

July 2nd, 2010

MF Global Daily Report

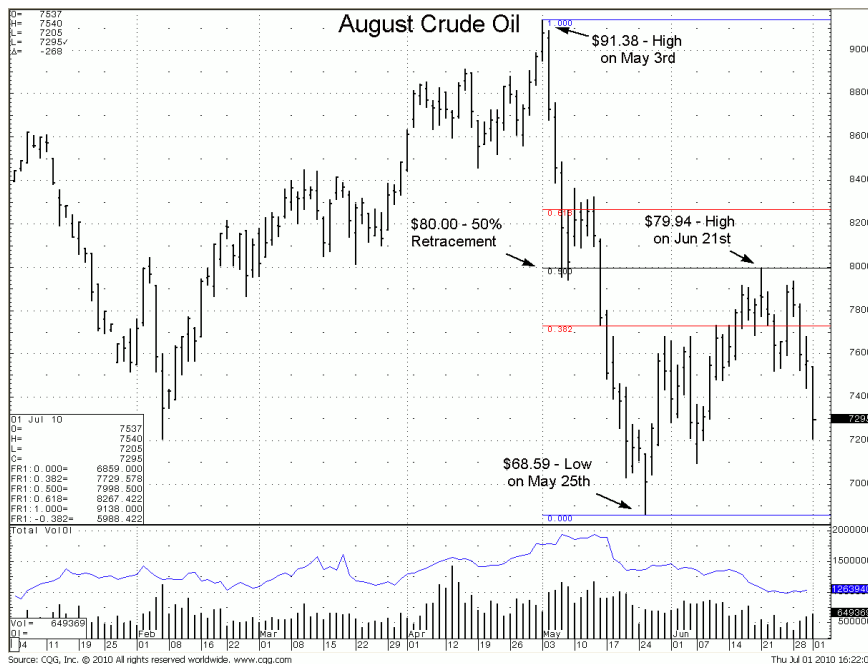
COMMODITIES | ENERGIES

# Energy

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## Price Outlook

Crude oil prices are expected to bounce in today's session, with the market approaching \$75.00/bbl in the next day or two. Support will come from the possibility that the stock market rebounds and from the potential that risk appetite grows. Pressure will come from a growing lack of confidence in the U.S. economic recovery, and from weakening U.S. demand figures. We examined the potential effects that end-of-quarter flows could have on commodities prices in the Analysis section below. Oil traditionally trades higher through today's close, but doesn't have much implicit correlation with stocks at quarter-end. We entered a long position yesterday in CLQ0 at \$73.00 which we favor holding with a \$77.00 objective and \$72.00 risk.



The oil market may trade firmly today if the U.S. equity market can rebound. Payrolls are due shortly before the oil market's open, and are forecast to drop by 110K, with private payrolls increasing by 110K. The number would obviously be a bad sign at a time when the U.S. economy is still struggling to recover. But at the same time, we wonder how much bad news has already been priced into the equity market. The S&P is down 10.9% in less than two weeks from the Jun 21st top to yesterday's bottom. We wonder at what point, the market will have adequately priced in enough bad news. Additionally, S&Ps tested and held exactly at the 38% retracement of the Mar '08-Apr '09 uptrend at 1006.00 at yesterday's low. If the stock market rallies today on either a better number or on short-covering, it could create support for oil prices on expectations that demand could increase.

The negative side of the oil market will focus on the growing lack of confidence that the U.S. economy will recover. Weakness in U.S. equities recently has been the result of a lack of confidence in either the government or the Fed.

After stimulus, bailouts, and mortgage modifications by the government, and low rates and quantitative easing by the Fed, both bodies appear to be out of bullets with which they can further influence the economy. It seems now up to the markets to make conditions better. Such despair among consumers and weakness in leading indicators like stocks has led to reductions in U.S. oil demand, which fell another 516 kb/d in Wednesday's EIA data. It marked the third decline in four weeks, bringing the total to 1.06 mb/d in that time.

**TRADE:** Long CLQ0 at \$73.00, target \$77.00, risk \$72.00

### Upcoming Energy Events

Tue - API Weekly Stats 4:30 pm EST

Wed - Oil Inventories 10:30 am EST

Thu - Natural Gas Inventories 10:30 pm EST

Oct 14th - Next Ordinary OPEC Meeting

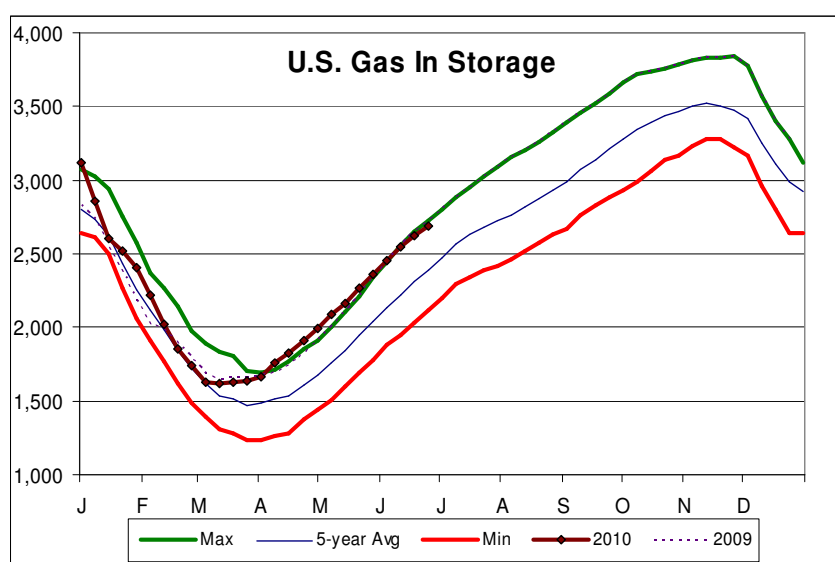
### Global Economic & Dollar News

The dollar traded weaker yesterday after the euro rebounded on less-than-expected demand for short-term funding from the ECB. The euro wasn't able to maintain all of its early-morning recovery, however, as the U.S. stock market fell and after Germany's Merkel won her presidential election after three rounds and eight long hours of voting.

- » **The ECB's Three-Month Tender** attracted demand of only €132B compared to expectations that €200B-€300B. Banks need to roll over €442B by today.
- » **The EU Commission** said that countries should face budget discipline steps if they don't reduce debt quickly enough.
- » **Eurozone Flash Inflation** was +1.4% y/y vs. +1.5% expected and vs. +1.6% previously.
- » **ECB's Mersch** said that there's an uneven economic recovery taking place, and that we're still in an environment of strengthened and heightened financial tensions.
- » **The German Labor Office** said that the labor market is better than feared but still uncertain.
- » **Angela Merkel's Candidate**, Christian Wulff, won the election for president, but only in the third round. Delegates apparently used the first two rounds of voting to send a message to Merkel that she doesn't have her own party's full confidence. Since 1949, just two of 13 elections have gone to three rounds.
- » **UK's GfK Consumer Confidence** was -19 vs. -18 previously, and was the lowest reading since Dec.
- » **BOE's Posen** said that the UK economy is tentatively in a recovery state, and still subject to switching to recession.
- » **ADP Payrolls** were +13K vs. +60K expected and vs. +57K previously (revised up from +55K).
- » **Fed's Evans** said that "the recovery is definitely on" but that it will take longer to take off. The employment outlook is still struggling and that Europe that poses additional risks on the U.S. recovery. He expects inflation to average under 2% for the next three years or more. He's not optimistic on securing 200K per month job growth.
- » **Chicago PMI** was 59.1 vs. 59.0 expected and vs. 59.7 previously. Employment was 54.2 vs. 49.2 previously while prices were 61.9 vs. 64.0 previously.
- » **Fed's Duke** said that the level of credit outstanding continues to decline and the banking sector continues to recover slowly. Credit growth has lagged all other cycles in the past 40 years except for 1990-1991. Said that the Fed should not start selling assets until after raising rates.
- » **Sen Collins** said that she's still studying the FinReg bill but is inclined to support it.
- » **Fed's Lockhart** said that the recovery is proceeding but lacks solid underpinnings. Said that now is not the time to adjust monetary policy and that the economy has downshifted in the first half of 2010. Said that the risks to the present recovery include European debt, state and local budgets, commercial real estate, and the oil spill.
- » **Lockhart** later said that it is appropriate to think about potential deflation and what the Fed would do under a deflationary scenario.

## Energy News Stories

- » **Sinopec** will begin build oil storage in China's eastern Shandong province.
- » **Hurricane Alex** crossed into an unpopulated area of Mexico late Wednesday evening as a category 2 storm. There wasn't much damage in U.S. cities even though Brownsville TX suffered 3 tornados. U.S. oil production platforms in the Gulf of Mexico were unaffected.
- » **Offline Production** due to Alex was put at 421,350 b/d in crude oil and 919 mcf in natural gas. Additionally, there was 163,000 b/d of refinery output taken offline.
- » **The LOOP** said that it would reopen late on Thursday following passage of Hurricane Alex.
- » **Natural Gas Inventories** were +60 bcf vs. +64 bcf expected.
- » **Oil Movements** said that OPEC exports will rise 190,000 b/d in the four weeks ending Jul 17th.



## ANALYSIS

### EIA Oil Inventories

	EIA Inventories - w/e June 25th					API Inventories		
	Actual	Market Estimate	MFRG Estimate	Five-Year Average	Last Week	Converge with EIA	Actual	Previous
Crude Oil	-2.0 MB	-1.1 MB			+2.0 MB	-6.1 MB	-3.4 MB	+3.7 MB
Gasoline	+0.5 MB	-0.4 MB			-0.8 MB	-2.7 MB	-0.9 MB	+0.8 MB
Distillates	+2.5 MB	+0.9 MB			+0.3 MB	+1.8 MB	+4.0 MB	+1.1 MB
Utilization	88.4%	+0.2%			89.3%	-2.4%	86.9%	87.2%
Natural Gas	+60 bcf	+64 bcf			+81 bcf			

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

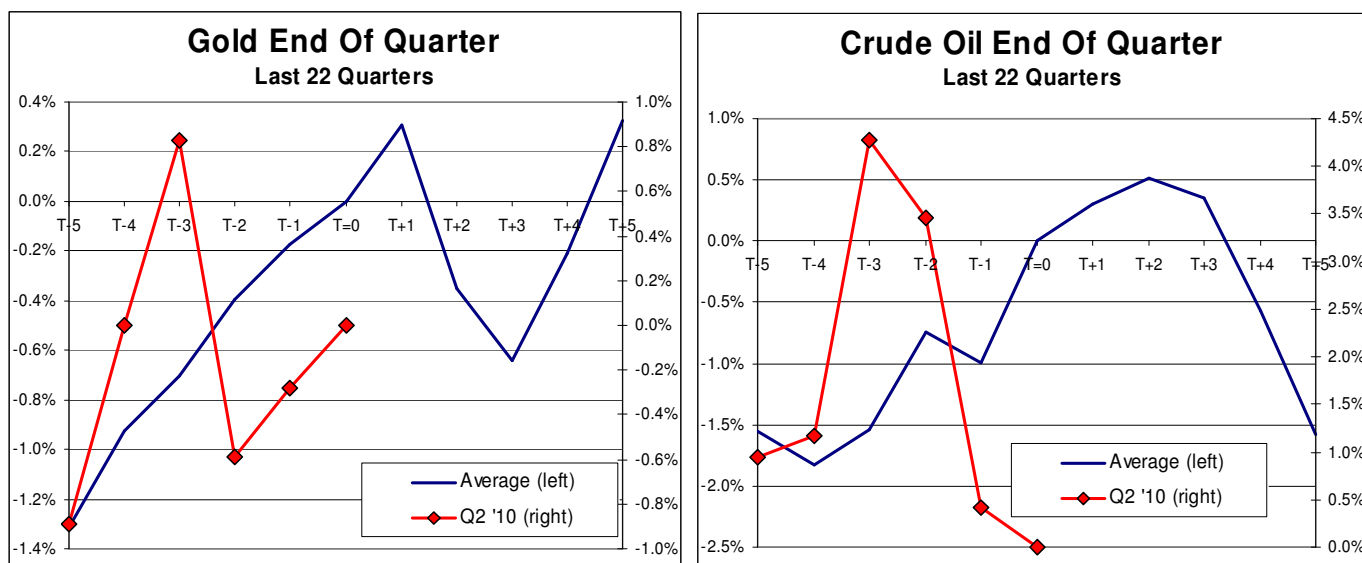
### Stock Market Drop and Commodities

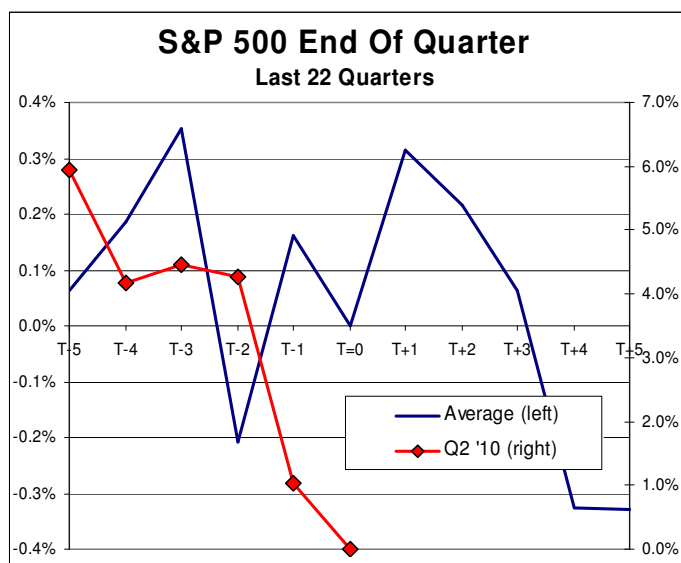
The Dow Industrials dropped 268.20 points on Tuesday while S&P 500 futures fell 35.60. U.S. traders arrived on Tuesday to see that the cause of the drop was a downward revision in Chinese leading indicators, an IPO of China's Ag Bank, and speculation that European banks would have trouble rolling over €442B in ECB bank loans before they came due on Jul 1st. The reasoning for the decline seemed hard to believe, since traders rarely pay attention to

leading indicators from any country, and since the rollover of debt in the Eurozone was already known. On Wednesday, it turned out that banks needed only €132B compared to expectations that at least €200B-€300B would be needed. The euro was able to fully recover Tuesday's losses on Wednesday, but S&P's closed down another 8.70 points while the Dow was -96.30 points. Yesterday's trade was fairly similar. Manufacturing PMIs in the Eurozone and UK were near expectations while the U.S. PMI was 2.8 points below consensus. The Chinese Ag Bank IPO reportedly had grown an order book that is 3.5 times oversubscribed. The result was that the euro rallied sharply yesterday, with help potentially also coming from austerity measures across several member countries. Participation in strikes protesting austerity measures in Greece has fallen from 100,000 on May 5th to 15-20K on May 20th to 10,000 on Jun 30th. We believe that the government is gaining credibility for staying put on austerity, and thus contributing to the euro's strength.

To apply recent market thinking to the strength in the euro, we would think that it's an indication of risk appetite. Such a development should pressure gold prices and lift global equities. However, gold traded slightly higher on Tue & Wed before selling off yesterday. Stocks have traded weaker throughout the three day period, with weakness spurred by evidence of weakness in employment and lower purchasing managers' surveys. Weakness in U.S. equities has also been triggered by a lack of confidence in either the government or the Fed. After stimulus, bailouts, and mortgage modifications by the government, and low rates and quantitative easing by the Fed, both bodies appear to be out of bullets with which they can influence the economy. Such despair among consumers and weakness in leading indicators like stocks has led the market to believe that a double-dip, deflation, or a "lost decade" similar to Japan's are real possibilities. Such an environment should be slightly negative for oil and stocks, mixed for gold, and positive for treasuries.

We were also curious about the effect of quarter-end flows, and whether they would exert any impact on gold or crude oil prices. Specifically, whether excessive weakness in equities in either the ending quarter or the five days leading up to quarter-end would result in a rebound in equities, gold, or oil at the beginning of the new month. The answer we found was that there would virtually be no effect. Typically, gold prices rally between five days prior to quarter-end and one day after. In the past 22 quarters, 17 of them finished higher, which an average gain of 1.7%. Yesterday's selloff was day t+1, and should pressure the average. In crude oil, prices tend to rally from four days before quarter-end and two days after. The pattern has worked in 13 of the last 22 years, with an average increase of 2.8%. The pattern in the stock market is a bit more flattish, with the exception of a selloff in the beginning of the new quarter.





We ran regressions between stocks and the gold and oil markets to find very little relationship between the markets and the days surrounding the end of a quarter. Out of the three quarters that stocks fell more than 2% in the last five days of the period, two of the three quarters saw trade move higher in the first five days of the new quarter. Similarly, out of the seven quarters that traded more than 2% lower at the end of the period, four periods saw a higher trade in the first five days of the new quarter. Liquidations of 2% or more are in red boldface in the table below. The liquidation in late-Mar '08 was made two weeks after the Bear Stearns rescue, so the rebound in markets at the start of the new quarter may have been on bargain hunting. The liquidations made in late 2008 were the result of weakening economic data into the U.S. election and growth in the credit crisis. Stocks and crude oil began the new quarter with further weakness, while gold was either slightly higher (in 2008) or strongly lower (in early 2009).

### S&P Performance

### First Five Days Performance

Quarter-End Date	Q/Q	Last Five Days	S&P	Gold	Crude Oil
12/31/04					
3/31/05	<b>-2.6%</b>	0.7%	0.9%	-0.5%	-2.3%
6/30/05	0.9%	-0.8%	1.7%	-3.0%	5.5%
9/30/05	3.1%	1.1%	-2.7%	1.2%	-6.6%
12/30/05	1.6%	-1.6%	3.4%	6.1%	4.0%
3/31/06	3.7%	-0.6%	0.1%	1.1%	1.1%
6/30/06	-1.9%	2.1%	-0.2%	4.4%	0.3%
9/29/06	5.2%	1.6%	1.0%	-4.4%	-5.0%
12/29/06	6.2%	0.0%	-0.4%	-3.6%	-8.9%
3/30/07	0.2%	-1.1%	1.7%	1.3%	-6.6%
6/29/07	5.8%	0.1%	1.9%	1.8%	2.1%
9/28/07	1.6%	0.1%	2.0%	-0.4%	-0.5%
12/31/07	<b>-3.8%</b>	-1.1%	-5.3%	5.0%	0.4%
3/31/08	<b>-9.9%</b>	<b>-2.0%</b>	3.8%	0.7%	7.4%
6/30/08	<b>-3.2%</b>	<b>-2.9%</b>	-0.5%	0.1%	-2.8%
9/30/08	<b>-9.3%</b>	<b>-2.1%</b>	-15.2%	0.5%	-10.5%
12/31/08	<b>-22.2%</b>	4.6%	0.7%	-3.4%	-6.5%
3/31/09	<b>-11.7%</b>	-1.0%	2.2%	-4.4%	-1.0%

6/30/09	15.2%	2.7%	-4.3%	-2.0%	-14.0%
9/30/09	15.0%	-0.4%	0.0%	3.5%	-1.5%
12/31/09	5.5%	-0.5%	2.7%	3.9%	4.3%
3/31/10	4.9%	0.1%	1.5%	3.5%	1.9%
6/30/10	-11.9%	-5.6%			

Stocks can certainly rebound in today's trade, and we expect them to do so in a short-covering rally. However, it will be due to factors other than end of the month tendencies, such as oversold conditions or valuation. The impact on gold will likely be negative, as investment gravitates toward riskier asset classes, while crude oil could trade firmly. Gold prices may also suffer due to growing lack of confidence that the U.S. economy will recover. Continued weakness will promote a deflationary environment, and ensure that treasuries continue to perform best as both a safe-haven play and slow growth play.