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Exchange-Traded Funds: ETF Focus: ETF Strategy Aims to Profit From \$4 Gas

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ETF Strategy Aims to Profit From \$4 Gas

By [Rob Wherry](#) | [Rob Wherry Archive](#) | Published: May 8, 2008

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THIS SUMMER IS shaping up to be a back-breaker for consumers at the gas pump. Oil topped an unprecedented \$123 per barrel this week, and gasoline could easily stay above \$4 a gallon as vacation travelers hit the road starting Memorial Day weekend.

No doubt that will have a profound impact on millions of households across the country. Indeed Patrick Collins, founder of Greenspring Wealth Management in Towson, Md., recently sat down with one of his more affluent clients who could easily afford to absorb the rising costs. Nevertheless, the client was wrestling with whether to take his family on a cross-country vacation this summer or simply head to a nearby beach instead.

"If you talk to people about where their money is going, a big percentage is going to energy costs," says Collins.

Advisors like Collins — [here](#) is an in-depth interview with him on SmartMoney TV — have been searching for ways to make that situation a little less painful. After all, companies that rely on commodities have long locked in their costs using hedging strategies. Why can't consumers do the same thing? The problem was there was no product that allowed for easy access to oil or gasoline. Now, though, advisors have just begun to devise strategies using exchange-traded funds that could, at least on paper, lessen the blow to drivers' wallets.

The ETF industry has been accused of launching products simply for the sake of getting a certain strategy to market. That's one of the reasons dozens of funds languish with little assets and thin trading volumes. However, it scored a home run when fund companies like PowerShares, **State Street** (STT: **72.22**, **-0.51**, **-0.70%**) and **Barclays** (BCS: **35.13**, **-1.06**, **-2.92%**) launched commodity ETFs that track everything from gold and silver to cattle and crop to oil and gas. As a group these funds hold well over \$30 billion.

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Most of these ETFs are designed to increase in value at the same time the underlying commodity is rising in price. So what many advisors are exploring is whether it makes sense to invest in one of these ETFs to offset high energy prices. The strategy is sound, but as you will see it also has many drawbacks.

Markets	Top 10 Movers
DJIA	12745.88 ▼ -120.90
Nasdaq	2445.52 ▼ -5.72
S&P 500	1388.28 ▼ -9.40
Rus 2000	720.05 ▲ 0.50
10 Yr Bd	3.77 ▼ -0.01
DJTA	5193.98 ▼ -30.75
Wil 5000	14040.05 ▼ -81.01
S&P 400	853.93 ▲ 0.72
Nas 100	1960.29 ▼ -6.57

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To illustrate the idea, Collins came up with a hypothetical example of a family that drives two vehicles a total of 35,000 miles in a given year. Collins estimates that if the cars average 20 miles per gallon and they pay an average \$3 a gallon for gas they will spend around \$5,800 to fill up the tanks. If the price per gallon happens to jump to an average \$3.75, a 25% increase, the family would see its gas bill jump \$1,500.

Collins then suggested that same family could invest an initial \$5,800 — its estimated gas expenses — in the **United States Gasoline ETF (UGA: 59.33, +0.93, +1.59%)** at the beginning of the year. This fund tries to match the percentage increase in the unleaded gasoline futures that trade on the New York Mercantile Exchange. In concept, this fund would increase in value by the same amount that gas rises in price at the pump. At the end of the year the family would sell the position and bank a tidy \$1,500. In other words, they would have locked in their annual gas costs at \$3 a gallon.



UGA vs. DJIA for the last 3 months.

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Conceivably, the strategy could be implemented with other energy ETFs. **United States Oil (USO: 102.12, +1.46, +1.45%)**, a sister fund of the gasoline ETF, tracks the price of West Texas Intermediate crude. Dean Harman, owner of Harman Wealth Management in The Woodlands, Texas, likes the idea of offsetting high energy prices with funds like **iShares Dow Jones U.S. Oil & Gas Exploration & Production (IEO: 79.71, -0.55, -0.68%)**. That ETF owns 62 companies like **Occidental Petroleum (OXY: 87.85, -0.07, -0.07%)**, **Devon Energy (DVN: 115.72, -1.61, -1.37%)** and **Apache (APA: 135.67, -2.51, -1.81%)**. Funds like this one won't correlate to the price of oil or gas, but they will move up or down with those commodities nonetheless. Over the last year iShares Dow Jones U.S. Oil & Gas has returned 41.8%.

"The [energy] sector is still really strong," says Harman. But, he adds, you have to pick your spots. "There is very little growth to be had with big oil companies."

There are some obstacles to pulling off this hedging strategy. For Collins' example to work, a family needs to have \$5,800 to invest, a tall order during these trying economic times. Of course, consumers don't have to hedge the entire year. They could do just the summer months. But let's say the strategy is successfully implemented. When Collins' hypothetical family goes to sell the position at the end of the year they will realize a profit. If they don't have any losses in other parts of their portfolio to offset those gains they could be looking at a tax bill. They may

have fended off Big Oil but not Uncle Sam.


The biggest concern, though, may be the commodity market itself. It can be extremely volatile and, depending on whom you talk to, has all the hallmarks of looking like a bubble about to burst. This strategy isn't a long-term one, so it means retail investors will have to essentially time their bets. Even the pros have a hard time doing that. Indeed, our hypothetical family could have easily seen their investment drop 25%, too.

Both Collins and Harman accept those flaws and admit this tactic isn't for everybody. That's especially the case, they admit, given the recent stock market. If you can do a little belt-tightening to weather the current storm, the best strategy may be to plow money into a diversified portfolio that will reap big rewards when the market recovers.

Also See:

- [Hotels Offering Gas Incentives to Lure Guests](#)
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haneyk1

Posted: 8:36 AM On May 9, 2008

I may be crazy but my math works out a little differently. I get the family paying \$5,250 per year. Can some one help me out.



DKP50

Posted: 6:17 AM On May 9, 2008

Good Idea... with ETF's all you want, but I just take \$10,000 & Buy Black Rock Global Resources Fund (SSGRX) and It's Top Energy Stock on margin & Another Fund's Top Energy Stock > XTO.. being +25% YTD and more importantly over 540% past 5 yrs, helps pay my Combined Energy Bills for both the Car and Home..(It's just too bad our Social Sec. \$ couldn't be partially Invested in Energy Funds like these, the past 5 yrs) :.(



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