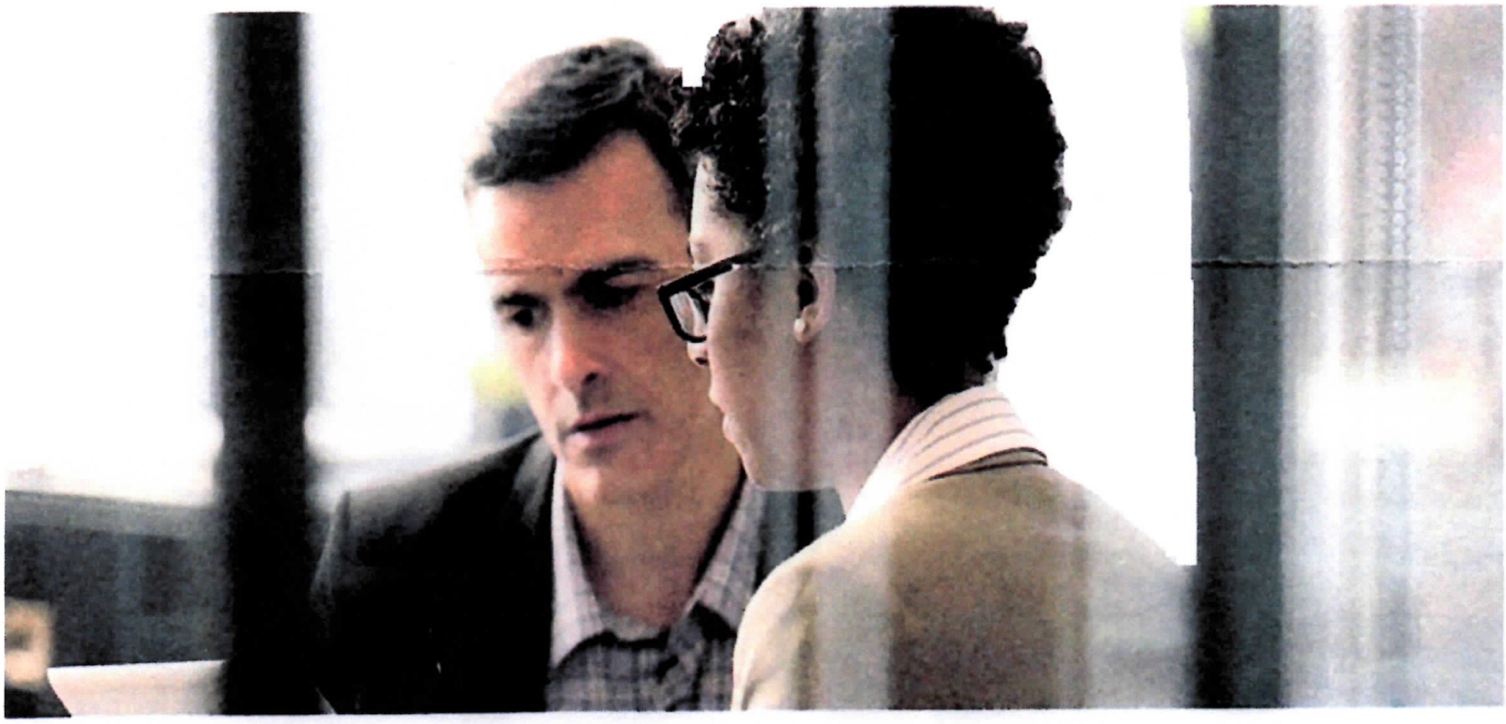

How Do Oil Price Fluctuations Affect Consumers and Their Portfolios?

Oil impacts many industries and its price fluctuations can cause a lot of uncertainty. While consumers are seeing immediate benefits at the gas pump, there are more far-reaching implications for investors.

Swings in the price of oil are poised to be a major force shaping the global economy in 2015, and there are clear winners and losers.

The national average price at the gas pump on January 30, 2015, was $2.05 per gallon – more than 45% lower than the 2014 peak average of $3.70. For consumers, lower oil prices translate into lower prices for gasoline and jet fuel. That impact means that a 12-gallon tank, filled once a week, equals more than $1,000 a year in a driver's pocket. This extra disposable income may be used for shopping, eating out or a vacation.

Consequently, lower gas prices and transportation costs can help businesses such as airlines, cruise operators, restaurants and retailers as their costs fall and spending by consumers increases. Energy costs for manufacturing plants could be reduced, which benefits many other industries. "It's a net positive for the U.S. economy," says Don O'Neal, a portfolio manager with 33 years of investment experience. "It's really good for the consumer and

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for a whole range of consumer products. But there is an offset – not all sides are benefiting from low oil prices."

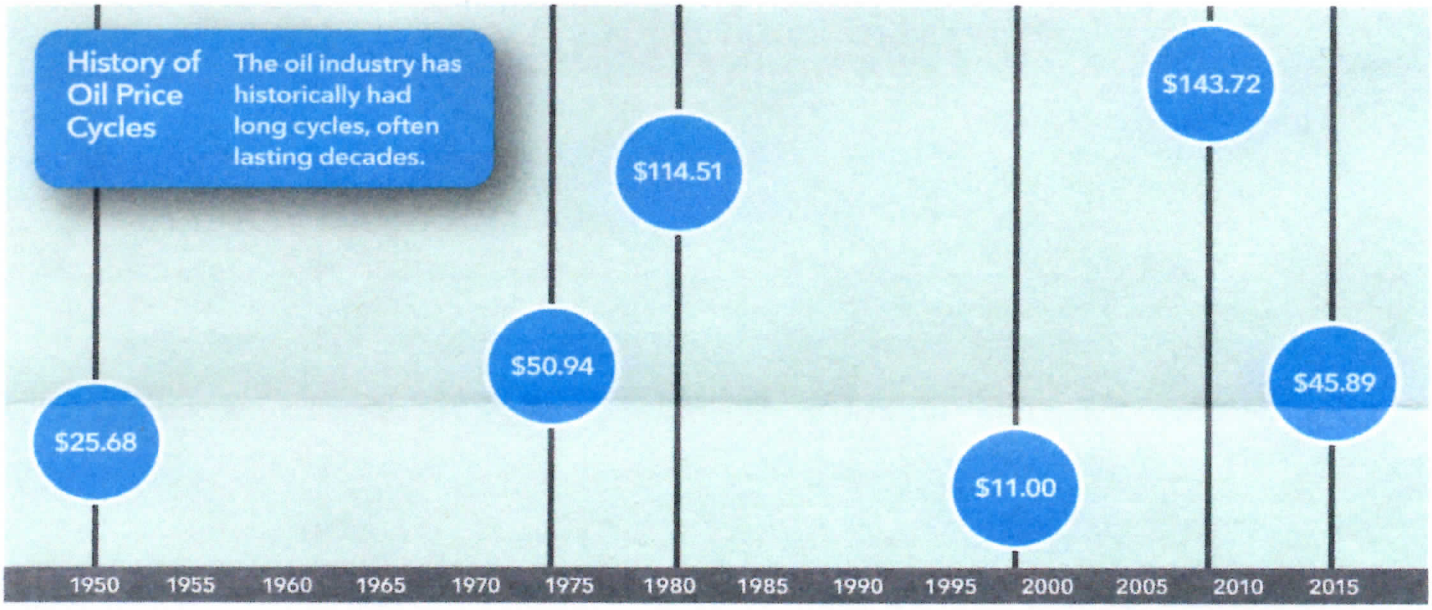
On the losing end, falling oil prices can hurt those extracting oil and natural gas, and oil services companies – pipeline construction for example – that move those resources. For producers, cheaper prices mean less profits, or even losses. Many small, independent producers in the American heartland may not have cost structures that make them viable with such depressed oil prices. Some may go bankrupt and cease production.

The result could also affect jobs indirectly related to oil and gas production, such as construction of housing to serve the growing population of workers servicing the oil producers. Plummeting prices can also make it more challenging for solar and wind power companies to be competitive on price, so the alternative energy industry may suffer.

Falling Oil Prices Present Investment Opportunities

With oil prices substantially lower, many stocks heavily dependent on energy have declined, concerning investors about the resulting impact on their energy-related investments.

On the other hand, lower oil prices mean cheaper gas for airlines, manufacturers, shipping companies and other industries with significant fuel costs. The subsequent boost to consumer spending, which represents



From the 1950s until 1972, there was a surplus of oil and the cost of crude remained low.

Throughout the 1970s, petroleum shortages and embargoes, combined with rising demand, led to a sharp rise in prices.

After the Iranian hostage crisis in 1979-1981, the cycle shifted and demand for oil declined, beginning a 17-year period of low oil prices, finally bottoming out in 1998.

From 1998 to 2004, as global demand expanded – in part because of the rise of China – prices doubled from $15 to $30 a barrel, doubled again in 2005 to $60 a barrel, and more than doubled again to over $140 a barrel in 2008.

From 2008 to mid-2014, oil prices ranged between $65 and $110 a barrel. Then came the June to December decline from just above $100 to under $50.

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> – Lars Reierson

about two-thirds of the U.S. economy, may also mean greater revenues for these businesses.

Some see the oil price drop as a temporary situation. As shown in the timeline on page 2, oil production has historically gone through cycles, and some portfolio managers foresee another time when oil prices will again rise to more than $100 a barrel. This could create an environment in which energy stocks could reach very attractive valuation levels.

Bonds issued by oil and gas producers have slumped in value right along with energy stocks. Valuations are starting to look more appealing, which could lead to attractive bond investment opportunities in 2015.

Is the low oil price a short-term cycle or a long-term trend? A lot depends on whether the Organization of Petroleum Exporting Countries (OPEC) maintains its current production or cuts back. The next formal meeting of OPEC is scheduled for June 2015, although a decision could come in interim meetings. Some portfolio managers and analysts expect that OPEC may maintain current production levels to keep prices low and put pressure on American producers (see box on right) to achieve a higher oil price in the long run.

How Are Our Funds Positioned?

Over the past few years, many of our portfolio managers have reduced their energy investments, partly because of the low returns on exploration projects. So in general, exposure to energy stocks is currently relatively low – compared to the index and historical levels – in our funds. Concurrently, some managers have also increased their investments in industries benefiting such as airlines, for example, based on the lower oil price, attractive valuations and the long-term prospects for the industry.

"Sentiment is so negative right now, and so focused on the short term, that investors who can take a longer term approach to the market have a compelling advantage," says Lars Reierson, a portfolio manager and equity investment analyst who covers global energy exploration and production. "Valuations may fall to the point that energy stocks offer an exceptional investment opportunity, but we aren't necessarily there yet."

What happens if oil prices stay low for a decade or more, or if there's a dramatic price escalation? It's important to note that long-term investment opportunities exist no matter what the price of oil. "We're prepared for any scenario," says Don. "We continue to have weekly meetings where we convene energy analysts and portfolio managers from around the world to have in-depth discussions about what's going on in energy ranging from policy to individual companies."

American Funds portfolio managers seek to identify opportunities created by cyclical shifts within the oil and gas industry and search for innovative companies poised to capitalize on the next long-term trend. While it's impossible to predict how the global energy landscape will look in the future, our experience and extensive global research effort are advantages to investors, particularly during times of industry turmoil. ■

How Did We Get Here? Supply and Demand Dynamics

Price is derived from the interaction of supply and demand. The sharp decline in the oil price from more than $100 a barrel in June 2014 to around $50 a barrel in January 2015 is primarily due to a much greater supply of oil than the demand for it. The rise in supply has been driven by the shale oil boom and innovation in deep-water drilling in the U.S., where oil production has nearly doubled from five million barrels a day in 2010 to roughly nine million today.

Exacerbating the excess supply, OPEC, a 12-country organization that coordinates oil production policy for its member nations, has decided it would not cut back the current production level of 30 million barrels a day. At the same time, demand is stagnant as China's economic growth slows and the economies of Japan and Europe struggle. This means that despite a sluggish global economy and a boom in U.S. oil production, countries like Saudi Arabia and Venezuela are going to keep pumping rather than reduce output to lift prices. Lower prices will prevail until this supply/demand gap is closed.