



Crude Oil

Only last month China eclipsed the US as the number one energy consumer. In Oil China is still number two consuming 9.56 million bpd still far behind the US which guzzles 18.86 million bpd. China is expected to consume an additional 4.8% next year based on continued economic growth of 9.1% on this expectation the price of Oil is trading just a dollar off weekly highs and looking set to break higher. However, current fundamentals and market commentary is suggesting otherwise. So why is the market so negative yet the price so firm? By looking at current themes at play in the market we can formulate a view as to why oil is holding up and regardless of the negative rhetoric would be happy trading with the break through US80.25. As this is a breakout stops must be placed.

Bernanke's most recent comments suggested that we should remain vigilant on the prospects of the US coming out of the downturn. Greenspan provided similar negative words on the housing market. Like both of them we remain concerned as well. The recent set of earnings in the US has presented a confident feel. However, are these earnings based on real growth or as a result of the stimulus packages rolling off? The key question which still needs to be answered is "Can the US economy expand without ongoing government intervention?" Recent GDP data suggests other wise. The market was expecting a steady uptick in growth. However, Q2 data showed a drop off to 2.4% prompting fears of a double dip and a revision of forecasts for oil. Backing these fears up are the continuing builds in US inventories at a time where we should be expecting draws die to summer drive time in the US. So if consumption in the US is falling, then how is consumption with the number 2 consumer going; China.

The picture is not too positive as well. The economic picture in China is relatively

mixed, the economy continues to expand at 9.1%, however, we have experienced a raft of data that suggests the economy is indeed cooling. Manufacturing in China dropped to a 17th month low and the PMI dropped a full point. Industrial output dropped to its lowest level since 2008. The interesting aspect to the slow down is that it looks creatively controlled. Government agencies have been quick to point at that the desired effects of fiscal and monetary policies instigated to take the heat out of the economy are occurring. Let's hope the government does indeed remain in control. As a socialist market economy we can see that the authorities have greater control over the economy and have been exercising this control well. If China's economy is cooling then demand for Oil would also slow. Why is Oil remaining at the top end of the range and why is it trading just under US 80.00?

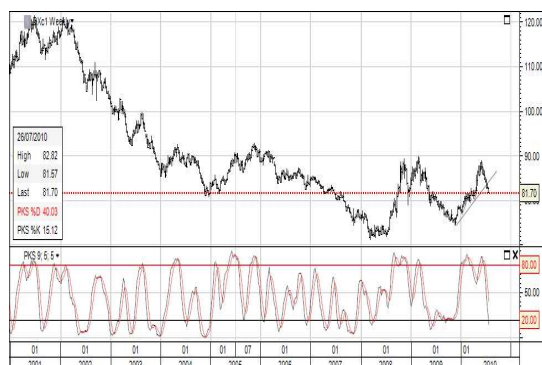
Expectations given the data and rhetoric firmly suggest that the price of Oil should be coming off yet it remains resilient. As we are working our way to the top end of the range and into break out territory is there any news that could propel it higher.

We can suggest that two forces are at play that is keeping oil range bound and may help to provide a catalyst for a move higher regardless of what the market is saying.

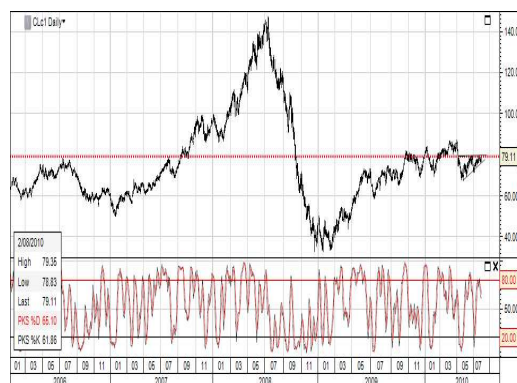
USD

The USD...As crude is priced in USDs any movement in the USD will affect the price for Crude. As can be seen for the following chart the USD looks to have resumed its down trend bias. We can suggest that a high of importance is in place and thus can suggest that rallies will be sold into. As can be seen for the chart of the USD Index the USD has broken considerable support and with momentum indicators looking weak we can suggest that further downside is expected. Given this and the recent trend the USD has been a major contributing factor into supporting the Oil prices.

USD Index



Technical's.....



Chinese growth

This is interesting as the economy has been cooling. Over the last three months we have experienced a drop off in the spot price of other primary inputs mainly iron ore and coal. Both commodities have dropped by between 25 and 30% in pricehowever only the last week we have seen the prices paid for these commodities lift. And with freight down by close to 50% over the last 6 months it is an ideal time to start builds again. In addition, we have picked up some important rhetoric from Premier Weng. He suggests that China having pattered herself on the back with the slow down is getting ready to load up again. The Premier mentioned that prospects of loosening monetary policy over Q3 and 4 were on the cards. If this is the case the consumption of Oil should also pick up. What is the technical picture looking like?

The market has been working its way into a narrow range and a break out is imminent. Will the bears have their way or will the bulls win the day. It is a difficult question and experience has taught us not to camp on either side and wait for direction. We are focused on two limits to monitor, US80.25 and US75.50. Look for a break either way and given that we are close to the top end of the band can suggest a test at this level is on the cards. Remember in order to confirm the trend we need to see a daily break and close above the level of the break.

Happy trading

Cheers

Jonathan Barratt

Level 2, 428 Little Bourke Street | Level 2, 25 Park St SYDNEY NSW 2000 | 109 Burton St , WARREN NSW 2824

Ph: +613 8602 6130 Fax: +613 8602 610 Ph: +612 8267 9000 Fax: +612 8267 9050 Ph: +612 6847 3302 Fax: +612 6847 3676

ABN 32 110 128 286

AFSL 280 372

FICS 4312

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