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WEALTH MANAGEMENT

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**Portfolio Manager Musings**

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With the significant decline in oil prices on the minds of most of us over the past year or so, it has prompted the question, “is there more to this than just an oversupply problem?” In other words, is oil trying to tell us something about the long-term structure of the supply/demand equation? It wasn’t that long ago that many academics and industry experts were using the term “peak oil.” At the time it meant that we had basically discovered all of the oil there was to find, other than small incremental additions to existing fields that were being depleted faster than any new capacity could be brought on line; that the industry had done all of the work possible and there were no new “elephants”, or major new fields to be found. The inevitable result was oil at \$200 plus per barrel and the US, like Europe would be resigned to 6, 7 and 8 dollars a gallon gasoline. The forecasts, which seemed to be absolute, prompted a flurry of efforts to lower the growth in consumption. The results have been hybrid cars, all electric cars, lowered thermostats in the winter, higher thermostats in the summer, LEED certified buildings, fields of photovoltaic panels and windmills, and generally more efficient use of energy in our daily lives.

To the surprise of few observers, the peak oil efforts have had their intended consequences. Per capita consumption of energy in the developed world has declined over the past 20 years. The unexpected surprise has come from the energy industry and its application of technology to bring about the total debunking of the peak oil hypothesis. Fracking is not a new technology. It has been used for decades. What has changed is how efficient it has become and its application to unconventional reserves. As a result, accessible global reserves have exploded. So we find ourselves in a price war. US “frackers” versus OPEC and a number of emerging countries, with neither willing nor able to reduce production and the concomitant reduction in cash flow. There is little doubt that higher prices will bring additional production from resources we never thought accessible a decade ago. The conundrum exists that the industry could use higher prices, but with all of the potential supply, higher prices anytime soon seem unlikely.

Back to our original question, is this more than a supply problem? We have gone beyond the concerns of high-priced gasoline and lines at the local gas station. The conversation has become about the environment and clean air and the survival of the planet, at its most extreme. Again, technology is moving the discussion forward. Natural gas is replacing coal and oil in our power plants. Electric cars have achieved 200 miles on a single charge. We use our mobile device to shop. Looking out on our parking lot, it would not be hard to imagine seeing it half full of electric cars of all sizes and shapes ten years from now. At the Detroit Auto Show this year, Volvo won Truck/SUV of the Year with an all-wheel drive SUV that gets over 50 miles to the gallon.

Perhaps we are witnessing “peak demand?”

Respectfully,

James L. Schrott, Portfolio Manager

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