged 351 percent in 1999, lost 89 percent over the next three years. Broadcom fell 1.1 percent to $25.30 in Nasdaq trading yesterday.

``You can look at the chart and say oil's taking on the characteristics of a bubble,'' said **James Bianco**, the president of Bianco Research. Still, ``it may have a long way to go before it eventually peaks,'' he said.

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