Global Macro Research | US

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MF Global Daily Report

COMMODITIES | ENERGIES

Energy

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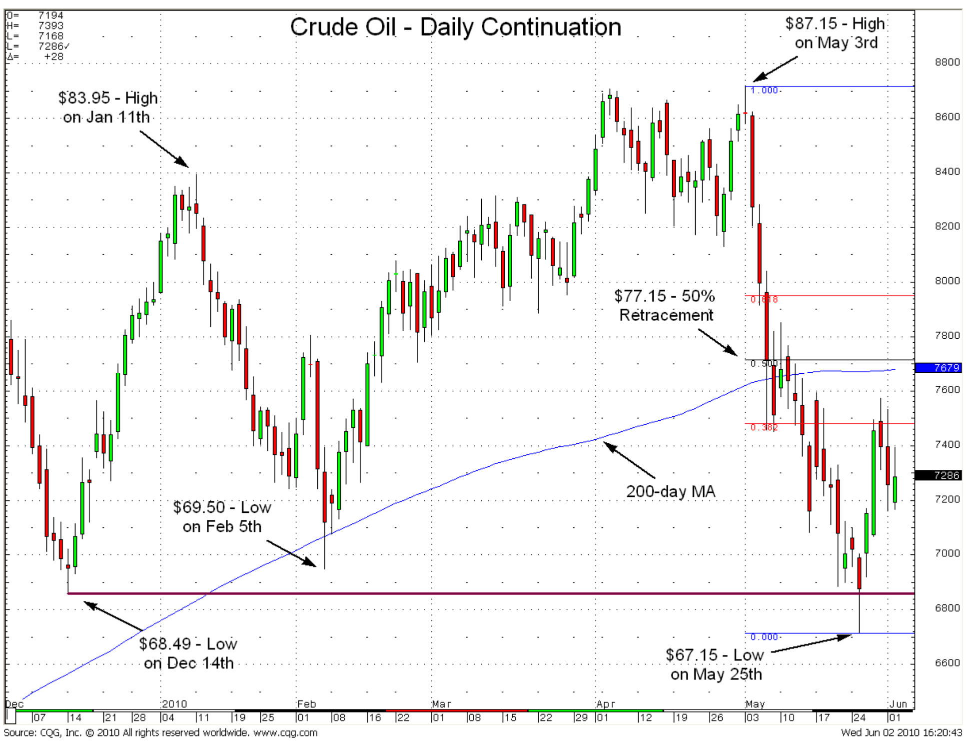
Price Outlook

Energy prices are expected to continue yesterday's rebound and maintain the upward trend that's been in place for five days now. Support will come from increases in risk appetite, improved U.S. demand, and from heightened fear over an active hurricane season. The API data were slightly positive on their own, but were increasingly so due to the API-EIA convergence figures. Pressure could come from the potential that the "risk off" trade returns, but we think that's unlikely today. Our favored trades have been buying breaks in both crude oil and natural gas, but both have been unable. Energies should continue to strengthen in the near-term, and we like the long side. However it would take a fall toward $70.00 in CLN0 to change our opinion, making the risk/reward too high at yesterday's closing price level.



The oil market should benefit from an increase in risk appetite that has generally been in place over the last five days. We still think that the "risk-on" trade can grow after the May selloff in equities turned rational de-risking into a fire sale. While a portion of the selloff was created by passage of FinReg and other political maneuvers in both the U.S. and Eurozone, an equal portion of the selloff was created by fear, which we think was overdone. If that's the case, than risk markets like oil should at least be able to regain the half of the selloff dominated by fear, putting oil prices back near the 50% retracement at $77.15. In recent days, it has seemed like almost every rally in equity markets was quashed by an adverse comment or action by a government official or by a political action. Yesterday's trade didn't see such a maneuver, helping S&Ps to rally 27.20 points at the close. As risk markets see increased calm in the near-term, the likelihood of adverse political action should become less in our opinion, thereby preventing the circular logic that exacerbated last month's selloff. Another positive factor is Iran's demand for oil payment in euros instead of dollars, if that demand is a fade. Iran began demanding payment in euros instead of dollars a couple years ago, and the euro seems to have fallen ever since. If the move is a fade now and the euro begins firming, it could be synonymous with growth in risk appetite. Lastly, support could come from a heightened focus on the hurricane season. Last week, NOAA issued its 2010 Atlantic hurricane forecast of 14-23 named storms. Colorado State University upgraded its forecast yesterday to 18 named storms from 15 previously. Of course, the first storm of the Pacific season, Agatha, struck Guatemala on May 29th, but there haven't yet been any Atlantic storms. The season should be more active because of the near-neutral el-Nino, which typically helps create wind shear in upper levels of the atmosphere, thus inhibiting formation.

TRADE: Buy NGN0 at $4.07, target $4.50, risk $3.97
Buy CLN0 at $71.50, target $77.00, risk $70.00

Upcoming Energy Events

Thu - Natural Gas Inventories 10:30 pm EST
Thu - Oil Inventories 11:00 am EST
Tue - API Weekly Stats 4:30 pm EST
Oct 14th - Next Ordinary OPEC Meeting

Global Economic & Dollar News

The dollar was supported by continued worries over the status of European debt. However, the dollar weakened a bit during the session as gains in risk appetite shown in the U.S. stock market translated to increased comfort with the euro. The euro may also have benefited from technical factors, after Tuesday's trade held at the late-May lows.

- **Japanese PM Hatoyama** resigned, with a new party leader to be chosen on Friday. FinMin Kan is the frontrunner replacement, and has previously advocated a weaker yen to increase demand for exports.
- **Australian GDP** was +0.5% q/q and +2.7% y/y. Treasury's Swan said that the figure is a sign of a self-sustaining recovery, and that export prospects are very positive.
- **ECB's Noyer** said that the euro will remain a strong and stable currency.
- **French FinMin Lagarde** said that she's not planning to cut the country's growth forecast.
- **German FinMin Schauble** will urge clarity on regulation at the next G20 meeting.
- **German Car Registrations** were -34% y/y in May.
- **Iran Announced the Sale** of €45B ($55B) in reserves for dollars. Said that it will substantially decrease its sales of oil in euros and also consider diversifying reserves into gold.
- **The CME's Volume** rose to a record of 16.8 mln contracts per day in May, which is +58% y/y. Forex volume rose the most at 140%, with alternative investments the least at unchanged. Energies increased 42% while metals rose 93%.
- **Challenger Layoffs** were 38.810K vs. 38.326K previously.
- **U.S. Pending Home Sales** increased 6.0% in Apr on the index to 110.9 vs. 104.6 previously.
- **U.S. Domestic Vehicle Sales** were 11.64M vs. 11.40M expected and vs. 11.19M previously. Ford Motor said that it is ending its Mercury brand.

Energy News Stories

- **UAE's al-Hamli** said that oil prices are reasonable, and that there is no shortage of supply.
- **Russia's Seaborne Exports** rose to 2.92 mb/d from 2.79 mb/d in Apr.
- **Pres Obama** said that the Gulf oil spill may be the result of human error or from corporations taking shortcuts. Said that putting a price on carbon pollution is the only way to transition to a clean energy future, and that he

expects to find the votes "in the coming months" to pass an energy bill. Said that the U.S. must tap into its natural gas reserves and expand its fleet of nuclear power plants.

» **Pres Obama** said that he will "clean house" in cases where government officials have been too cozy with the oil industry.

» **Colorado State University** raised its prediction for the 2010 Atlantic Hurricane season to 18 named storms from 15 previously, 10 hurricanes from 8, and 5 major hurricanes from 4.

ANALYSIS

EIA Oil Inventory Preview

The EIA oil data will be released on Thursday at 11:00 EDT due to the Memorial Day holiday. Natural Gas stocks will be released at their normal time on Thursday.

The EIA is expected to report a decline in oil stocks of 1.0 MB this week, which is less than the 2.6 MB decline seen in the five year average. Oil stocks typically begin falling in the w/e May 21st which was last week. Last week's inventories actually grew 2.5 MB, however, which we expect to begin to unwind. Refinery utilization has recovered toward its five-year average, which should help draw down inventories this week. Opposing the draw from utilization gains will be increases in imports, which could rise again this week. Oil Movements reported that OPEC seaborne shipments improved from -150 kb/d to -110 kb/d during the survey week, and improved another 280 kb/d for deliveries scheduled for next week.

Product stocks should show gains this week, as demand for petrochemicals has outpaced that for transportation fuels. Gasoline stocks could gain 0.5 MB while distillates could increase 1.0 MB. Stocks of both gasoline and distillates typically increase beginning in mid-Apr, and the upward trend lasts until mid-Jul in gasoline and mid-Sep in distillates. This year isn't expected to be different. Countering our expectation for an increase in product stocks is the likelihood that refineries find reason to fully stock retail fuel stations in front of the U.S. Memorial Day holiday. AAA said that total travel would rise 5.4% y/y based on improved economic conditions, with auto travel up 5.4% and air travel up 2.4%. Another potential factor that could pressure inventories is the divergence with API statistics. The EIA's gasoline and distillate series are currently 3.5 MB and 4.4 MB above those of the API, meaning that either the API has to rise or the EIA has to fall. A decline of that magnitude in the EIA would be expected to offer a bullish impact on prices, while the potential for an increase in API's statistics will make those numbers equally important.

Natural gas stocks are expected to show a build of 87 bcf this week, which would represent a decline from last week's 104 bcf increase. Last week's build will likely remain as the highest build of the year, as the seasonal pattern shows declines in the rate of increase into the height of the summer cooling season. Our prediction is based on a cooling degree day forecast of 44.1, which is 13.3 degrees above the 30.8 ten-year normal. Temperature maps show generally above to much above-normal temperatures covering the eastern half of the country. Temps moderate slightly next week, with the eastern half of the country covered by either normal or above-normal temps. The early CDD forecast is 49.0 compared to a ten-year normal of 38.1. The implication on inventories is for an increase of 94 bcf compared to a five-year normal of 96 bcf.

	EIA Inventories - w/e May 28th						API Inventories		
	Actual	Market Estimate	MFGR Estimate	Five-Year Average	Last Week		Converge with EIA	Actual	Previous
Crude Oil		-0.2 MB	-1.0 MB	-2.6 MB	+2.5 MB		-2.4 MB	-1.4 MB	+0.6 MB
Gasoline		-0.5 MB	+0.5 MB	-0.1 MB	-0.2 MB		-4.4 MB	-1.0 MB	-3.2 MB
Distillates		+0.3 MB	+1.0 MB	+1.1 MB	-0.3 MB		-3.5 MB	+0.9 MB	+1.5 MB

Utilization		-0.3%	+0.3%	+1.3%	87.8%		-1.2%	86.6%	85.9%
Natural Gas		+94 bcf	+91 bcf	+95 bcf	+104 bcf				

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