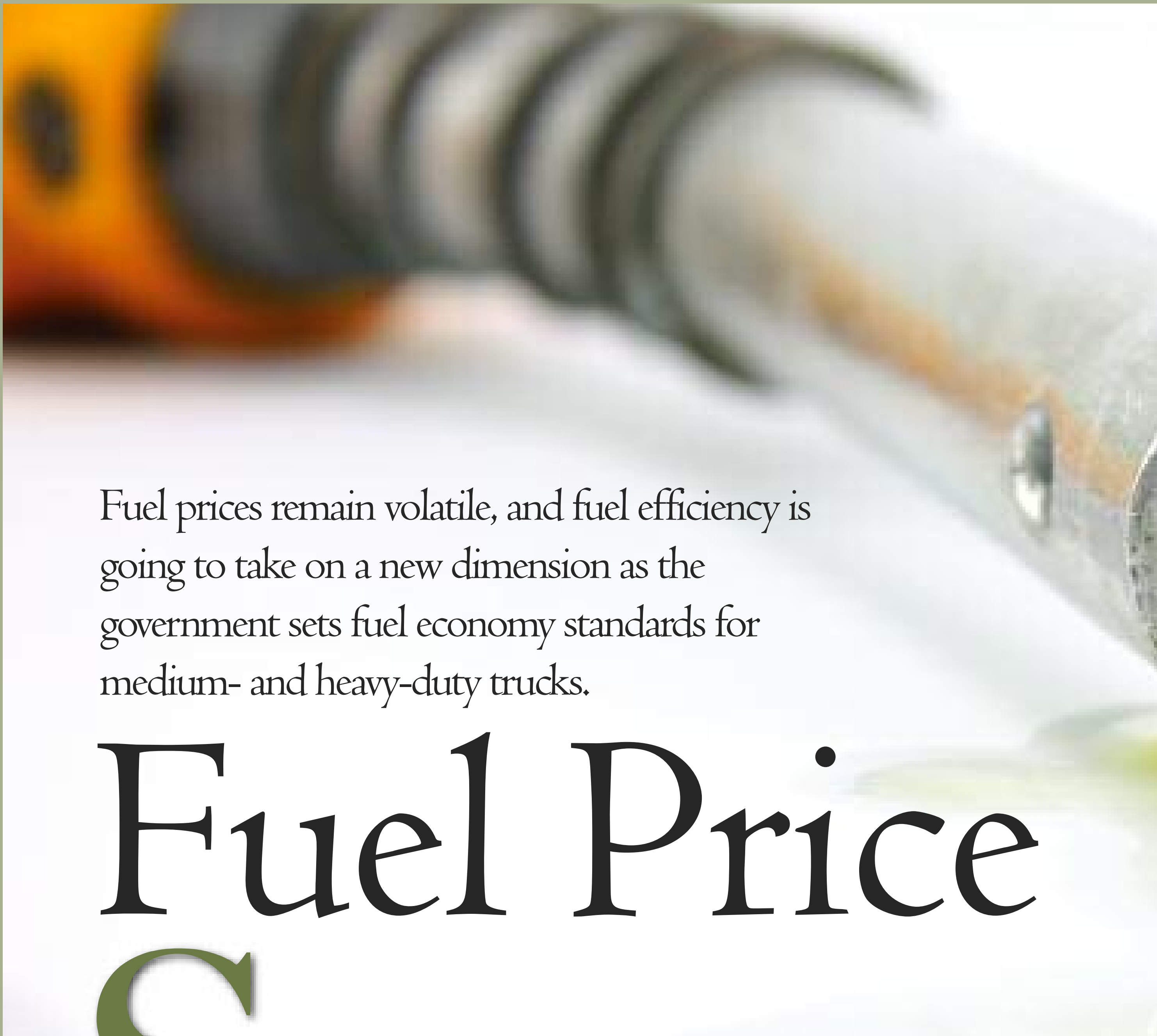

Fuel prices remain volatile, and fuel efficiency is going to take on a new dimension as the government sets fuel economy standards for medium- and heavy-duty trucks.

Fuel Price

Soaring diesel prices in the first quarter of this year fueled fears of a dampened economic recovery, and prompted flashbacks to 2008's record high oil prices. However, the worst may be over – for now.

At the time of this writing, the price of on-highway diesel has risen about 18 percent since the beginning of the year, and 23 percent year over year, according to the Energy Information Administration. Benchmark West Texas Intermediate crude, which averaged $79 per barrel in 2010, shot up to $114 before a broad-spectrum collapse in commodities in mid-May, which sent prices back briefly to below $100 per barrel. Oil is now expected to average $103 for the year, with diesel at $3.89. At press time, it had dropped to a $3.997 per gallon national average.

In the broadest sense, many commodities, oil included, experienced a small bubble early this year. That bubble has popped. Even so, the recent run-up, although a bit more extreme than what we are accustomed to, was not out of the ordinary for the time of year. Oil has experienced a seasonal jump toward the beginning of spring in 29 out of the last 30 years, says Tom Knight, oil analyst with TAC Energy in Texas.

"From a mid-winter low, oil rallies to peak in late April or early May," Knight explains. "It is [typically]

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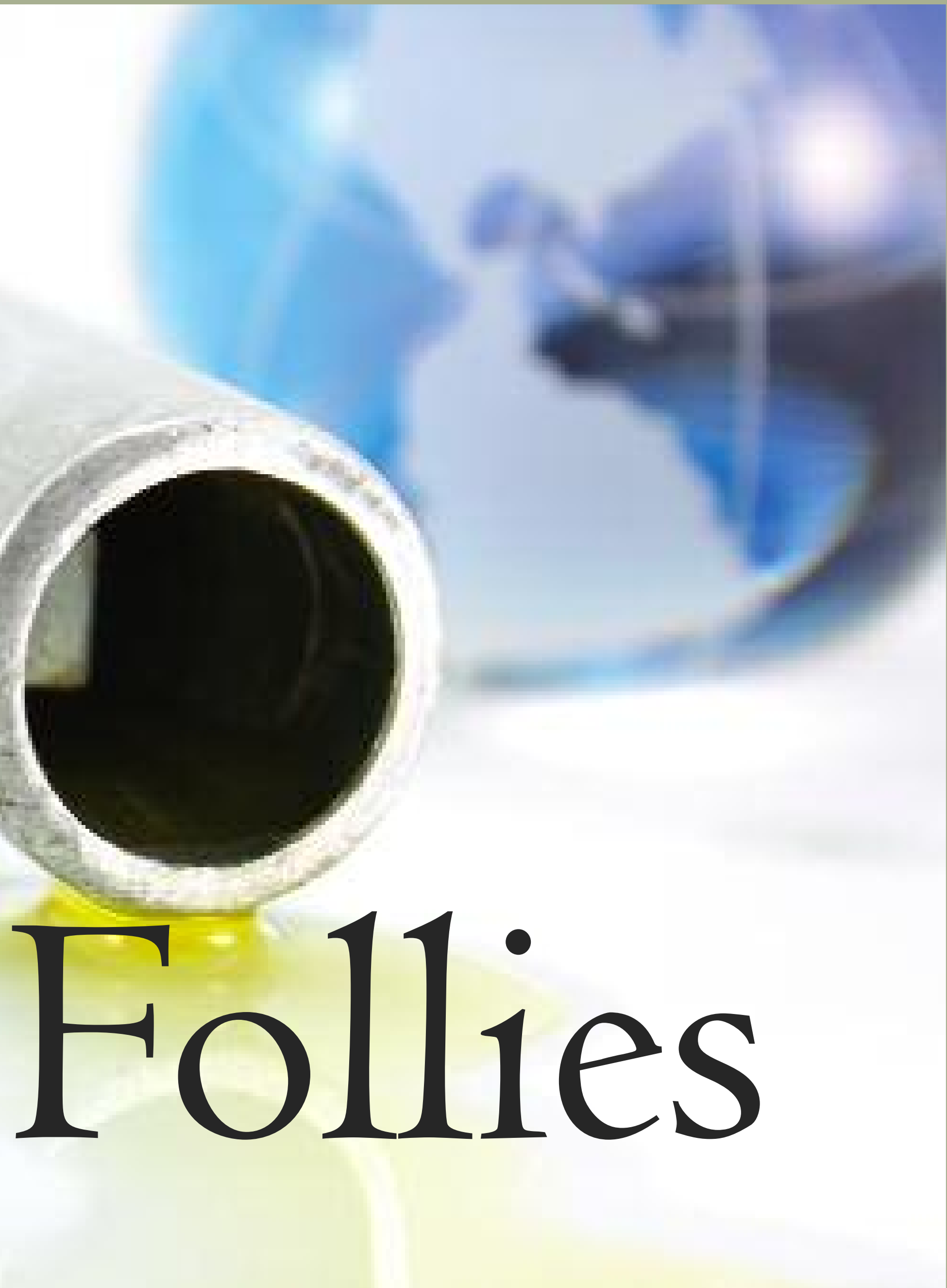

Follies

fueled by refinery maintenance, which is done around this time of the year, and ends around the start of the driving season."

Knight added that gasoline prices, which led the charge, peaked on April 30 this year – only days before last year's May 3 peak. What was different this year, he said, was a confluence of factors that, together, magnified the otherwise normal trend.

First, and perhaps most obvious, was fear of geopolitical instability in the Middle East. While some important production was lost in Libya, the price drive really came from the potential disruption of truly major producers, such as Saudi Arabia and Kuwait. Second, and trumpeted a bit in the media, was good old-fashioned speculation. The broad rally in commodities, which included metals and to some extent even grain, attracted investment from financial institutions across the board. The effect of frenzied pie-grabbing is well known.

Third, and perhaps less talked about in trucking circles, was the weakened dollar. Knight suggested this was the biggest culprit in the run-up. The dollar, he says, has been heavily shorted in the past six to eight months due to the Federal Reserve pumping money into the economy. As a result the dollar lost value in relation to other currencies, the Euro in particular. But the renewed fears of European sovereign debt, as Portugal, Ireland and Greece (again) are facing bailouts, has helped move the currencies back toward balance. The strengthening dollar, Knight explains, coincided with the drop-off in May, which was the largest weekly drop-off in 28 years.

Finally, this spring also saw a cluster of U.S. refinery problems that damaged production – fires, maintenance issues, power outages and, most recently, flooding on the Mississippi. The floods are not likely to damage the refineries themselves, but they will have an impact on shipping access as vessels find it difficult to navigate high water and low bridges. But the threats were still real enough to cause price fluctuations.

Again, no one of these factors was responsible for the spike. It was everything at once on top of seasonality that caused the temperature to go up.

Where are prices headed?

Every oil man chuckles at this question – because if they truly knew, they'd be on the beach and not on the phone with *Heavy Duty Trucking*. This is why you should talk to different experts and tease out the common threads.

From a historical perspective, there is a chance that oil could end up trading down significantly further than the EIA yearly prediction of $103. According to Knight, the market typically retraces to the downside about 25 percent from the peak of the spring rally. If that holds true, we could see prices drop into mid-$80s. That is, of course, if reality lives up to that 30-year seasonal average.

Tom Kloza, chief oil analyst at the Oil Price Information Service, also predicts lower prices, though perhaps not as low as Knight.

"Crude oil prices are [comparatively] down and are remaining down," Kloza says. "My sense is we are seeing the highest prices for the next 100 days." Diesel, he says, will stay below $4 per gallon throughout the summer. He says many built-in excesses overvalued the price of oil in the first five months of 2011, as bankers, as is their habit, overreacted to shifts in global stability.

The volatility problem

However, cheaper prices notwithstanding, it will still be an expensive year for trucking companies. Fuel has surpassed labor as the number one expense for trucking operations. According to Bob Costello, chief economist with the American Trucking Associations, our industry will spend $138 billion on fuel alone this year, up from about $100 billion last year. But he carefully notes that volatility is the actual problem.

"If we were to stabilize at $100 per barrel, we would all adjust," Costello explains. "What really hurts is a sudden, fast increase."

Such increases, like the one we have seen in the first few months of this year, don't give companies adequate time to adjust pricing. As Costello says, it kills companies. A survey conducted in early April at the 2011 NAFA Institute and Expo found that 29 percent of fleet managers place fuel volatility as their top concern this year, even higher than new CSA regulations and a looming driver shortage.

That volatility is not going away.

One issue is weather. The past few decades have seen increasingly severe hurricane seasons in the Gulf of Mexico. Another hurricane like Katrina making landfall in refinery country, or indeed anywhere, would drive oil and refined products up immediately.

"If we were to stabilize at $100 a barrel, we would all adjust. What really hurts is a sudden, fast increase."

On the potentially positive side, there is still no telling what will happen in Libya. Oil production in the tumultuous country has virtually stopped and markets have gotten used to life without it. But it won't be gone forever. If the increasingly desperate Gadhafi is knocked out of power for good and Libyan production suddenly returns, the effect on global markets could be quite large.

"[Deposing Gadhafi] will send prices down by probably $15 per barrel," Kloza predicts.

Finally, and most importantly, there is the issue of how the markets themselves function. With the rise of the powerful, purely profit-driven financial industry, the markets will be forever subject to fast movement, even in times of ecological and political calm.

The longer haul

"That is really a new paradigm in the market – higher volatility regardless of market movement," Knight says. "Money creates its own level of volatility."

In Kloza's words, predicting oil and fuel prices beyond about 100 days is a bit like witchcraft. Next year is a different story, but it's still worth considering. The EIA recently revised the 2012 oil price prediction down to $107 per barrel yearly average, and diesel down to $3.93. Kloza thinks next year will be more interesting.

"Based on what happened this spring in the Middle East, it is not a one-off," says Kloza, who thinks unrest will dampen through the blistering summer months, but perhaps return when seasonal temperatures cool. Even the risk of another round of protests is enough to make prices jumpy, he says. Come winter, a worry premium will be built into prices once again.

"The prices of later winter, early spring are back on the front page and flirting with the all-time 2008 highs," he predicts for next year. "Again, that's a little bit of witchcraft."

Guessing oil prices will always be akin to predicting the wind, but most analysts expect fuel to stay high for the duration.

"We are always going to be at the mercy of the pump," Costello says. "But there is a lot of stuff we can do."

Among the options, which we'll explore further in this issue, are more fuel-efficient power units, aftermarket aero improvers such as side skirts, as well as APUs and other idle reduction strategies. The EPA's SmartWay program can help fleets find these technologies and measure their progress. One of the biggest potential savings is in training and incentivizing drivers to drive more efficiently, a tactic explored in this month's Clean and Green section as well as in Rolf Lockwood's column on page 92. (Look for the yellow "Fuel Focus" button.)

Since oil prices will always be somewhat of a question mark, we should always bet on them being high – and plan accordingly. ■