Change is Good! Making the Most of Volatility

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ABSTRACT

We’ve seen it before: “Please Lord, just give me one more boom, and I promise not to mess it up this time.” It’s funny on a bumper sticker, but is it possible? Can we not only weather the cycles but also perhaps use them to our advantage?

Unfortunately, I cannot promise any easy-fix answers or get-rich-quick schemes. Those are found on bookstores’ “best seller” shelves—where often the only one getting rich is the publisher—or on television, where the news channel “talking heads” are adroit at explaining what happened in the recent past in financial, real estate, industrial, or political arenas but are much less successful in terms of useful forward prediction.

I will try to avoid too much prognostication or passionate expression of convenient (or inconvenient) truths. Instead, I will simply examine various—mostly U.S.—data trends that are directly or loosely related to the oil and gas industry. Such diverse data include such things as oil and natural gas price, rig count, wells drilled, producing wells, production rate, energy consumption, reserves, summer and winter peak temperatures, resource estimates (and forecasts), private and government investment in energy research, population demographics, gross domestic product, inflation, stock indices, employment, and college enrollments, to name a few.

Some of the relationships that can be observed in these data are fascinating and exhibit a range of cyclic, rhythmic, but unfortunately, not always easily predictable behaviors. For example, a prediction that oil price will go up would not be particularly insightful, since oil price behaves cyclically. However, if I were to predict that oil price will rise from $78 per barrel in February 2011, to $96 per barrel in April 2011, and am correct, you might think I am either very good or very lucky; more than likely very lucky.

Commodity price volatility is the life blood of capital investors, who look at mountains of diverse and dynamic data. They scour news and weather channels, financial markets and policy sheets, and global events and political happenings. They put their money, and the money of those who have placed it in their care, to work in an ever-changing world. And they ride it out, trying to make the right timing decisions. It is not for the faint of heart. Over the long term, those who understand the data interrelationships well and have the courage of their convictions can do very, very well.

Then there are the rest of us! The geologists, engineers, economists, accountants, lawyers, and others who work each day for a major company, as a large independent, in academia, or in a smaller firm. What can we learn from these trends and relationships that will help us do our jobs better?

For starters, change happens in this industry, and change is not something to dread. It is important that we understand that many factors are related, some are correlated, and some even affect change in other areas. A simple example is the causative relation-

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