



Oil Review

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Oil – trading in line..will momentum keep it up

Oil- trading in line with expectations. The last three reports outlined our positive sentiment towards the commodity where we repeated our mantra that oil was cheap and marking time for a push higher. So far the commodity has traded in line with our view having just touched US60.50. This has been the target we have held for some time and realising this raises a question.... where to next? In this report we briefly examine the drivers behind the move to help provide the basis for either a continued push higher or for the commodity to enter into a period of consolidation?

It has been a combination of drivers that has seen Oil higher with the main ones being the weakness in the USD, the hopes of a faster recovery, OPEC cutting supply and increased demand from emerging economies. This has created a bullish environment since the lows however, in the same breath this push higher can also be seen as a wet blanket on the chances of a speedy recovery. Why?

Oil as we are fully aware is classed as a primary input. The prices paid for it in the open market will always filter through the various economies around the world. So it goes without saying that if the price for the commodity increased by 20% then this increase would result in higher prices at the pump in doing so act as a break as people balk at the new higher prices. As it stands the increase in Oil from its low of US32.70 on 1st Jan 2009 to its current level of US60.00 suggests an additional cost to any economic recovery, in fact in this instance a cost of close to 38%. Such a price rise will naturally retard what growth we have and suggest that whilst prices continue to trend high then the recovery process will therefore be longer.

This rhetoric for oil is the same when looking at other primary inputs such as base metals, like for oil prices have gone extremely hard for the last couple of month as end users and investors rush to buy commodities and to put on commodity recovery trades. This has seen the prices paid for many of the inputs exaggerated to levels where current demand is not sufficient to keep these prices at current levels. We have seen for instance China for the first quarter aggressively buy and stockpile as much primary inputs as possible to feed the stimulus packages as they kick in. However, an interesting aspect to this is that although they aggressively bought at the beginning of the year these prices have not translated into any form of inflationary prospects in fact it has been the opposite. Recent price data from China suggests that we have more of a concern with dis inflationary pressures rather than inflationary pressures. The CPI for the last quarter

came in down 0.4% which came as a surprise to many economists. The Central Bank mentioned that this was expected and that the figure has come off a high base however, regardless of this the fact remains that prices are not moving higher rather the opposite. As a result we feel that demand as a result of the emergence of dis inflationary pressures in China suggest that commodity prices are over stated and should correct back to more realistic levels where current supply will equal current demand. We do suggest that any correction can simple be viewed as this "a correction" and that on the dip we can re enter longs however, at the moment we feel that prices across the board for primary inputs should retreat from current levels. Does the technical picture reveal the same?

Technically, as can be seen from the chart below oil has been edging higher and higher. We have just realised our target (US60.00-US61.00) mentioned in recent reports and on Bloomberg and as a result are looking for a correction. This will be confirmed when we get a break below US57.00. On breaking this we expect Oil to trade to US52.85 and may even extend to US47.00. We are wrong if we get a daily break above US61.00. In addition, to this our momentum indicators have rolled over however, as of yet they have not confirmed the trend. We need to see the momentum indicator break below 80% to confirm that the trend has changed for the time being.



If you are already long Oil based off out previous reports then we would either raise stops or take some profit off the table. If you are a savvy investors then look to grant a few options with a strike at US62.00 for Jun as they expire shortly. We continue to see prices ultimately higher however at the moment we feel that prices have just gone a little too far too fast,

Happy trading

Jonathan

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