Global Macro Research | US

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MF Global Daily Report

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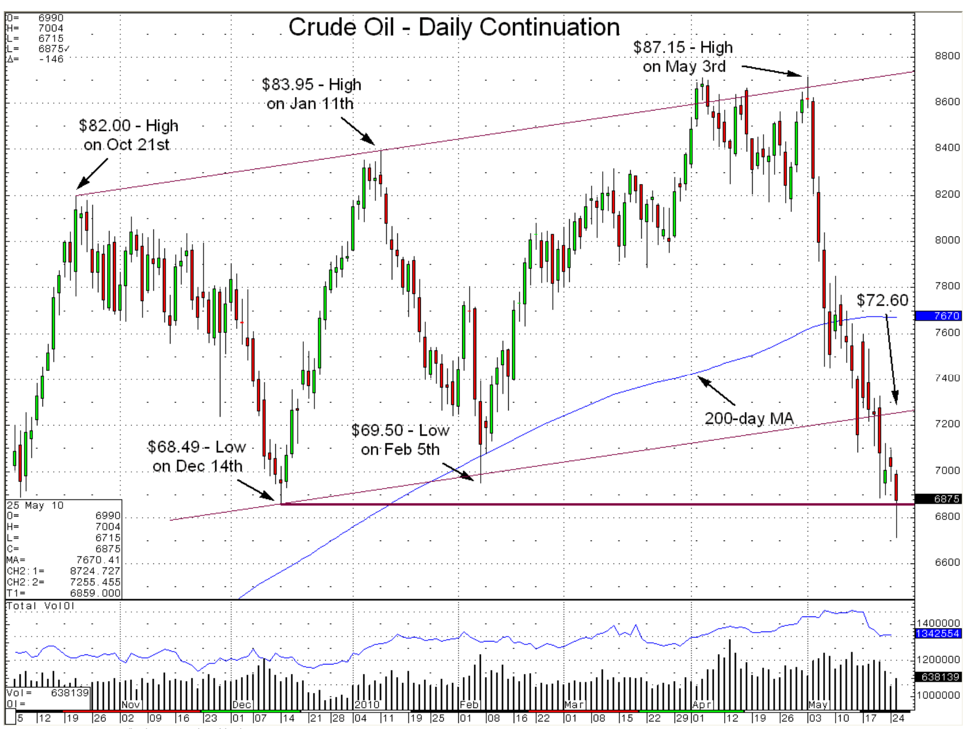
COMMODITIES | ENERGIES

Energy

Price Outlook

The oil market is expected to firm in today's trade, with prices advancing toward the $71.00/bbl level. Support will be offered by yesterday's recovery in the stock market, signs of improving U.S. oil demand, yesterday's drawdown in API gasoline inventories, and from favorable technicals. Pressure could come from ongoing worries over European debt issues, and from geopolitical tensions in the Korean peninsula. We favor trading energies as a positive affair today, and think that natural gas could see upside as well. We favor buying NGN0 at $4.07, targeting $4.50 and risking $3.97.



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The oil market reacted favorably to the recovery made in the stock market yesterday, with most of oil's recovery being made in the afternoon electronic session. The recovery in equities came amid a bullish case that's been growing over the last few days and one which we believe can continue. Economic data recently has been either mixed or positive on the economy, and includes stronger U.S. consumer confidence, Eurozone industrial orders, and Spanish & Taiwanese GDP numbers. Confidence hit a high for the current recovery and was the highest since Mar '08. Banks performed well last Friday after the Senate passed the financial reform bill. Additionally, Goldman Sachs traded higher yesterday on a likely settlement with the SEC and on positive comments from Rochdale Securities. Rochdale pointed out that value is being created in bank stocks by investor panic, and that an economic recovery would help loan losses fall. Copper has held up well amid the liquidation and has created a bullish divergence with the stock market. Same for the euro currency, which held 0.34 points above last week's low at 1.2143 during yesterday's trade. European governments including Greece, Spain, Germany, and Portugal have announced austerity measures within their budgets, which have yet to be rewarded by the markets. We've been asking in our commentaries how far risk markets need to fall before de-risking no longer makes sense amid fire-sale prices, and when are risks adequately priced. Should the recovery in risk markets be maintained in the near-term, energy prices are likely to provide confirmation to yesterday's bullish reversal.

Support will also come from yesterday's API data, which showed a 3.2 MB draw in gasoline inventories. In order to converge with the API, today's EIA numbers will have to show a decline of 3.7 MB in gasoline and a decline of 4.6 MB in distillates. We think such a development will set up for a positive inventory number today. Growing levels of total oil demand will also be supportive for oil prices today, as U.S. demand numbers have increased 497 kb/d over the past three weeks. This is a time of year that typically sees total oil demand see its last declines in the spring shoulder period.

Lastly, technical factors will offer support to today's market. The continuation chart that we've been including in our comment over the last few days shows continuation prices that are rolled over with trading activity. It was well respected in yesterday's trade, when prices dipped below the Dec 14th low at $68.49. Yesterday's trade held above that level on a closing basis due to the recovery in the stock market and rebounded sharply. The market rallied another $1.00/bbl in the afternoon electronic session, which will be tacked onto today's session. What's also interesting was that open interest declined 127,945 contracts between May 17th and May 21st, indicating a potential "blowout" of long positions. Friday's commitment of traders data indicated the same thing, with the non-commercial net long falling 25,534 contracts last week and down to the lowest level seen since the w/e Feb 9th '10. A market that is near "even" in terms of positioning at a time when prices appear to be at a potential inflection point could help fuel the market's rebound.

TRADE: Buy: NGN0 at $4.07, target $4.50, risk $3.97

Upcoming Energy Events
Wed - Oil Inventories 9:30 am EST
Thu - Natural Gas Inventories 10:30 pm EST
Tue - API Weekly Stats 4:30 pm EST

Global Economic & Dollar News
The dollar was supported again yesterday due to worries over the European debt situation. The Financial Times reported that Eurozone countries will discuss levying a fee on banks to help pay for future financial bailout, as safe-haven flows migrated o the U.S. currency. Dollar support also came from a report that North Korea put its troops on high alert and warned South Korea about violating its waters on the western side of the peninsula.

» **Japanese Minister Sengoku** said that the risks to global and Japanese growth from the Eurozone problems will extend into the mid- and long-terms. He said that risks are extremely large, and he doesn't see a quick Eurozone economic recovery.
» **Eurozone Industrial Orders** were +5.2% m/m in Mar vs. +2.0% expected and vs. +1.9% previously.
» **EU's Rehn** said that the Eurozone economic recovery is in progress but it still fragile.
» **EU Countries** may be forced to levy a fee on their banks to raise capital to help pay for future financial bailouts, according to the Financial Times. The plan may be announced today.
» **The German Ban** on naked short selling may receive some coordinated support from other European governments, possibly by the end of this week, according to the Financial Times.
» **There were Rumors** yesterday that Europe would take measures to push Libor rates lower.
» **Italy Unveiled** a budget with austerity measures yesterday, including cuts in health spending and public sector salaries. Those salaries were proposed to be frozen for three years. The move was seen as a preemptive measure

to avoid Greek-style debt problems. The move followed similar measures in Greece, Spain, Germany, and Portugal.

- **Case-Schiller** 20-city Home Price Index was unchanged in Mar vs. -0.3% expected and vs. -0.1% previously. On an unadjusted basis, prices fell 0.5% vs. -0.4% expected and after a 0.9% drop in Feb.
- **U.S. Consumer Confidence** was 63.3 vs. 59.0 expected and vs. 57.7 previously.
- **Rep Barney Frank** said that the Volcker Rule prohibiting risky derivatives trading is likely to be in the final financial overhaul bill, but that the Lincoln amendment to force banks to spin off derivatives business goes too far.
- **Fed's Bullard** said that Europe's woes are unlikely to create a global recession, but that macroeconomic volatility is likely to be higher over the next few years. He said that governments have made it clear that banks will not fail and that euro solvency is not under a true threat. He added that the U.S. may actually benefit from Europe's troubles.
- **The U.S. AAA Credit Rating** is in jeopardy because of debt ratios, according to Moody's.

Energy News Stories

- **Gulf Oil Ministers** played down the slide in oil prices and said there are no plans to call for an emergency meeting. Kuwait and UAE both suggested that low prices had existed before and that it's not too big of an issue to see them below the $70-$80 target range right now.
- **Bank of America** cut its 2010 oil demand growth forecast to 1.5 mb/d from 2.0 mb/d due to anticipated slowing in global growth in the second half of this year.

ANALYSIS

EIA Oil Inventory Preview

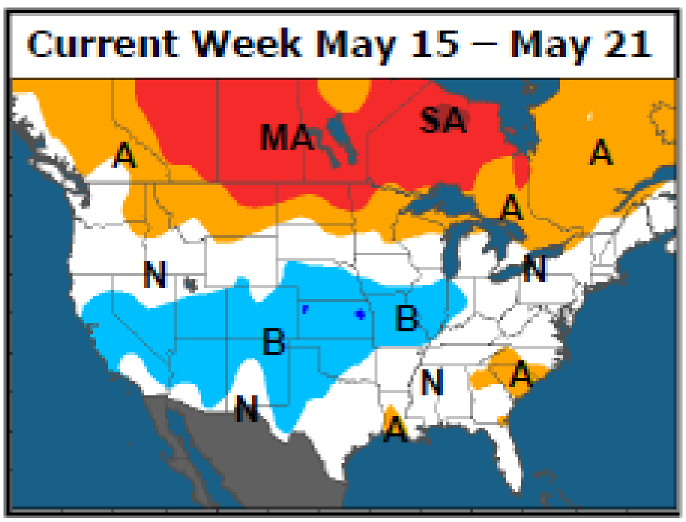
The EIA is expected to report inventories this week that will generally be in-line with five-year averages, except in the case of distillates. Inventories of crude oil are likely to fall 2.0 MB, which would be in-line with the five-year average. We think that's achievable because of demand levels that are increasing and because of refinery utilization rates that are close to their five-year average. Imports may remain stagnant near the 9.8 mb/d mark, which in the past few months have been steadily rising toward their five-year average. Oil movements showed a drop in OPEC shipments to -150 kb/d from -60 kb/d previously. The Chinese apparent demand figure reported on Friday by Reuters showed that demand remains strong there, which could also prevent imports to the U.S. from gaining this week. Any decline in imports shouldn't last long though, as OM reported on Thursday that shipments will rise 280 kb/d in the four weeks ending Jun 4th.

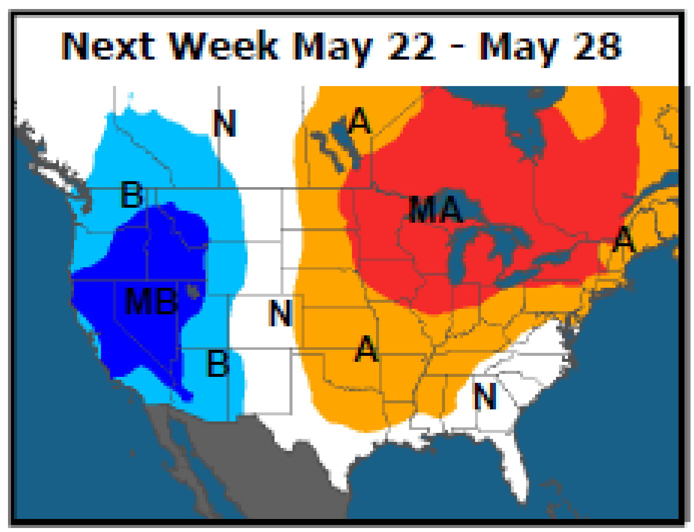
Gasoline stocks are in a seasonally sideways trend at the moment, and typically fall around 0.2 MB this week, according to the five-year average. Gasoline demand as well as imports have been steady in the past few weeks, but we would expect a slight uptick in demand as we approach the Memorial Day holiday. Our forecast on gasoline stocks is in-line with the seasonal decline of 0.2 MB as a result. The only potential surprise in Wednesday's data resides in distillates, in our opinion, because of the divergence with API. The EIA's level of distillate stocks is still around 6.2 MB above the level being reported by API. A narrowing of that gap could be made if the EIA's numbers fall. A decline in the EIA's figures may also be suggested by recent upswings in distillate demand, which has increased 296 kb/d in the past three weeks, and is now closing in on its five-year average. The API noted on Friday that gains in diesel demand reflect an improving economy.

Natural gas stocks are one week away from the best seasonal build all year. The five-year average gains 95 bcf this week and 100 bcf next week. Our estimate is for a build of 95 bcf this week, which would match the average. Temperatures during the survey week were near-normal across most of the country, except for blow-normal temps in the Midwest. The CDD forecast this week is 21.5 compared to a 10-year normal of 24.3. Next week's temps are likely to rise, with much-above normal temps being seen across the Great Lakes and Northeast U.S. The early read on the CDD forecast is 42.5 vs. an average of 30.8, implying an inventory build of 96 bcf instead of the 100 bcf norm.

EIA Inventories - w/e May 21st						API Inventories		
	Actual	Market Estimate	MFGR Estimate	Five-Year Average	Last Week	Converge with EIA	Actual	Previous
Crude Oil		-0.1 MB	-2.0 MB	-2.0 MB	+0.2 MB	+1.4 MB	+0.6 MB	-0.8 MB
Gasoline		Unch	-0.2 MB	-0.2 MB	-0.3 MB	-3.7 MB	-3.2 MB	-1.0 MB
Distillates		+0.3 MB	-1.0 MB	+1.1 MB	-1.0 MB	-4.6 MB	+1.5 MB	-0.3 MB
Utilization		-0.3%	+0.3%	+0.3%	87.9%	-2.0%	85.9%	85.9%
Natural Gas		+105 bcf	+95 bcf	+95 bcf	+76 bcf			

*The API convergence figures are the amounts that EIA data need to change in order to match the previous day's API figures





Geopolitical Tensions/Developments

North Korea: North Korea reportedly put its military on high alert yesterday, and threatened military action if the South continued to violate its waters off its west coast. The news was not published by an official news agency, but instead on the website North Korea Intellectuals Solidarity, which is run by a group of communist defectors. NBC News later said that the North's military was not on high alert.

South Korea cut most economic ties with the North on Sunday, after evidence surfaced that the North intentionally attacked the South Korean ship on Mar 26th. The South imports $230M worth of seafood each year and the North earns $50M from sales of clothes.

South Korea resumed propaganda efforts including loudspeakers at the border, radio broadcasts, and leaflets dropped by balloon.