

May 26th, 2011

MF Global Daily Report

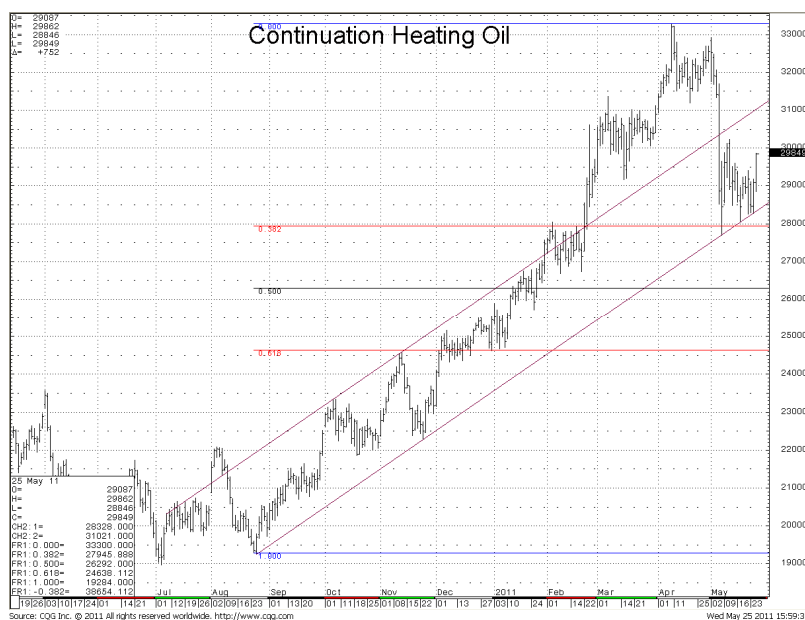
COMMODITIES | ENERGIES

Energy

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Price Outlook

Energy markets are expected to trade firmly in the near-term, with oil potentially reaching \$105.00 resistance within a week or two. Support will be offered by yesterday's favorable inventory report, fresh problems with North Sea production, tensions in the Middle East, backwardation in oil futures, and from technical factors. Downside risks come from volatility which can easily take prices back toward recent lows, worries over European sovereign debt, weakness in PMI surveys, the return of Canadian oil sands production, and the bearish seasonal in the gasoline market. We think that the new 10-day high in prices may signal that some of these negatives are already priced in and favor buying a dip in July crude at \$98.00 and in HON1 at \$2.93/gal.



The oil market traded nicely higher yesterday and was able to move above the May 18th high at \$101.42. Some of the strength came from a weaker dollar and recovery in the stock market, which seemed to create an environment of risk appetite. The market looked favorable on the chart because of its rise to new 10-day highs after a three-day period of stability in open interest numbers. Product markets had been holding above key Fibonacci retracements which also appeared favorable from a technical perspective. Fundamental support came from the EIA report, which suggested that a 3.1% increase in refinery utilization would soon translate into declines in oil stocks. Oil stocks gained despite being two weeks past their traditional seasonal peak, however, near-term declines could further deteriorate the inventory overhang that developed in 2H 2008 and 2009. Inventories peaked in Oct '10 at 44.60 MB above the five year average and are only 22.98 MB above it now. Fundamental support was also offered by news of another delay in North Sea oil loadings due to production problems in the Forties stream.

The gains in the market provide the appearance that the "all-clear" siren has sounded in terms of the negative factors that had pressured prices in early-May. While we don't believe that we're out of the woods yet, we're encouraged by the fact that prices advanced to a new 10-day high despite an adverse durable goods report. Purchasing manager

surveys will resume on Tuesday and Wednesday. Considering Tuesday's weak Richmond survey and the prospect of weak auto production stemming from earthquake-related parts shortages, there are risks that the Chicago and ISM are weak as well. The prospect of fear returning over these data points caused us to bias down our buy entry levels. Some pressure could also come from the resumption of oil sands production in Alberta Canada following wildfire-related shutdowns and from the bearish gasoline seasonal which starts from yesterday's close. We're not that concerned about the gasoline seasonal, since it projects a 3.5% loss through Aug 30th and this year's trade had already declined 15.2% through Monday's close.

TRADE: Buy CLN1 at \$98.00, target
Buy HON1 at \$2.93/gal, target \$3.20/gal, risk \$2.88

Upcoming Energy Events

Thu - Natural Gas Inventories 10:30 am EST
Tue - API Weekly Stats 4:30 pm EST
Wed - Oil Inventories 10:30 am EST
Jun 8th - OPEC Meeting

Global Economic & Dollar News

The dollar traded in a slightly lower direction for most of yesterday's trade as France's Lagarde threw her hat into the candidacy of the IMF President and after ECB's Stark said that the ECB is ready to raise rates again. Germany's DIHK also boosted the euro after they raised their 2011 GDP forecast. There was a rumor of a snap election in Greece, but it was quickly denied by the government.

- » **The OECD** said that the Fed should start hiking rates while the ECB should remain on hold. Said that the global recovery is on track and helped by a stronger U.S., but that threats ranging from high oil prices to European sovereign debt could combine to create a bout of stagflation.
- » **A Snap Election in Greece** was rumored yesterday but denied by the government.
- » **Pimco's European credit portfolio manager** said that Greece may be able to extend maturities without triggering CDS.
- » **Finland's Parliament** officially approved Portugal's bailout package.
- » **French FinMin Lagarde** announced her candidacy for the IMF presidency. She said that she opposes a debt restructuring in principle.
- » **ECB's Stark** said that the ECB is ready to raise rates again "if needed" to prevent a temporary upsurge in inflation from becoming more persistent.
- » **German June GfK Consumer Sentiment** was 5.5 vs. 5.6 expected and vs. 5.7 previously.
- » **Germany's DIHK** raised its 2011 GDP forecast to 3.5% from 3.0% previously.
- » **U.S. News & World Report** said that Republican sources tell them that they will miss the Aug 2nd debt ceiling deadline and will instead negotiate through September.
- » **The WSJ** was more optimistic, saying that a potential "down payment" on spending cuts of more than \$1T over 10 years would be made.
- » **Rep Paul Ryan** later said that fiscal policy is on a collision course with monetary policy but hopes that he can get a "serious down payment" to lift the debt ceiling and buy time.
- » **The DOJ is Probing** statements made by Blankfein in 2008 that could result in his exit as Goldman's CEO.
- » **U.S. Durable Goods Orders** were -3.6% vs. -2.2% expected and vs. +4.4% previously. Non-defense capital goods orders ex-aircraft were -2.6% vs. +0.2% expected and vs. +5.4% previously.
- » **The American Trucking Association** said that its seasonally adjusted truck tonnage index fell 0.7% in April vs. March. The index rose 4.8% y/y, however.

Energy News Stories

- » **Japanese Crude Oil Imports** fell 14% y/y in Apr, while LNG imports rose 9%.

- » **China Raised** the price of jet fuel by 11.7% or 800 yuan (\$123.10) per tonne in its fifth hike since Oct last year.
- » **Another Cargo of Forties** oil loading in June was delayed due to production problems.
- » **India's Local Fuel Sales** rose 4.2% y/y in Apr to 12.63 mln tonnes. Annual crude oil imports in Apr rose 5.9% from a year ago.

ANALYSIS

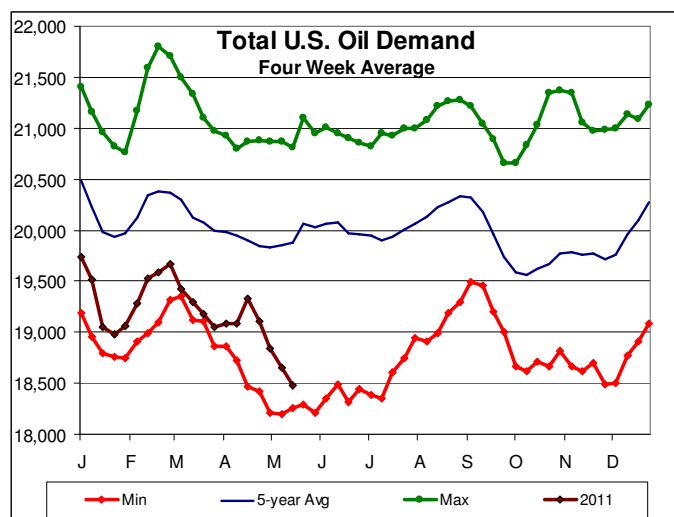
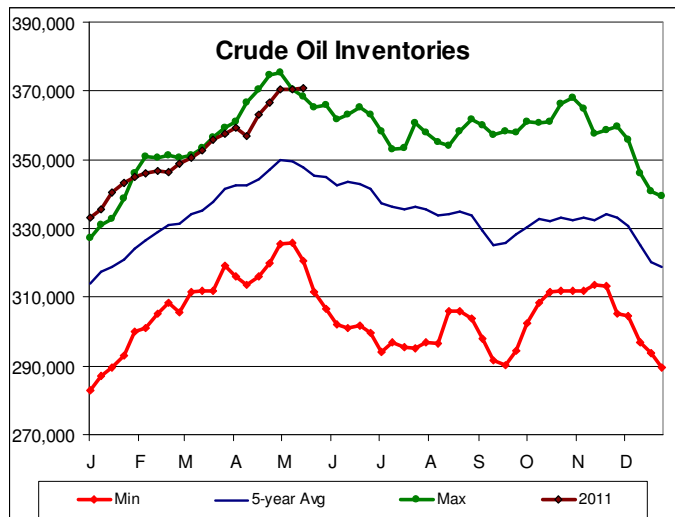
EIA Oil Inventory Preview

The EIA reported oil inventories that were above expectations across the board and created a weaker tone in energy markets upon their release. The selloff was short-lived, however, as further analysis of the numbers made it evident that the gain in refinery utilization laid the groundwork for a fall in oil inventories in coming weeks. Such a decline would also be in-line with seasonal norms. Other support came from a continued tightening in distillate stocks and a 401 kb/d increase in total demand (kb/d = '000 b/d). Cushing inventories gained just 56,000 bbls and essentially lingered about 1.8 mln bbls below the record high made six weeks earlier. Overall, we interpreted the developing tightness in distillates and potential for decline crude oil stocks as positive for those segments and factors that should keep their prices firm in the near-term. The numbers and our analysis follow below.

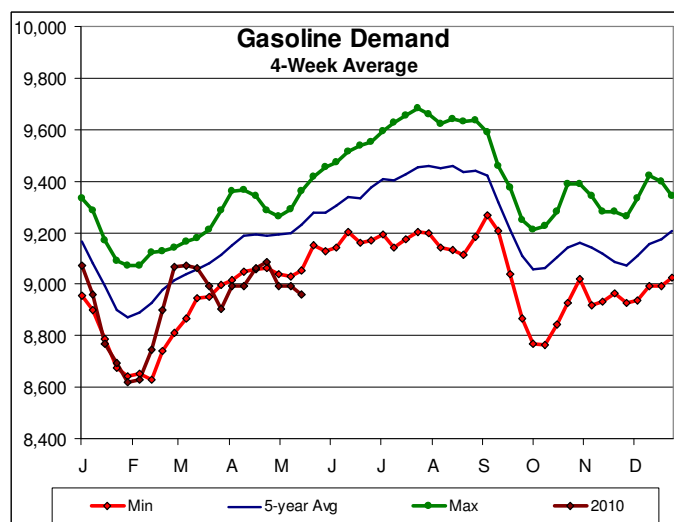
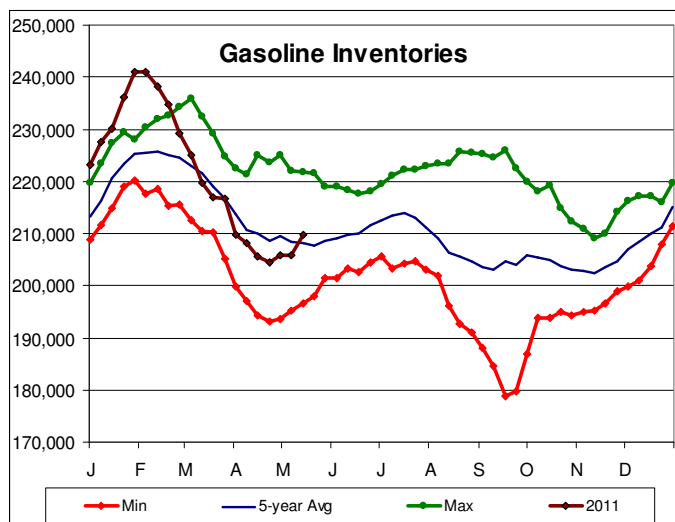
EIA Inventories - w/e May 20th						API Inventories		
	Actual	Market Estimate	MFGR Estimate	Five-Year Average	Last Week	Converge with EIA	Actual	Previous
Crude Oil	+0.6 MB	-1.3 MB	-0.5 MB	-1.7 MB	-15 KB	-2.2 MB	-0.9 MB	+2.7 MB
Gasoline	+3.8 MB	+0.3 MB	+0.5 MB	-0.4 MB	+0.1 MB	+5.3 MB	+2.4 MB	-0.7 MB
Distillates	+0.6 MB	+0.0 MB	+0.1 MB	+0.5 MB	-1.2 MB	+0.6 MB	-0.8 MB	-2.8 MB
Utilization	86.3%	+0.5%	+0.1%	+0.1%	83.2%	+0.3%	83.5%	-0.5%
Natural Gas		+94 bcf	+85 bcf	+96 bcf	+92 bcf			

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

Crude oil inventories were +0.6 MB vs. -1.3 MB expected. The gain was larger than consensus due to an increase in imports of 662 kb/d. That gain was more than offset by an increase in refinery inputs of 538 kb/d and a gain in demand of 401 kb/d, but it's possible that these factors offer a larger impact on next week's data. Crude oil stocks increased to 22.98 MB above their five-year average compared to 20.71 MB above it the previous week. On the demand side, total demand increased 401 kb/d w/w due to an increase in distillate demand of 364 kb/d and a gain in "other oils" demand of 93 kb/d. Gasoline and jet fuel demand fell. Despite the w/w increase in total demand, the four-week average fell 168 kb/d as shown in the second chart below. Looking ahead however, we expect demand to recover somewhat as gasoline prices fall from their April peak and as diesel demand continues to firm. Better demand should continue to alleviate the overhang of oil inventories from their Oct '10 peak of 44.60 MB above the five year average to 22.98 MB currently.

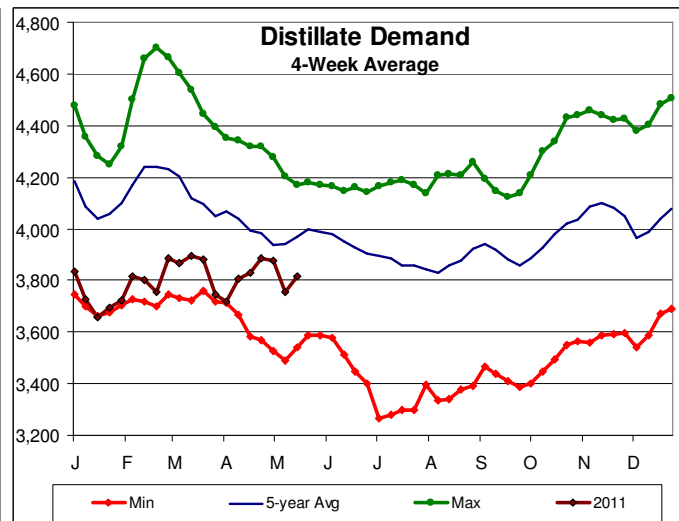
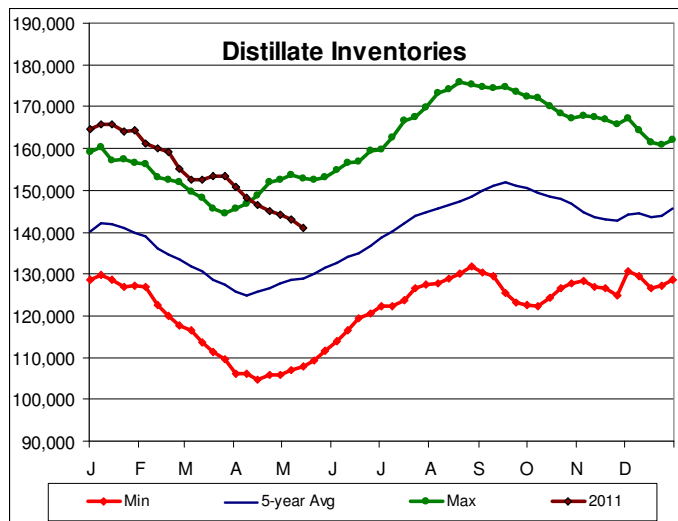


Gasoline inventories gained 3.8 MB vs. an increase of 0.5 MB expected. One of the tougher aspects of predicting gasoline stocks in the last few weeks has been the divergence with API and determining if and when the two series would converge. This week's gain may have at least partially reconciled the divergence, which had grown to +5.3 MB with API above EIA. The divergence presented a constant risk of a bearish number, which may have already been factored into the price. Gasoline inventories are now 1.66 MB above their five-year average compared to 2.50 MB below it last week. The gain was the result of a 128 kb/d increase in production, a 585 kb/d increase in imports, and a 23 kb/d decrease in demand. Demand has been weakening relative to historical trends in the last two weeks as shown in the second chart below. However, it's possible that if gasoline prices stabilize between \$3.00-\$3.50/gal this summer, demand could recover and return pressure on inventories. Overall, it's not very bearish or bullish in our opinion.



Distillate inventories gained 0.6 MB vs. an unchanged reading expected. Distillates were one of the brighter spots in the report as stocks fell to a 25-month low in what is a counter-seasonal decline (chart 1). Stocks typically reach their lowest point of the year during the second week of April, however this year's numbers have continued to drop. An EIA analyst addressed this yesterday, saying that the decline is unusual at this time of year and should return to normal patterns in coming weeks. That's certainly possible as demand for the heating oil component of distillates is

out of season and increased refinery utilization should soon be very additive. Exports of distillates have been trending lower as well, having fallen to 671 kb/d from 882 kb/d that was prevalent back in Dec '10. However, demand for diesel appears to remain strong and could act as a drag on distillate inventory growth. These numbers appear positive for distillates and should keep heating oil on the upswing against gasoline in the near-term.



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