



Crude Oil...Fed, Jackson Hole and Stimulus

Since Sept 2009 the volatility in the oil market has been restrained to a wide trading range; US\$87.00 on the upside and US\$67.00 on the downside. This is comfortable if running a business as the unpredictability of primary input costs is also contained and focus can be on driving the business forward rather than trying to defend the costs of inputs. As the market continues to be focused on economic growth of the US, the number one consumer it is interesting to note the recent rhetoric concerning the Federal Reserve (Fed) and stimulus. Once the rhetoric is understood then this should provide a clear direction for the commodity.

We have been divided on whether or not the US will in fact “double dip” and this still remains a concern and as so, the Fed’s meeting at Jackson Hole 27th August was the platform from which we expected it to deliver support of its commitment to stimulus. Currently, GDP in the US remains soft and the most recent report suggested that GDP for the year grew at 1.6% revised from the prior month’s estimate of 2.4%. It seemed that the FED and policy makers are unsure whether consumer spending will remain “restrained” for some time and that as the consumers make up 70% of the economy it was important to get this revitalised in order to see GDP growth. However, to encourage confidence market players need to see the market for jobs improve.

The US jobs data has been suggested as the “litmus” test for economic recovery. This makes sense as once confidence is restored people will start to rehire. At the moment the US unemployment rate increased to 9.6% in July. To put this into perspective there are close to 154.2 million people in the work forces in the US so that makes 14,803,200 persons currently walking

around trying to find a job. The concern is that businesses owners continue to reiterate that the reason they are not hiring is due to slower growth in sales and the durability of the recovery. This sentiment is confirmed via contraction in factory orders and slowing vehicle purchases. So what did big Ben have to say about this?

Bernanke comments confirmed what the sceptics already knew. That the US economic recovery had weakened more than expected and that the Fed stands by ready to act when needed. He mentioned that the Fed was prepared to provide additional “unconventional measures if it proves necessary”. The market took this as the “go sign” to buy primary inputs as a result the crude oil market rallied significantly looking for more gains knowing that that Fed is in fact the stop loss on any trades. The market took this as an aggressive approach by the Fed to stimulate sooner rather than later. However, the interesting aspect to the comments is that in the FOMC meeting minutes a different story was told.

In the minutes the Governors reiterated the need for additional easing/quantitative easing, however the perception on timing of this differed significantly to his comments. A quantitative easing is a monetary policy adopted by central banks to increase money supply when interest rates are close to zero. The central banks purchase of financial assets from Banks and other financial institutions thereby giving them additional measures to create new money. As a result the stance by Bernanke on interest rates was dovish and it appeared that there was more “wait and see” attitude to stimulus. Stimulus would only apply if there was a serious deteriorating in growth. That policy adjustment would not occur at the 21st Sept meeting and that the economy would have to sink significantly if any change to policy would occur at the Nov 3 and Dec 14 meetings. The result was a

readjustment of input prices and the crude market came under pressure again.

Fundamentals in the Oil market at best currently remain extremely bearish and this news concerning the timing of stimulus dampened expectations on a recovery for the price. It is interesting to note that the neutral/hands off stance by the Fed may have the effect of pushing primary inputs lower particularly in oil. Lower input prices will drive profitability higher as this goes straight to the bottom line faster than other forms of stimulus in doing so, helps confidence, orders and the need for more employment. Given that inflation is benign and growth slow perhaps lower inputs would be a positive outcome for ailing economic growth and this is what we feel could be at play.

Currently, the market remains in a wide range and has been testing either side. However these recent "wait and see" comments could open the way for a significant fall for the commodity if US70.50 is broken on a daily basis.

Crude Oil Chart



Technically, we remain stuck to the range and will have to be guided by a break of US70.50 on the downside, which remains the key. Naturally if the range holds we are back in it with the prospects of a re test of the highs. Momentum indicators remain positive, however if price momentum to the downside accelerates then expect a succession of quick moves. Areas of support are US70.50 then US67.50 then outside this there is not much support until US60.00.

At any rate if it gets to US60.00 then this represents a saving of 25% in any bills the consumer has to pay...maybe then will they start to employ more people.

Happy Trading

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