



Your family's CFO.

Update on Oil Shock

March 15, 2011 | Bud Boland, CFP®

©Smith & Howard Wealth Management, LLC

As if investors needed a new challenge to confront following what most would deem a successful resolution to the Egyptian crisis, we now find ourselves dealing with higher oil prices as a result of further unrest in the Middle East-North Africa (MENA) region. The result of these crises on our personal economic situations and the global economic recovery as a whole remain in question.

The root cause of the surge in oil prices has been fear on the part of oil buyers that protests in the MENA region will cause further supply disruptions. Thus far, instability in the region has been confined to countries such as Libya and Algeria whose lack of output is not expected to undermine the global economic recovery. OPEC currently maintains spare capacity significantly higher than its historical average. Furthermore, oil reserves are running higher than average (the U.S. Strategic Oil Reserve is filled to capacity at 727 million barrels) and leaders in a position to tap these supplies or increase production have made it known of their willingness to do so if conditions warrant. In our opinion, the real threat to oil and the global economic recovery is political turmoil spilling over into some of the larger oil producing nations like Saudi Arabia and Iran. While many believe the large oil exporting nations win with high oil prices, high prices may eventually threaten their market share as consumers look to alternative sources. Consequently, these exporting nations also have an interest in keeping oil prices in check.

For the typical consumer, the increase in oil prices and the subsequent jump in gasoline prices give further credence to the inflation sensation being felt in our wallets. Energy spending makes up about 9% of the average consumer's spending, according to the Bureau of Labor and Statistics. Increased oil prices function as inflationary in the near-term, but, ironically, turn deflationary over the long run. Common sense tells us that if more money is spent filling up the car, less money is left for movies, clothes, and flat screen TVs. In this case, the real headwind to the U.S. economy is not so much inflation, but reduced demand for finished goods and services as a result of higher oil prices.

As investors, these are indeed interesting issues to sort through. Inflation, however defined or measured, is gaining a presence in our everyday lives. Historically, equities and commodities, in particular, have fared well in times of low and rising inflation. Our belief in the need for

well-diversified and balanced portfolios with allocations to uncorrelated alternative investments is underscored by the events of late. Our alternative allocations, in particular, are charged with maintaining stability and consistency in the midst of volatility through the other asset classes.

We will continue to monitor the political situation as it affects global and national investments. If you have any questions, please call us at 404.874.6244.