Oil...lets take stock of the fundamentals

Since September 2009 Oil has been stuck to a range. Actually, it has been fun trading as the range has been well defined; expensive over US81.00 and cheap under US71.00. This suggests that the fundamental influences effecting supply and demand are well balanced. However, most of the commentary we read continually points to lower prices yet they remain resilient. Are we failing to analyse the market correctly or is the market just gathering steam for an eventual break out.

We prefer to think that the market is just gathering steam for an eventual break out to the topside. Remember that the market roughly spends about 80% of the time ranging and 20% of the time trending. The trick is working out when we move from a ranging market to a trending market and the sustainability of the new trend. At the moment the mix of fundamentals has been balanced hence the ranging market however, bullish evidence is creeping in that we feel will provide a bias for a new uptrend to begin. Why?

Over the last couple of months the market has been squarely focused on the bearish side of the equation, stimulus packages rolling off, potential for a contagion to fire up over Greece debt default, China tightening monetary policy, rising inventories, and a strengthening USD, yet on the bullish side of the equation we have had to be content with bad weather and investors seeking confirmation that the worst of the recession is behind us. So why are we bullish?

We are starting to become bullish for two main reasons:

1. Data has remained US centric and this is influencing direction: It is interesting to note that the world hangs on a knifes edge every week when we focus on the American Petroleum Institute's (API) crude and product inventory numbers, then later on in the week the more important Department of Energy (DOE) data is released. Data to date indicates that inventories have been building for the last couple of months, however, they are not as high as they had been when compared to the same period in 2009 when we were at the depths of the GFC. Although the builds continue to occur, we feel that these builds are partly seasonal and partly in anticipations of draws associated with global growth. At the moment we can only be optimists of global growth, economic numbers continue to support a resurgence of confidence and with an acceptable solution over the Greek sovereign debt behind us we would have to be better bid on the recover story at the moment. In addition to this we see that many commentators focus remains purely on the US supply builds and not globally. Although the US is still the number one energy consumer Asia is easily playing catch up and when combining demand from China, Japan, India and Korea the US focus seems under weighted for global direction.

2. China's thirst for the commodity continues to expand: China has just come back from its New Years break and it may take a few weeks for the economy to come back on tap. Commentators suggested that China took it's "foot off the peddle" when the government noted that it would be decreasing money supply and Banks needed to increase their reserve requirements which further added weight to a potential slow down. However, taken from a different direction perhaps they had little choice and have decided to take a more conservative tone. After all, new loans during January were three times larger than the average loans made in the previous three months. So now that China is back from its break we would expect to see more demand filter through the market. By the way, in January demand for Crude was 34% higher than the same period the year before, indicating to us that the year of the Tiger may be a thirsty one for Oil.

So by taking the old bearish rhetoric and giving it a shine we can come up with a scenario that sees the potential for higher prices as the season changes and momentum for the global recovery picks up. Does the technical picture show the same?

Technically, the price action has seen a range between US81.00 and US78.00 the greater range is US84.00 and US70.00. It looks as if we are still consolidating on the move from US70.00 from back in early February. As can be seen from the chart below this consolidation is interesting as it is very flat, basically a US3.00 range. It's a telling sign that the market is well supported.

On trading the commodity we would look to add to positions on a break through US81.00. If the consolidation continues we remain bullish as long as US75.00 remains intact. Our target is US85.00 then on a break of this level and with no curve balls then US100.00 is attainable.

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