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Hope Is Not a Strategy: Positioning for the Reality of Oil Scarcity

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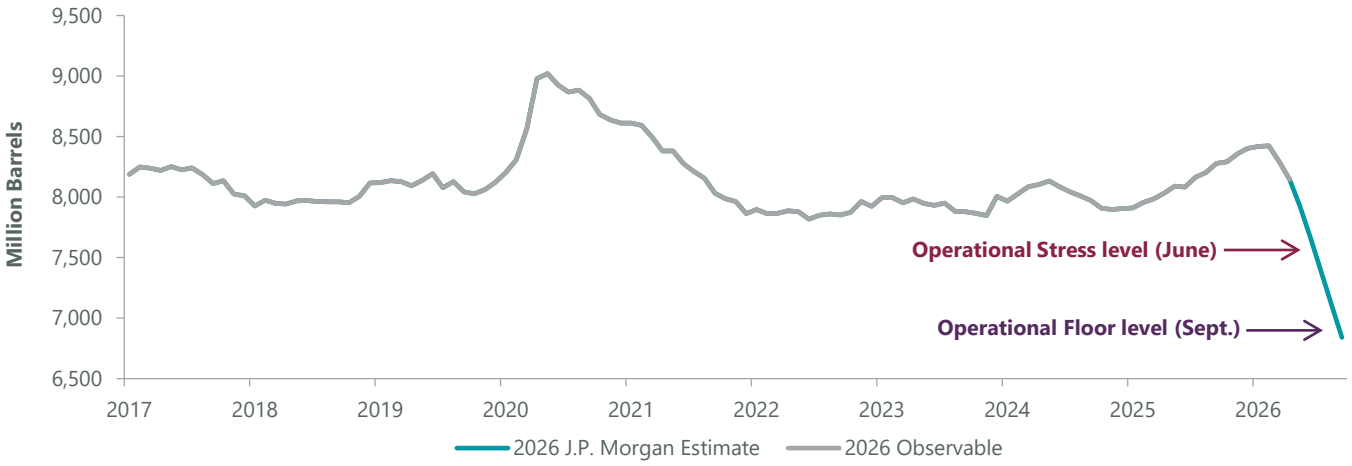
Key Takeaways

- The extended closure of the Strait of Hormuz is pushing global oil inventories toward critical lows, where the market's "balancing mechanism" could quickly give way to operational stress.
- Markets may be looking through the crisis because excess inventories, SPR releases, sanctioned barrels and China's strategic reserves could extend the runway before shortages become severe, but they do not eliminate the risk of a bullwhip effect.
- We are raising our energy overweight and modestly reducing our materials exposure, using energy stocks as a relatively inexpensive hedge against a surge in oil prices and the reality of a tighter energy market.

Energy Shock Absorbers Under Strain

The extended closure of the Strait of Hormuz has created one of those rare moments in markets when something both knowable and important appears to be underappreciated. In this case, we know with a greater degree of certainty that the ongoing energy crisis is pushing global oil inventories, including many critical product inventories, toward all-time lows — levels that could result in outright stock-outs of critical products like jet fuel in certain markets (Exhibit 1). This is one of the largest supply disruptions we have experienced, and the problem is that it is ongoing. Current estimates are that if the Strait opened today, cumulative unproduced barrels would approach 1 billion. If this continues until June 1, that estimate jumps to 1.4 billion barrels.

Exhibit 1: Global Oil Inventories Teetering on the Edge



As of May 11, 2026. Source: J.P. Morgan Commodities Research.

So far, this has been an historic, but still largely linear, time-driven process in which the initial shock has been absorbed by excess oil inventories and strategic petroleum reserve (SPR) releases. The problem is that we are approaching the point where record inventory draws rapidly erode these crisis shock absorbers, creating the conditions for stress to spread quickly across the global energy supply chain. It is practically impossible to model the price per barrel required to force demand destruction, especially in markets that simply run out of product, but we know the right price will not be $100 per barrel — it will likely be significantly higher.

This is not an obscure conclusion; energy experts and analysts see the same intensification ahead. The core issue is that the "balancing mechanism" of inventories will soon be lost as global oil markets begin to reach the hard floors required to keep the energy supply chain functioning. Like a biological circulatory system that can bleed out, the system can quickly move from manageable stress to operational strain once those buffers are gone.

So why is the market largely looking past this crisis? Beyond those initial shock absorbers, sanctioned cheap barrels, primarily Russian and Iranian, likely boosted oil consumption in key consuming markets like China and India, suggesting there may be more discretionary demand cushion than traditional models assume. China has also spent recent years adding massive amounts of strategic oil storage capacity, which it filled with cheaper sanctioned barrels. If those barrels are released, particularly into targeted Asian markets where shortages could become most acute, it could extend the runway while giving China tremendous strategic leverage.

Another way the market appears to be looking through this crisis is in recession odds, which remain relatively sanguine. We closely monitor these signals and think the current consensus could prove too complacent if the energy crisis intensifies as expected. The risk is that economic stress does not grow in a smooth, linear fashion. As supply chains tighten, product shortages emerge and oil prices rise to force demand destruction, the macro drag could compound quickly, adding another layer of uncertainty to an already fragile energy backdrop.

Ultimately, we do not think markets are fully prepared for the potential bullwhip effects of plummeting oil inventories. One of the cyclical models we are using, due to the magnitude of the inventory shifts, is the DRAM inventory cycle, which is prone to extreme booms and busts when inventory buffers disappear, supply cannot respond quickly and customers begin to pull demand forward. That dynamic has become especially visible recently as AI-driven demand for high-bandwidth memory has tightened supply across the broader memory market, pushing prices higher and reinforcing the power of the inventory cycle. A similar inventory-driven reflexivity could emerge in energy if consumers, refiners or countries begin acting not on the reality of today's supply availability, but on the fear of tomorrow's scarcity.

Positioning for Reality

The critical portfolio construction question is: how do we position for a risk that appears increasingly knowable, but not yet fully reflected in markets? With equity markets near all-time highs and index valuations historically elevated, we are adjusting our positioning pre-emptively rather than waiting for the energy shock to be fully reflected in prices and raising our energy overweight through the addition of new holdings like oil and natural gas company Diamondback Energy, as well as increasing our position in existing holdings like diversified oil major ConocoPhillips. The most direct reason is that energy is the clearest expression of the risk we see building. If global inventories are approaching hard floors and product stock-outs become more likely, then energy companies should experience materially positive estimate revisions and generate much higher cash flows.

The second reason is that using energy stocks to hedge against a surge in oil prices is still relatively inexpensive. Energy stocks have some of the highest free-cash-flow yields in the market, fortress balance sheets and healthy dividends. Even if this crisis ended today, oil prices would likely remain materially higher than before the crisis, as global inventories will need to be rebuilt over the next couple years and rebooting the global energy supply chain will take time.

The third reason is portfolio construction. When energy spikes, pretty much everything else goes down. We saw this negative correlation pattern early in the crisis, and we think the risk is growing that it will reassert itself as inventories start to plummet. In an energy-induced volatility spike, energy will likely be one of the few truly defensive sectors.

We are funding part of this energy increase by modestly reducing materials exposure. This is not a rejection of the long-term bull market in real assets, which we still think remains intact as the energy crisis creates more ongoing inflationary risks. Rather, it is a near-term portfolio construction decision. Materials stocks, including gold, have recently been among the most negatively correlated areas versus energy, with gold behaving more like a risk-on asset. If the central issue is the risk of hard inventory floors and stock-outs across the global energy supply chain, then energy is the more direct expression of that risk.

We invest in a world where we are constantly dimensioning the probabilistic landscape, pushing that process until we reach the border of irreducible uncertainty. It is extremely rare to know something about the future to a degree that takes us in the opposite direction, toward certainty; however, this is one of those rare times. The unknowable part is how quickly markets will reprice the reality of scarcity if oil inventories continue to plummet. We hope this crisis de-escalates quickly and we are proven wrong. But hope is not a strategy, and we are positioning accordingly.

About the Author

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