

July 28th, 2010

MF Global Daily Report

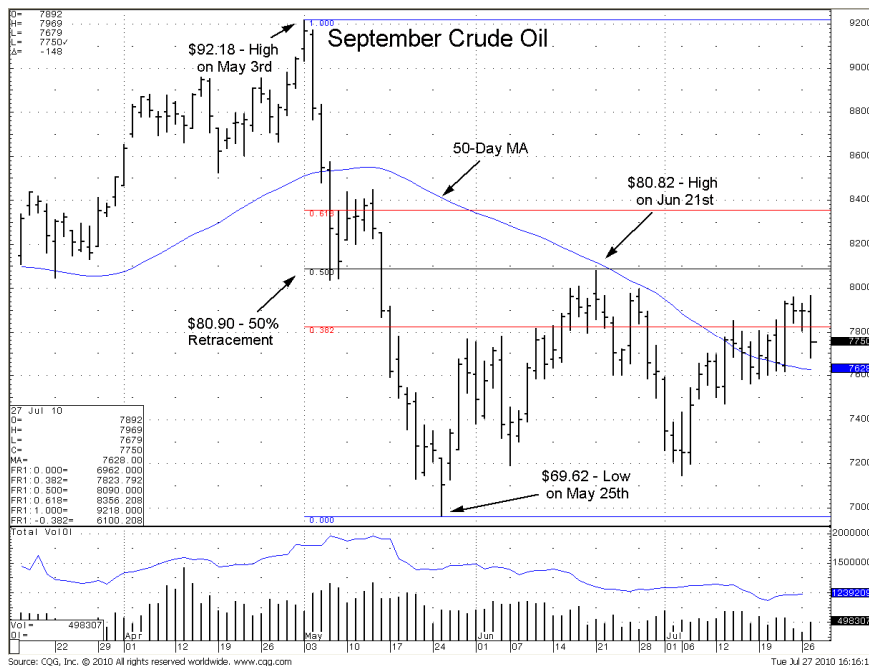
COMMODITIES | ENERGIES

# Energy

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## Price Outlook

The crude oil market could trade a little bit lower today in follow-through from yesterday's selloff, but we think that the downside will be held near \$76.30. Support will be offered at that level from the 50-day MA, with additional support coming from a lightening in the legislative schedule, the generally firm trade in copper, and the ongoing recovery in the stock market. We analyze the general effects of a recovery in the stock market when combined with other positive signs like a peak in volatility and low levels of interest rates. The API data yesterday were slightly bearish for energy prices, and we're leery about potential negative effects of the EIA data today. We favor trading crude as a trading affair today, but think that prices could form a bottom near \$76.30 fairly soon.

**TRADE:** None

## Upcoming Energy Events

- Wed - Oil Inventories 10:30 am EST
- Thu - Natural Gas Inventories 10:30 pm EST
- Thu - RBQ0 & HOQ0 Rollover
- Fri - RBQ0 & HOQ0 Last Trade
- Tue - API Weekly Stats 4:30 pm EST
- Oct 14th - Next Ordinary OPEC Meeting

## EIA Oil Inventory Preview

EIA Inventories - w/e July 23rd						API Inventories		
	Actual	Market Estimate	MFGR Estimate	Five-Year Average	Last Week	Converge with EIA	Actual	Previous
Crude Oil		-1.8 MB	-0.5 MB	-1.3 MB	+0.4 MB	+2.9 MB	+3.1 MB	-0.2 MB
Gasoline		+0.6 MB	-0.2 MB	-0.2 MB	+1.1 MB	+0.1 MB	+0.9 MB	-0.4 MB
Distillates		+1.6 MB	+0.5 MB	+1.8 MB	+3.9 MB	-4.3 MB	+0.4 MB	+1.0 MB
Utilization		-0.6%	-1.0%	-0.7%	91.5%	-4.0%	87.4%	88.7%
Natural Gas		+35 bcf	+30 bcf	+48 bcf	+51 bcf			

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

## Global Economic & Dollar News

The dollar fell during yesterday's early trade based on increases in risk-appetite, but soon began to rise when consumer confidence fell short of expectations.

- » **The PBoC** said that the European debt crisis will not have a big effect on the Chinese economy.
- » **India's Central Bank** raised its repo rate by 25 bps to 5.75%, which was as expected, but it also raised the reverse repo rate by 50 bps to 4.50%, compared to 25 bps expected.
- » **Eurozone M3** was +0.2% vs. -0.1% expected.
- » **German GfK Consumer Sentiment** was 3.9 vs. 3.5 expected and vs. 3.6 previously.
- » **UBS** reported better-than-expected earnings numbers, with help coming from investment banking.
- » **The Basel Committee on Banking Supervision** announced an easing in the changes to its draft reform aimed at increasing higher quality bank capital holdings.
- » **UK CBI Retail Sales Volume** was +33 vs. +8 expected and vs. -5 in Jun.
- » **Fed Pres Plosser** said that there's no need for more easing or stimulus measures.
- » **Case-Shiller 20-City Home Prices** were +1.3% m/m and +4.6% y/y. Expectations were +0.3% and +4.0% respectively.
- » **Yale's Robert Shiller** said that he sees more than a 50% chance of a double-dip recession.
- » **Consumer Confidence** was 50.4 vs. 51.0 expected. June's figure was revised up to 54.3 from 52.9 previously. Expectations fell as did the employment, income, and business conditions categories.
- » **Senate Democrats** unveiled an energy bill which intends to reform offshore drilling and promote natural gas powered cars, but will delay action on climate change. The bill provides \$5B to make homes more efficient and raises the fee for the oil spill liability trust fund to 49c/bbl. They aim for a vote next week, so that it will be done by the start of the August recess on Aug 9th.

## Energy News Stories

- » **BP's Macondo Well** may be permanently shut on Sunday, according to the Bob Dudley.
- » **Goldman Sachs** said that oil prices are significantly below the price level that's warranted by fundamentals.

## ANALYSIS

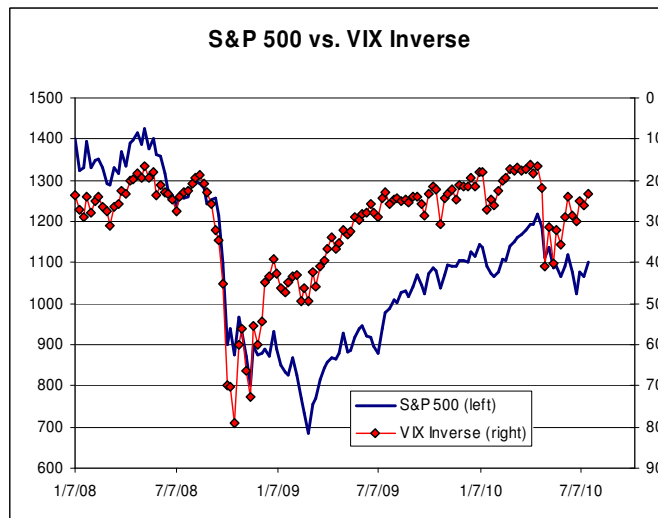
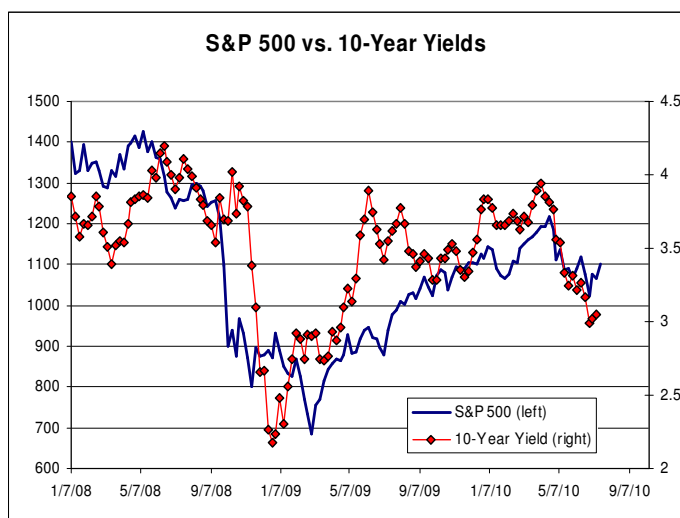
### Stocks, VIX, and Commodities Analog

Up until its June 21st peak, gold prices have traded strongly despite disinflation, weak demand, and supply/demand surpluses. Similarly, the oil market has steadily recovered since a short-term bottom on July 6th despite weakening U.S. demand and plentiful global inventories. Given the gold and oil markets focus on all factors external to their own fundamentals, we thought it fitting to look at the current state of risk and the likely effect that the equity market will

have on commodity prices. In our July 16th comment, we argued that the advance in the euro could continue and signal that risk-aversion was abating. We thought this would be good for oil and equity prices and slightly positive for gold as it indicated that risk-taking was increasing. We thought it could be positive for gold on the possibility that gold could use risk appetite as a sign that inflation would soon follow. We were wrong on gold, but the euro, equity, and risk commodities like oil and copper have benefited.

The S&P 500 has recovered a nice 10.7% off its Jul 6th low in the last three weeks, as the market appears to believe that the worst case scenario regarding sovereign debt defaults won't come to fruition. Additionally, the passage of FinReg on July 15th and the elimination of some of the uncertainty around the bill have also added support. Some economic data such as new and existing home sales has beaten expectations while speculation is growing that the Bush tax cuts will be extended and that any potential cap & trade plan unveiled by the Senate will be watered down from versions discussed when Pres Obama was elected. There's also potential that the upcoming mid-term elections could raise the prospect that a rejuvenated republican party may cut back on both government deficit spending and intervention in the economy.

In this current cycle, the S&P 500 bottomed on July 6th. Crude oil matched that and also bottomed on July 6th, while gold peaked on June 21st. The euro preceded all three by bottoming on June 7th. Signs of a potential bottom were signaled by a peak in the VIX on May 3rd and the building of a divergence until the stock market bottomed two months later on July 6th (VIX is inverted in chart below). Ten-year yields have yet to bottom, but their continued new lows are signaling reduced borrowing costs for corporations and imply support for economic growth. The two charts below show both the current and previous market cycles. During the stock market bottom on March 6th '09, the ten-year yield formed a bottom some 2 1/2 months earlier in late-Dec. Similarly, the VIX peaked in late-Oct '08, or 4 1/2 months before the S&P 500 bottom.



Looking back at other years, there seems to be a tendency for stock market reversals to be preceded by peaks in the VIX index. The relationship between interest rates and stocks doesn't work as well. We eyeballed the largest and longest lasting selloffs in stocks in the last 20 years to find that of the eight, the VIX peaked before stocks bottomed in six of them. The ten-year yield bottomed prior to a stock market bottom in three of them. Of these eight major selloffs, declines from top to bottom ranged from 8.1% to 57.7%, and six of them occurred in mid-term election years including this year's 17.1% liquidation. The impact of the trend reversal in stocks on gold and oil has been fairly mixed. It's been negative for gold in five of the eight years, while it's been positive for oil in five of the eight. The

impact on oil was more noticeable, as crude reversed higher within a few days of the equity market's bottom three times, while it reversed lower once. The other examples saw the market continue the prior trend.

Our take away is that crude oil will likely continue to track the equity market for direction. As long as stocks can maintain their gains, it should give support to crude oil prices regardless of what oil market fundamentals imply. The recovery in oil still may not be all that strong, given general expectations that the economic recovery will be continue to be sub-par. We think this sets up a backdrop for oil prices to potentially range up toward the upper-\$80s through the end of the year, while the downside should be held around \$65-\$70/bbl. We still don't see a chance of \$100/bbl this year. In gold, we interpret this data as implying that prices could range from \$1,100 to \$1,250 through the end of the year. We will be keenly interested to see how the S&P 500 react around key resistance at 1,135.00, which comes from both the 62% retracement of the Apr 26th-Jul 6th downtrend as well as the 138% extension of the Jul 6th-Jul 14th uptrend.

S&P 500 Downtrend	Top-to-Bottom Change	Gold Prices	Oil Prices
7/16/90-10/11/90	-20.4%	Continued Selloff	Peaked 10/10/90
1/31/94-4/4/94	-8.9%	Peaked 3/31/94	Reversed Higher
7/20/98-10/8/98	-22.4%	Peaked 10/8/98	Continued Selloff
3/24/00-10/10/02	-50.5%	Bottomed 10/24/02	Continued Selloff
3/5/04-8/13/04	-8.8%	Continued Rally	Continued Rally
5/8/06-6/14/06	-8.1%	Bottomed 6/14/06	Bottomed 6/14/06
10/11/07-3/6/09	-57.7%	Continued Selloff	Continued Rally
4/26/10-7/1/10	-17.1%	Reversed Lower	Bottomed 7/6/10