

September 2nd, 2010

MF Global Daily Report

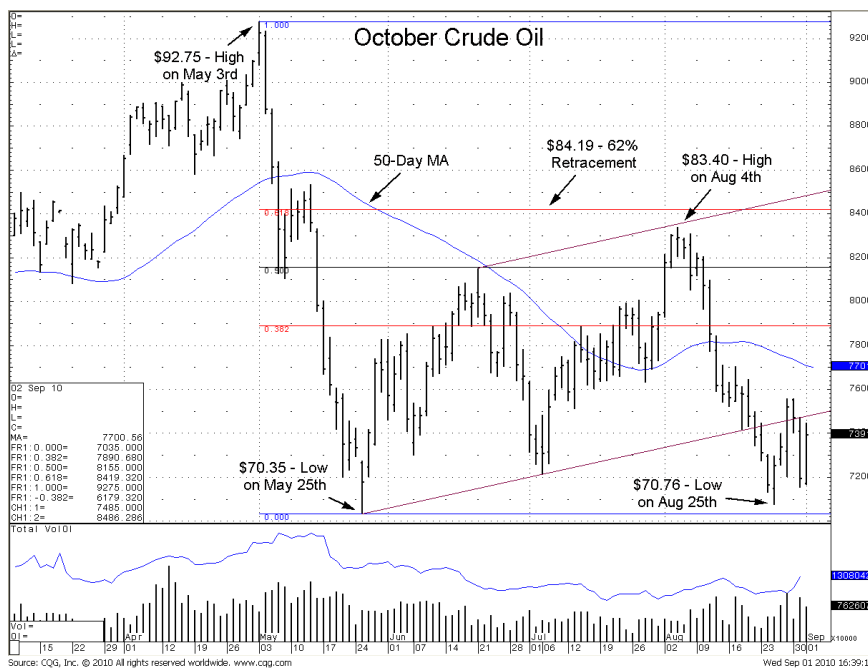
COMMODITIES | ENERGIES

Energy

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Price Outlook

It's difficult to get a feel for the direction of energy prices today in light of yesterday's strong rally. However, we believe that the bulk of both fundamental and technical evidence continue to support a bearish argument. We see pressure offered by yesterday's EIA demand figures, recent trends in open interest, and by yesterday's comments from Frontline's CEO regarding floating storage. Support will rest solely on momentum and the possibility that global stock markets trade higher again today. We favor maintaining our sell recommendation in CLV0 at \$77.00 with a \$70.50 objective.



Yesterday's trade in crude oil rallied an impressive \$1.99/bbl on the back of a 33.40 point jump in S&Ps and a 254.80 point advance in the Dow Industrials. The on-again off-again nature of the stock market's risk appetite makes it difficult for us to get too excited in the oil market's upside potential, especially with non-farm payrolls due on Friday. Amid all the support and enthusiasm for stocks yesterday, as well as the possibility that Hurricane Earl shuts down east coast oil refineries, oil prices were unable to fully unwind Tuesday's \$2.78/bbl liquidation.

We see the oil market weighed by poor fundamentals, which were updated in yesterday's weekly EIA data. Total oil demand rose 71 kb/d in the four week average, but demand is still 139 kb/d below the peak made on June 4th rather than 476 kb/d above it as the five-year averages suggest it should be. For gasoline, the calendar says that there's one week left in the summer driving season, but the data shows that it ended a month ago. Gasoline inventories also stretched to the highest level above the five-year average that we have on record (since 1995). Signs of demand weakness have also filtered through to the contango, which has widened significantly in the past three weeks. In the

active Dec 2010 & Dec 2011 contracts, the 12-month spread has fallen toward -\$6.00/bbl, which is the widest that it's been since Nov '09 when floating storage experienced a short-term bump. Floating storage may be on the rise again, as indicated yesterday by the CFO of Frontline. He said that he expects the world's fleet of VLCCs to increase next year and prompt new tanker leases for storage. Lastly, we noticed that open interest gained 66,003 contracts on Mon & Tue while prices fell \$3.25/bbl. Such a move suggests that short positions are building in once again, which may add pressure on prices in the near-term.

TRADE: Sell CLV0 at \$77.00, target \$70.50, risk \$78.50

Upcoming Energy Events

Thu - Natural Gas Inventories 10:30 pm EST

Tue - API Weekly Stats 4:30 pm EST

Wed - Oil Inventories 10:30 am EST

Oct 14th - Next Ordinary OPEC Meeting

Global Economic & Dollar News

The dollar fell yesterday after stronger Chinese PMI, Australian GDP, and U.S. ISM data created an environment of risk appetite. Favorable comments from Spain's PM regarding the gov't's ability to meet financing costs provided assurance to the euro.

- » **Australia's Q2 GDP** was +1.2% q/q vs. +0.9% expected. It was +3.3% y/y vs. +2.9% expected.
- » **China's NBS MFG PMI** was 51.7 vs. 51.8 expected and vs. 51.2 previously.
- » **China's HSBC PMI** was 51.9 vs. 49.4 previously.
- » **Spain's PM Zapatero** said that the gov't can meet financing costs and will reduce the debt-to-GDP ratio to 6% in 2011.
- » **UK Aug MFG PMI** was 54.3 vs. 57.0 expected and vs. 56.7 previously.
- » **MBA Mortgage Market Index** rose 2.7%. Purchases were +1.8% while refi's were +2.8%.
- » **Challenger Layoffs** were 34,768 in Aug vs. 41,676 previously.
- » **ADP Payrolls** were -10K vs. +19K expected and vs. +42K previously.
- » **U.S. Construction Spending** was -1.0% vs. -0.5% expected and vs. -0.8% previously (downwardly revised from +0.1%).
- » **U.S. ISM MFG PMI** was 56.3 vs. 53.0 expected and vs. 55.5 previously. Prices paid were 61.5 vs. 57.5 previously, while employment was 60.4 vs. 58.6.
- » **Fed's Plosser** said that the Fed should not ease more in an attempt to solve the unemployment problem, but should entertain the idea if real deflation risks arise. He believes that the economy has hit a soft patch rather than a double-dip.
- » **Fed Pres Fisher** said that he is reluctant to increase the Fed's balance sheet. He said that uncertainty and a lack of confidence is restraining the economy. He added that the Fed can't fix the economy alone, and that it needs an improved regulation environment to help.

Energy News Stories

- » **The NHC** downgraded Hurricane Earl to a category 3 storm centered about 815 miles southeast of Cape Hatteras, NC. The storm was 1,070 miles southeast on Tuesday. The NHC Chief later said that he's highly confident that the hurricane will make a northeast turn and keep the worst away from the east coast.
- » **TS Fiona** continued to strengthen in the Caribbean and is centered about 145 miles east of the northern Leeward Islands. Winds were 60 mph yesterday, compared to 40 mph on Tuesday. The storm's projected path still shows it turning northward and passing between Bermuda and the U.S. east coast.
- » **Tropical Depression Nine** formed in the eastern Atlantic, according to the NHC. The system could become TS Gaston during the next 48 hours.

- » **Frontline's CFO** said that he expects moderate growth in the world fleet of VLCCs in 2011, and expects floating storage demand to return.
- » **Turkey sold Iran** 35,444 tonnes of gasoline in July, according to the gov't stats office.

ANALYSIS

EIA Oil Inventory Review

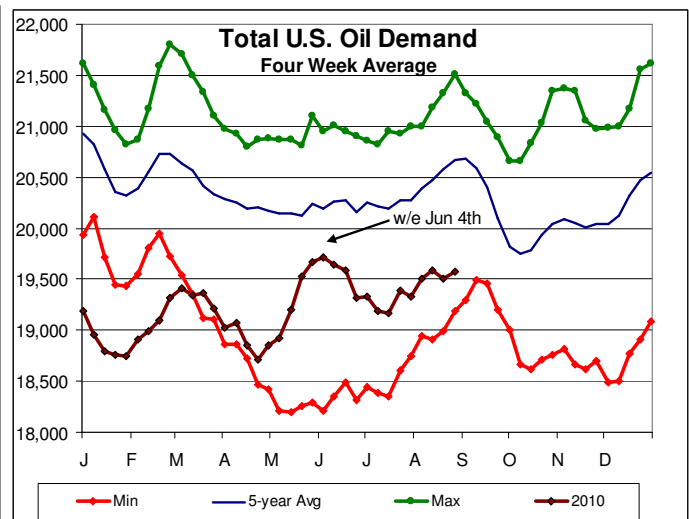
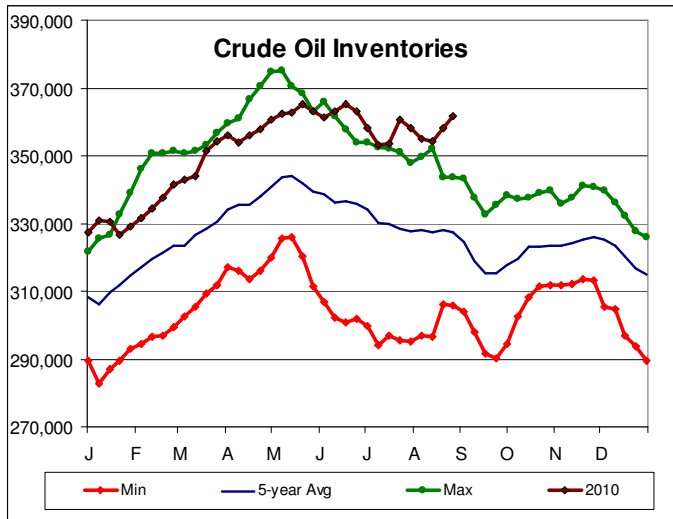
The EIA reported oil stocks yesterday which provided an overall boost to energy prices, although part of the rationale for the positive price reaction came from strength in the stock market following the stronger ISM report. Oil stocks gained 3.4 MB, which was largely in-line with what the API showed as a convergence figure. Product inventories fell and provided a positive input for prices on the surface. A decline in Cushing stocks also benefited oil prices. However, inventory levels on crude oil and gasoline built on their gaps with their five-year averages and overall demand is still unimpressive. In our view, these negative factors reinforce our bearish view of energy prices in the near-term, and suggest that yesterday's rally may not be able to last. The numbers and our analysis follow below.

	EIA Inventories - w/e August 27th					API Inventories		
	Actual	Market Estimate	MFR Estimate	Five-Year Average	Last Week	Converge with EIA	Actual	Previous
Crude Oil	+3.4 MB	+1.3 MB	-1.0 MB	-0.5 MB	+4.1 MB	+3.2 MB	+4.8 MB	-1.8 MB
Gasoline	-0.2 MB	-0.2 MB	+1.0 MB	-1.3 MB	+2.3 MB	+0.0 MB	-0.6 MB	+0.7 MB
Distillates	-0.7 MB	+1.1 MB	+1.5 MB	+1.2 MB	+1.8 MB	-8.2 MB	-1.9 MB	+1.9 MB
Utilization	87.0%	-0.2%	+1.0%	+0.8%	87.7%	-2.9%	84.8%	85.0%
Natural Gas		+53 bcf	+54 bcf	+61 bcf	+40 bcf			

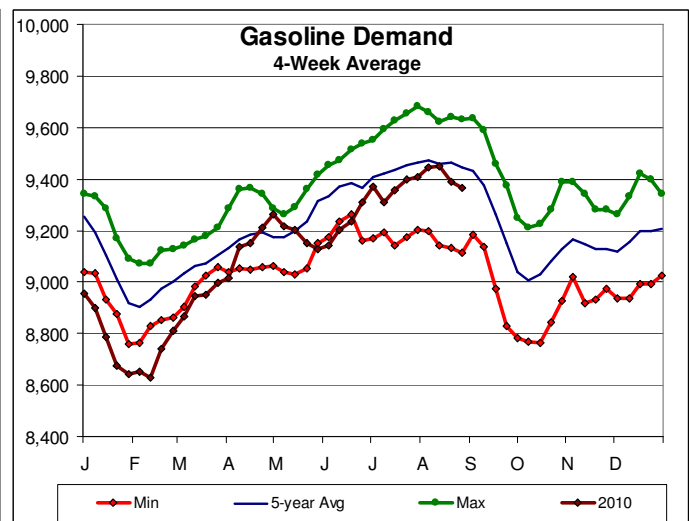
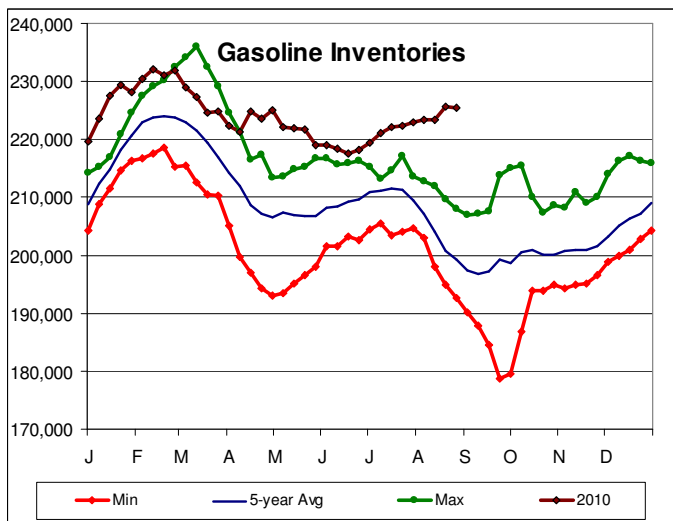
*The API convergence figures are the amounts that EIA data need to change in order to match the previous day's API figures

Oil stocks were +3.4 MB vs. +1.3 MB expected. Stocks were boosted by a 117 kb/d decline in refinery inputs and by an increase in domestic production of 91 kb/d. Pressure came from a 202 kb/d fall in imports and a 125 kb/d increase in total oil demand.

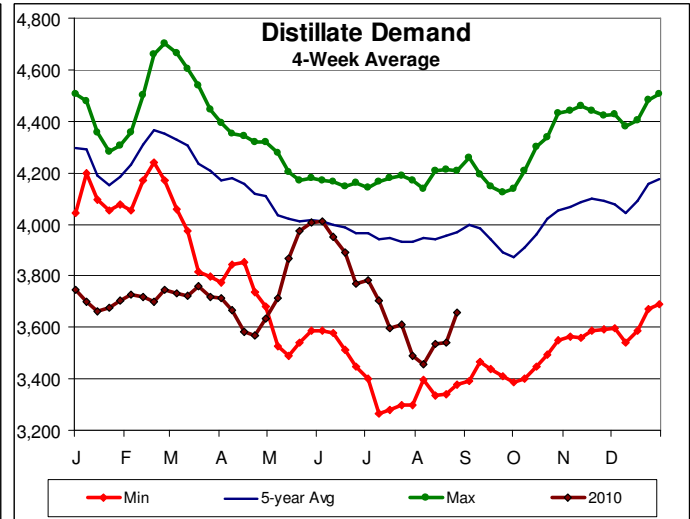
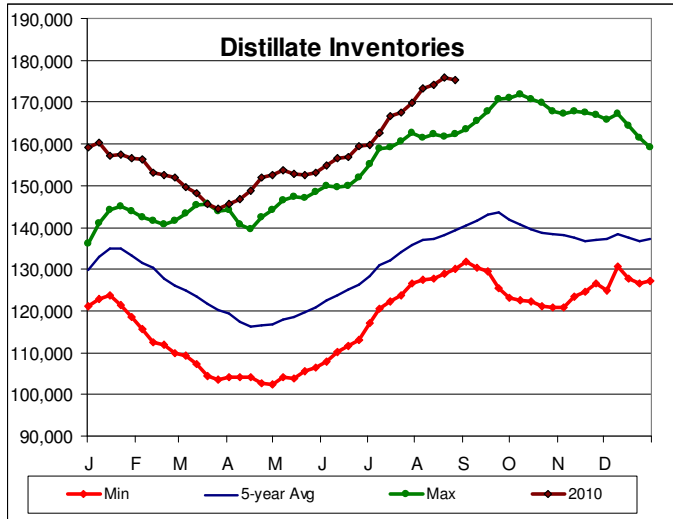
Oil prices may have been boosted though by the contractions of 503,000 bbls from stocks at Cushing Oklahoma. Stocks are now 35.75 MB there, and fell further below the record high made on May 14th at 37.95 MB. Usable capacity at Cushing has been estimated to be around 40 MB, so the decline in Cushing inventories helped the Brent-WTI spread fall from +\$2.90/bbl to +\$2.25/bbl in the hour that followed. Opposing that support for prices is the divergence with the five-year average which grew to 34.23 MB from 30.29 last week. The divergence is now the highest since Sep '09. Pressure on prices was also offered by the total demand data, which showed demand still below the level that existed in early-Jun. With one week left to go in the summer driving season, we don't have much hope for any last minute surges in demand.



Gasoline stocks were -0.2 MB vs. -0.2 MB expected. Even though the data matched expectations, we still several negative points in the report which are worrisome. Gasoline stocks rose to 26.09 MB above the five-year average compared to 24.96 MB above it the previous week. That reached the highest difference with the average in all of our 15 years of data. Gasoline stocks were lingering around 9.0 MB above the average just a few weeks ago, so the sudden surge has been the result of the excess levels of refinery utilization and weak U.S. demand. Total gasoline demand fell 23 kb/d in the four-week average as shown in chart 2 below. Gasoline demand typically falls about 500 kb/d during the month of September as the summer driving season transitions into the fall shoulder month for heating and cooling.



Distillate stocks were -0.7 MB vs. +1.1 MB expected. Distillates were the bright spot in the report, with inventories falling to 35.94 MB above the five-year average compared to 37.84 MB above it previously. Demand has been improving as well in the past few weeks, but is essentially still recovering from the June-July demand drought. Some help for inventories has come from exports of distillates, which lingered at 677 kb/d last week. However, we're still concerned over the level of diesel inventories, which are still only about 500 KB below the all-time peak made two weeks earlier.



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