

Stocks Could Be Hostage To Oil Prices All Summer

By Jeff Cox,
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For the stock market, this summer is going to be all about oil.

When once the two moved in tandem, equities and energy now are running in opposite directions, a trend most analysts expect to continue until oil finds a more comfortable trading range.

"At this point the market is almost held hostage to oil prices. It's very difficult to envision how the stock market moves appreciably higher with these huge swings we're seeing in oil prices now," says David Twibell, president of wealth management for Colorado Capital Bank.



The trend has been especially acute lately, particularly Friday **when U.S. light, sweet crude surged more than \$11 a barrel and the major stock indexes each fell about 3 percent.** It repeated itself Monday when oil fell and the Dow posted a modest gain, and performed similarly Tuesday as **oil lost ground** through the morning and stocks gained.

"I think we're going to have, at least for the time being, an inverse relationship," Twibell says. "I don't think historically that's been the case or needs to be the case. But energy prices are so high and have gone up so rapidly that it's really a psychological influence for investors."

Volatility became a watchword in the market when the credit crunch began to take hold in September 2007.

The Chicago Board Options Exchange's **Volatility Index** gained about 32 percent from early September to mid-March 2008. But the VIX dropped considerably through April and May, falling well below 20, which is considered the benchmark for a volatile market.

But it is back up since then as oil has skyrocketed and stocks have given back much of their gains. At the same time, the VIX has moved back into volatility ground, and with questionable volume levels ahead for the summer the waters could be choppy.

"People keep saying that one of reasons that oil prices are so high is because global growth is so high, yet everybody seems to be looking for a slowdown in global growth. You can't have it both ways," says Brian Gendreau, investment strategist at ING Investment Management. "I think the market is having trouble sorting it all out. There are a lot of cross-currents."

Of course, **not everyone thinks volatility is a bad thing**, but investment advisors counsel caution when it comes to playing this type of market.

How to Play the Oil-Stocks Disconnect

Money managers typically like to find market stalwarts like **Procter & Gamble** during hard-to-predict economic times. The stock has been a favorite lately for market bears, including Rick Pendergraft, editor at Investor's Daily Edge online newsletter.

"Their products are everyday use items that people just don't change up that much," he says of the company.

But Pendergraft also favors a host of bear plays, including shorting an exchange-traded fund for long-term bonds, the **iShares Lehman 20+ Year Treasury Bond** fund. He also advocates shorting stocks and buying inverse ETFs. Rydex offers a variety of inverse ETFs, including the **ProFunds Bear Inverse** which tracks S&P 500 movements.

Since oil has surged and caused havoc through stocks, investment counselors are advocating traditional down-time sectors.

They include health care and consumer staples, **Coca-Cola** surged Tuesday following an analyst upgrade. Pendergraft also thinks tobacco companies could do well now. Utilities also get some mention, particularly those that do business in foreign markets.

But some are looking directly to energy as a way to navigate the turbulent times, though not necessarily in the big producers.

"The energy area is going to be the primary area that is going to benefit," says Richard Sparks, senior analyst at Schaeffer's Investment Research. "Specifically, you want to look at the front end of the pipeline that benefits from that increase in price--exploration and production, rather than the refiners."

Sparks recommends two small-cap exploration firms: **PetroQuest** and **Goodrich Petroleum**.

Twibell takes a far more cautious approach to investing right now, and is in fact advising his clients to stay on the sidelines until the oil scenario plays itself out. The only areas he would play now are agriculture, due to soaring grain costs, and believes the community and regional banks will offer solid value over a longer time frame.

"If I had a cash reserve I'd be holding onto that, looking for some resolution one way or the other," he says. "Over the short run I don't even think you're really safe in energy right now."

While it may seem obvious, many analysts are simply counseling diversification and calm in the face of the wild oil and stock swings.

"Investors that have a well-diversified portfolio are probably best off right now hanging in tight," Twibell says. "If we can get some catalyst to move energy prices lower, I think the markets can do just fine."