



Oil finds a new range.....the trend is still up?

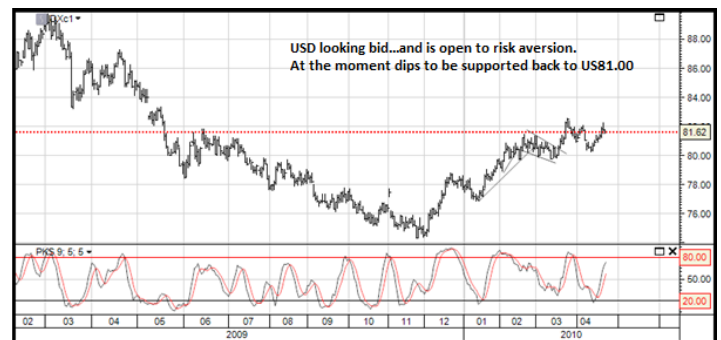
Oil looks to have broken the old range and seems content to stay above US\$80.00 a barrel. Does this mean the uptrend is still intact or are we setting ourselves up for a larger fall? In this brief we look at the new range US\$80.00 to US\$87.00 to see if the rally is sustainable and whether or not the future global economic optimism is enough to appease the forever growing oil inventories accumulating around the world.

Futures trading is all about expectations as generally most traders work in the forward market trying to gauge what the future price will do. There are two main types of contracts traded, those traded as "spot contracts" for settlement in two days and those traded as "futures contract". A futures contract is a contract to buy or sell a specific amount and quality of a product/commodity for future delivery, generally in three months. It can be traded at anytime as long as the market is open. Futures offer the trader the ability to manage positions using small deposits and margins. It is a market used by traders generally to neutralise commodity price risk. It can also be used in a highly speculative manner by traders guessing what the future price for the commodity will be. In essence, the trader is betting or hedging on future price movements by analysing market expectations and sentiment. So if you can properly gauge market expectations then it goes to reason that you could probably gauge the future price for commodities.

As Crude Oil is a primary input it is a good barometer for global economic activity, so if economic optimism picks up you would assume so would the price of Oil. In theory, this is how it should happen, however markets do not always move in a straight line and their gyrations are sent to test us. This is the skill in trading the markets well; we have to be able to see "the woods through the trees". In Oil, one of the primary gauges traders utilise to help determine it's direction is by focusing on global inventories or stocks. This picture is not helping as inventories and stocks keep building and the price keeps moving higher. Fundamentals are bearish with expectations that we have more supply over demand. Only recently we had a situation where US inventories for Crude jumped by 1.9 million barrels when an expected draw of 200k was on the cards. In addition, to this we saw gasoline stocks increasing by 3.6 million barrels when a 300k build was expected and distillate inventories more than doubled expectations. However, even in the wake of these builds the price managed to stay in the green for the trading session. It appears that there is a hidden strength under lining the market and we think this just may have to do with positive economic optimism.

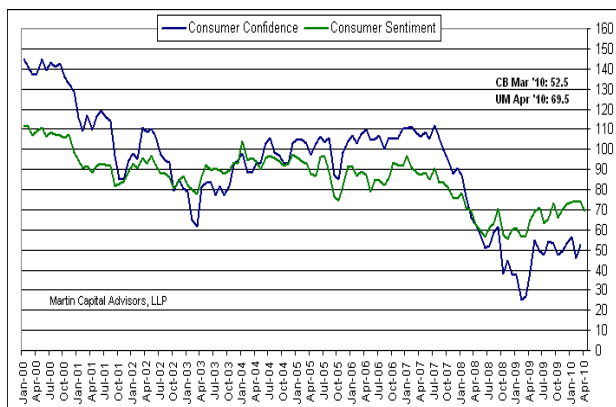
Over the last month traders have been concerned on the global economic stability and as a result investors have put on long USD positions (Chart: USD Index) as "risk aversion" trades. As a result of the USD strength, commodities have

come under pressure, more so for Crude as it also has a weak fundamental picture as well. However, it also goes to reason that if economic performance and expectations were to pick up then the USD would come under pressure. At the moment the USD remains strong however, if economic optimism grows then we can expect to see investors take off these "risk aversion" trades. Thereby giving commodities particularly Oil a lift. Oil, as it is also a primary input, should receive a further lift as our expectations for future demand due to this increased optimism would also be higher and this in effect would be enough to help drag the market higher and or provide a solid base. What is the best gauge to for optimism?



Optimism can be gauged by many indicators and it is important to be able to pick the better ones. As economic performance in any economy is gauged by growth then consumer demand and sentiment would be the key ones to monitor. As can be seen in US and from below confidence has picked up and sentiment is slowly improving, at least we are off the lows. If we can see sentiment turn around particularly in the US then we can be confident that Oil will be well supported on dips. Confidence in Asia remains an underlying theme to the stability of global commodity prices and we feel that once confidence and sentiment in the US and Europe turnaround then expect to see prices higher.

US Consumer Confidence and Sentiment



Technical picture

Technically, all is good and we would expect more consolidation in the price before it starts to move higher. We feel US80.00, the lower end of the new range, needs to be respected and any dip back to this level should be well supported. If US80.00 breaks on a daily basis then be cautious as this opens the way for a deeper correction. Momentum indicators remain mixed. Add to positions on a break above US86.50.



Summary:

Overall optimism about the global recovery remains the key and if this together with consumer confidence remains high we can expect prices to rally on. If optimism turns for the worst then we could be in for a fright in particular as inventory builds continue to grow and risk aversion trades a put back on. Happy to add to positions on a break to the topside and would look at support at US80.00 should it reach for signs that a base is trying to form.

Cheers JB