The Professional Commodities Trader

Your accurate, authentic and affordable guide to commodities trading

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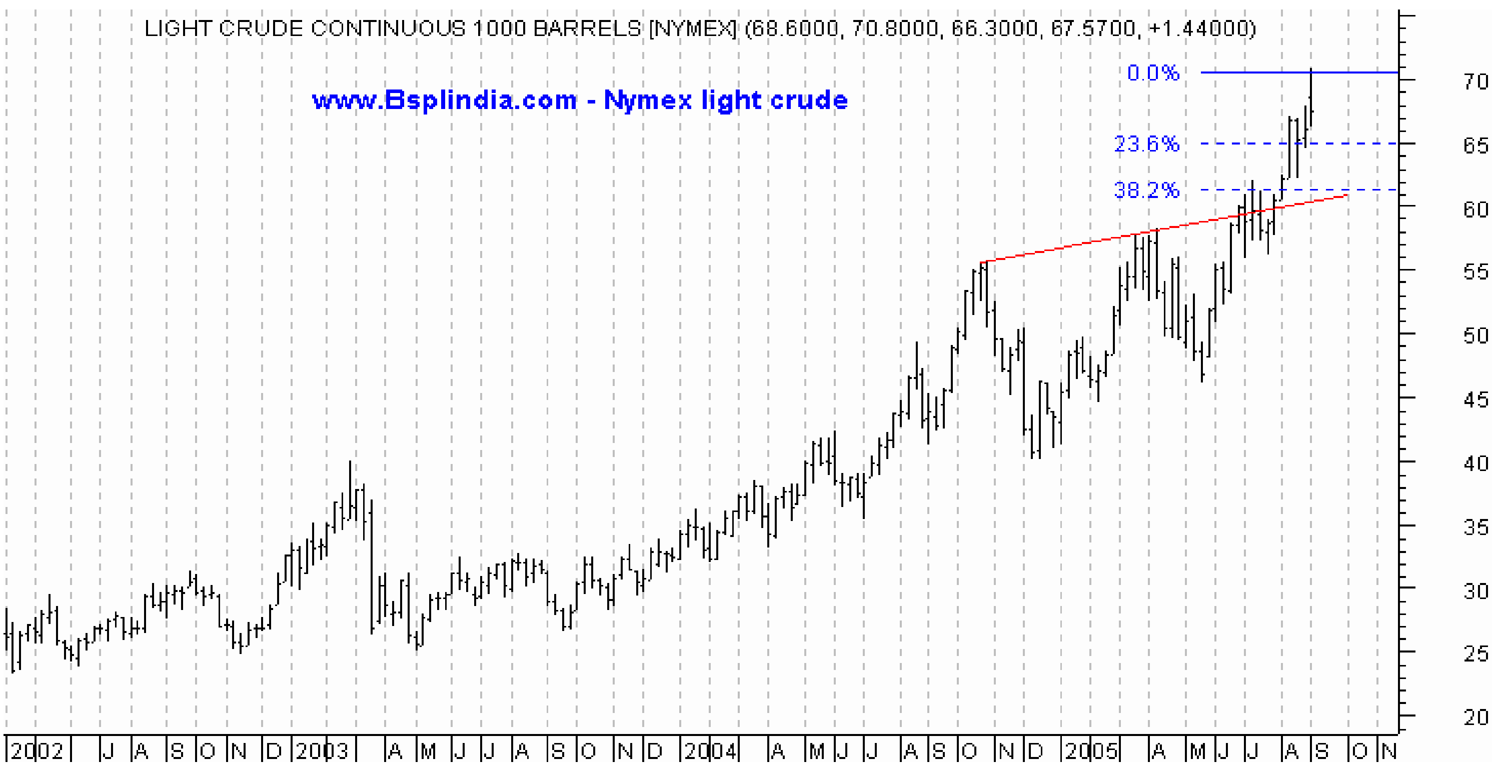
No other commodity has been attracting the kind of attention in the recent past that crude oil has had the dubious distinction of attracting of late. This is a factor that can throw a spanner in global economies, financial markets and individual homes. While I have been advocating a bullish outlook on this commodity since the last five months, the magnitude of the upmove has frankly taken even me by surprise. Since the move has been extra ordinary, an update would be in order.

The global scenario

The benchmark for crude can be taken as the Nymex light sweet variety. The price rise has actually accelerated from May 2005 onwards from a level of 46.20 $ levels. The run upwards to the 70 + levels has been swift and punctuated by one stop in June / July when there was a three week long consolidation. It maybe noted that the bottom made in May 2005 was significantly higher than the previous bottom in Dec 2004, and when the previous top of 57 - 58 $ made in March 2005 was surpassed in July 2005, a rising tops and bottoms formation was confirmed. Traders may note the rising tops resistance trend line (red) which has been surpassed but not yet tested since a breakout. In technical parlance, an erstwhile resistance (after being overcome convincingly) becomes a support in case of a corrective fall. That support is currently poised at the 62 $ mark. In another study pattern, a retracement of the entire upmove from the 46.20 to the 70.85 levels (a very conservative approach) seems to indicate a similar support level of US $ 62. While we are pointing towards a support at these levels, it does not necessarily imply that 62 $ mark be tested in a falling price line scenario. On the other hand, studies in forward price projections seem to indicate a level of 76 – 78 $ in the short / medium term. The longer term picture (12 months and above) seems to point towards an even bleaker scenario as the 84 – 85 $ maybe easily surpassed.



What to watch out for -

- If the prices do not fall below the $ 64.50 – 65 levels on the Nymex inspite of the assurances by the International Energy Agency (I.E.A. – www.iea.org), the message is clear – traders are aggressively bullish. On the flip side, a fall below the 64 level may see a slightly extended fall to the 62 level from where a bounce-back is almost certain. Technically speaking, the higher tops and bottoms would remain intact and the uptrend will continue.
- News of fresh hurricanes / storms in the gulf of Mexico. It is a season for climatic disruptions and another hurricane of a much milder velocity also will set the cat among the pigeons. In that case, there is a likelihood of a sharp upspike in prices.
- Political fluidity – any belligerence on the part of western / oil producing nations will raise tempers and oil prices geometrically.

- Terror attacks – in our opinion, there is still an element of " terror premium " yet to be built into the oil prices. What we have seen is a rally on account of natural calamities alone. Even a medium level terror attack on an oil installation / pipeline, tankers or the like will result in a flare up in prices.

The fallout of the current scenario –

While a major effort is on to curb the rally in energy prices, we feel the results will at best be a mixed bag. Here is why –

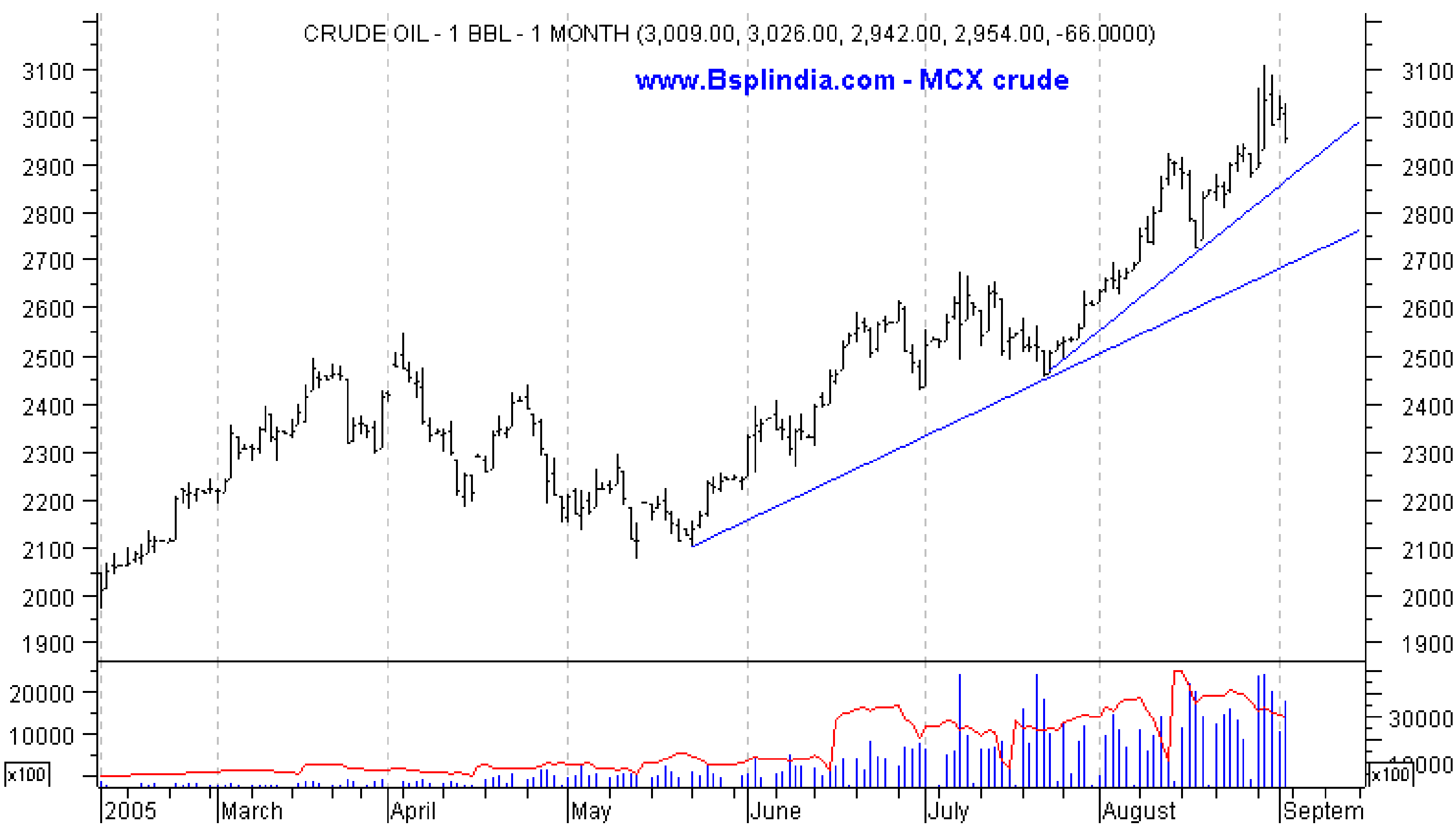
- The normally stringent pollution norms in the US being relaxed highlight the sense of desperation existing in the system.
- The release of crude from the strategic petroleum reserve will deplete crude buffer stocks to that extent. This move is likely to have a longer term fallout specified below.
- The onset of winter in the northern hemisphere is marked by a multitude of factors (in the oil specific context here). The US authorities release data (around the year) of buffer stocks, which is keenly watched. Now it is an open secret that stocks are depleting.
- The western nations will have lesser leverage to negotiate oil prices with oil producing countries in the wake of depleting supplies. The market is increasing shifting into the hands of the producers / sellers.
- The Asian nations are witnessing an ever increasing demand for oil. Increasing industrialization, automobile boom and rising per capita income is resulting in increased travel. The I.E.A. is of the opinion that China alone will be a major consumer of oil in year 2006 which will see a jump in international demand. As the winter sets in 6 – 8 weeks from now, year 2006 will not appear very distant.

The domestic scenario

The Indian commodities markets are still to evolve on their own, crude market especially so. The Indian MCX crude futures are a mirror image of their US counterparts (after adjusting for the currency conversion rates). The triggers specified above will apply equally to the Indian context.

Technicals –

After a steep rally in the MCX continuous futures from the 2100 levels in May 2005, the 3100 mark has seen a profit taking bias. Traders may note the twin trend-line graphic. The shorter trend-line will offer support to the short term prices at the 2910 levels, whereas the more meaningful and stronger support is at the 2770 levels. While it does not imply that the 2770 levels be compulsorily tested, trades initiated on the long side near these levels will have a high probability of profits in the short / medium term itself.



Traders may note the rising traded volumes and open interest (indicated as a red line on the volumes window).

Your call of action – We remain over-weight on crude oil in the medium / long term. In the absolute short term, the authorities will attempt to "talk down" the markets to calm frayed nerves. Technical studies indicate that crude is now out-performing equities as an asset class and we feel all savvy traders / investors must have exposure to this commodity to insulate their capital from a possible "oil shock"

Have a profitable day.

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The author of this article is a technical analyst, freelance columnist and investment consultant. He invites feedback at vijay@bsplindia.com or on 91-22-23438482 / 91-22-23400345.

Disclosure – the author of this piece has long positions in MCX crude contracts and therefore has a vested interest in the commodity.