US Crude Oil sinks to 12-year low

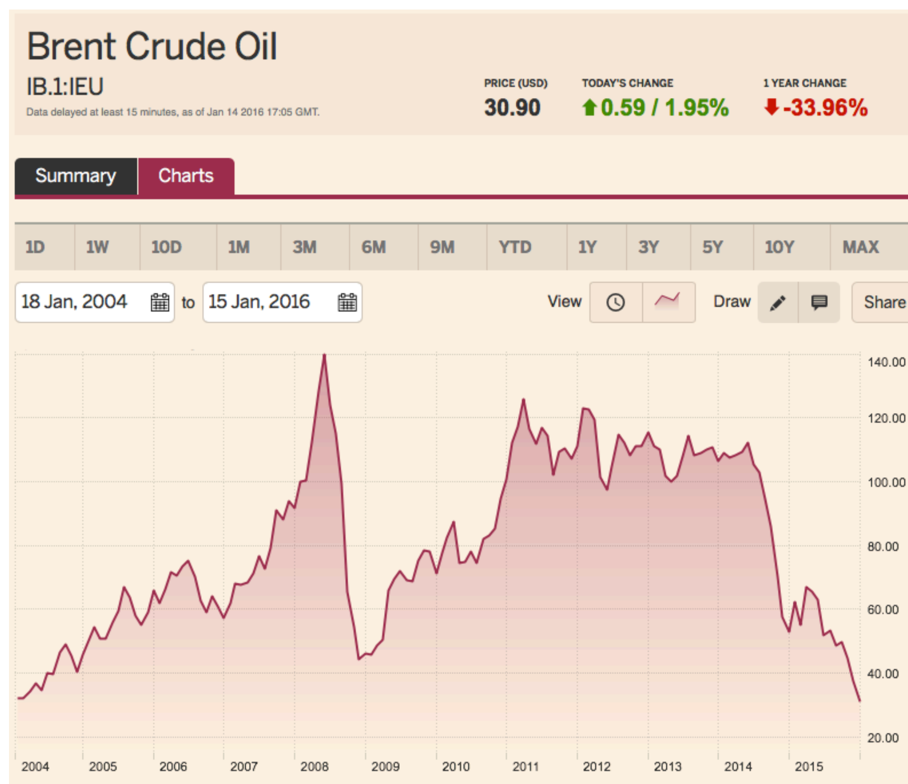
January 14, 2016

By: Direk Khanijou

Remember Murphy's Law: What can go wrong will go wrong. And don't forget O'Toole's commentary: Murphy was an optimist.

- Burton Malkiel, A Random Walk Down Wall Street

Oil prices have fallen by 70% over the past 18 months. I don't think anybody saw this coming.



You can often imagine market participants' dialogues: At $110/barrel, they are saying, 'I'll buy like crazy if it ever gets to $100.' Because of the way investor psychology works, at $90 they say, 'If it hits $70, I'll definitely consider buying.' But at $40, the inclination is to say, 'It's a falling knife, it's too risky to buy, I won't touch it at any price.'

This hardly makes sense. Investors *feel* better when the assets they're buying is rising, but it's usually much smarter to buy after they've fallen for a while.

The recent decline in oil prices has been a classic case of the late economist Rudiger Dornbusch's dictum: *In economics, things take longer to happen than you think they will, and then they happen faster than you thought they could.*

During good times – perhaps echoing Warren Buffett – investors talk about how much they'd like to see the stocks they own decline in price, since it would allow them to average down on their positions. But when prices collapse (like it has recently), the chance to average down is usually a lot less appreciated and a lot harder to act on.