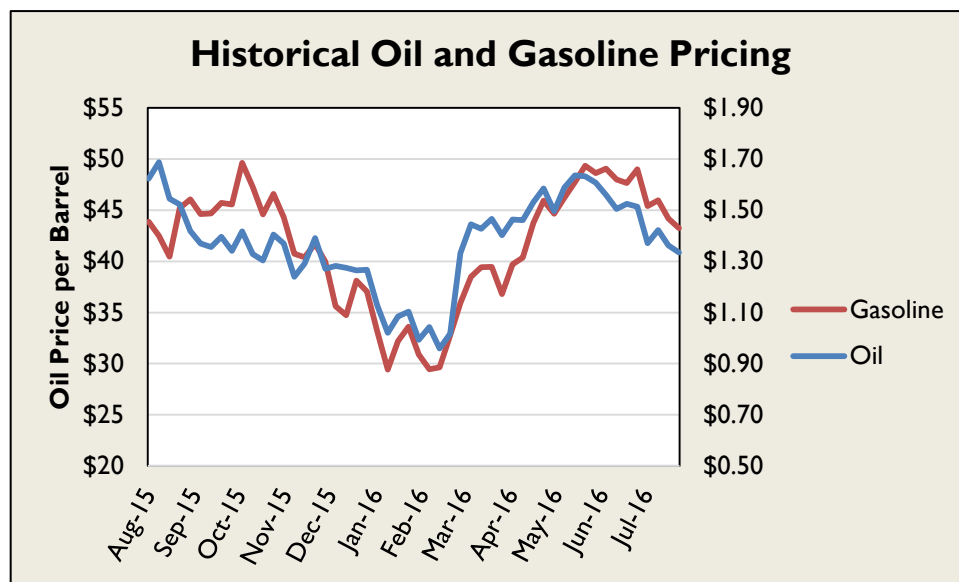


August 1, 2016

## **ValueScope's Oil & Gas Price Outlook August 2016: Gasoline Prices Not Costing an "Arm and a Leg" This Summer**

According to CNBC<sup>1</sup>, gasoline prices — at \$2.16 per gallon nationally — could fall another 10 percent or more, and while that's good for consumers, it may not be so for stock market investors.

That's because there's now a glut of gasoline, and that is pressuring oil prices. The oversupply of crude in world markets turned into a product glut this summer, with refiners producing more gasoline and diesel than is needed, even with near-record high demand. According to AAA, the national average for unleaded gasoline is down 15 cents in a month.

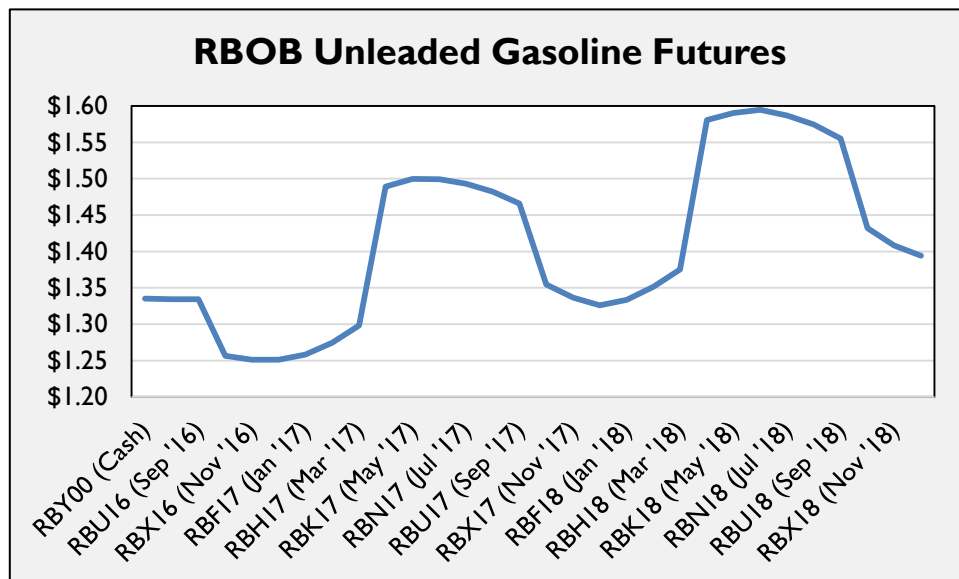


Gasoline futures trade under the symbol RBOB, or *Reformulated Gasoline Blendstock for Oxygen Blending* (simply the term given to unleaded gas futures). As one would expect, gasoline prices follow oil price movements.

Also, RBOB prices will always be lower than gasoline prices at the pump, since they are measured at a specific delivery point (for the contracts) and their prices do not include transportation fees, storage costs and retail profits.

"These are the cheapest gasoline prices for the end of July since 2004. There's 36 states where you see gas less than \$2 a gallon. The really cheap prices will be between Labor Day and Election Day," said Tom Kloza, global head of energy analysis at Oil Price Information Services. Kloza expects the national average to fall below \$2 per gallon, and said another 10 percent decline could easily be in store.<sup>2</sup>

Looking at the futures market for RBOB<sup>3</sup>, it is obvious there is a strong seasonal factor to pricing with the lows being around January of each year, so Kloza's comments above could pan out as the 2016 Election approaches.

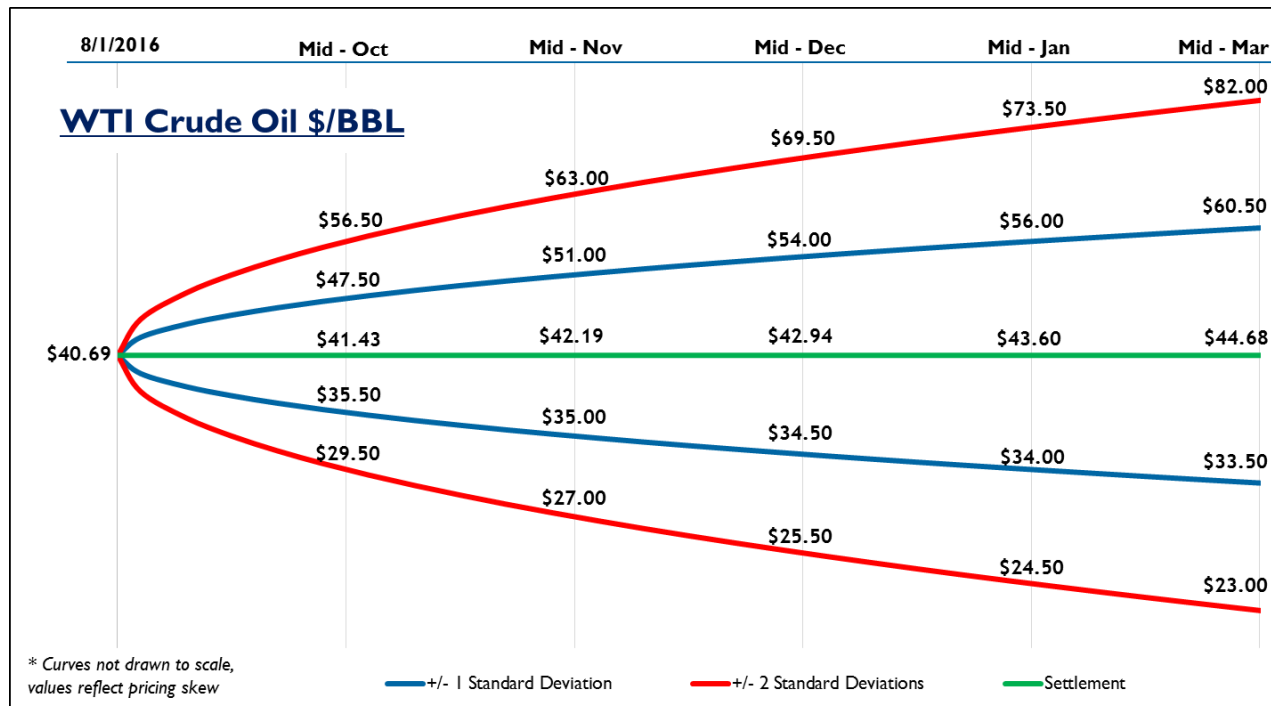


As with all statistical analyses, however, the devil is in the details and it is often difficult to discern between “correlation and causality”.

## **Crude Oil Outlook**

While futures markets aren't a crystal ball, their price levels and related options are useful for estimating future price ranges or “confidence intervals” for crude oil and natural gas. Crude oil prices have dropped by nearly 20% from one month ago, representing a decrease of approximately one standard deviation downward.

The graphic below shows the crude oil price on August 1, 2016 and predicted crude oil prices based on options on oil futures contracts (ticker /CL). The blue lines are within one standard deviation ( $\sigma$ ) of the settlement price (green line) and the red lines are within two standard deviations for each month (for a refresher on standard deviations, see the January 2016 blog).



Based on the August 1, 2016 prices, the markets indicate that in mid-October, **there is about a 68% chance that oil prices will be between \$35.50 and \$47.50 per barrel. Likewise, there is about a 95% chance that prices will be between \$29.50 and \$56.50.** For a longer-term view, by mid-December 2016, the +/- 1 $\sigma$  price range is **\$34.50 to \$54.00 per barrel. This upward skew in the price ranges also drives the expected midpoint of \$42.94 per barrel at year end.**

### Natural Gas Outlook

We can do the same thing for natural gas futures, currently trading at about \$2.82 per MMBTU on the Henry Hub (ticker /NG). Although more affected by seasonal factors than crude oil, in **mid-December 2016, the +/- 1 $\sigma$  price range is \$2.65 to \$4.15 per MMBTU and the 2 $\sigma$  range is \$2.05 to \$5.45 per MMBTU.** The expected midpoint of natural gas prices is \$3.28 for the end of 2016.

1. CNBC.com, July 25, 2016, Patti Domm
2. Ibid.
3. [http://www.barchart.com/commodityfutures/Gasoline\\_Rbob\\_Futures/RB?search=RB\\*](http://www.barchart.com/commodityfutures/Gasoline_Rbob_Futures/RB?search=RB*)

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