

September 21st, 2011

MF Global Daily Report

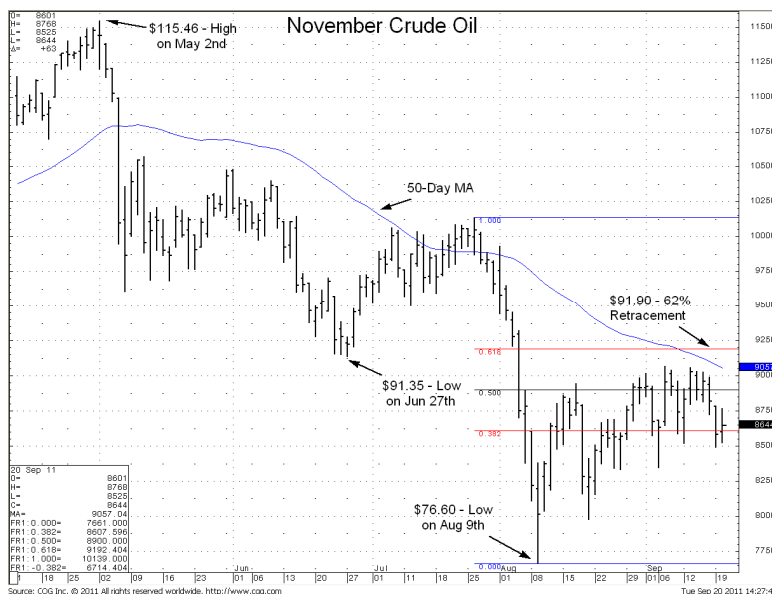
COMMODITIES | ENERGIES

Energy

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Price Outlook

Energy prices are expected to trade in a mixed-to-lower direction in the near-term. The market may receive pressure late in the day today from the potential that the FOMC disappoints expectations, poor chart action, cuts to global growth estimates by the IMF, and from our expectation that today's inventory report weighs on prices. Risks to our bias come from the possibility that Greece works out a deal to secure its next tranche of European aid for October and from yesterday's announced declines in Azeri oil exports. Yesterday's API data were mixed-to-negative in our opinion. We favor maintaining our short recommendation in the Nov Brent-WTI spread. The recommendation was entered on Aug 25th at \$24.50 and closed at \$23.62 yesterday.



The oil market will focus on the equity market's reaction to the FOMC in today's trade as well as on the weekly oil inventory figures. Both equity and energy markets have been trading firmly in the last few days on the expectation that the FOMC will engage in additional stimulus measures at today's FOMC meeting. While that speculation has helped the stock market move higher, it slightly pressured bond prices yesterday, which we think have already priced most of the impact of the measure. Background support for energies may have come from a potential deal between Greece and the Troika today and from reductions in exports from Azerbaijan. However, the FOMC results will be a key event today and may not be that supportive for energies if expectations are disappointed.

The focus on the FOMC will gravitate toward four policy options including QE3, "Operation Twist," lowering the interest rate on excess reserves (IOER), and/or changing its communication to increase certainty. QE3 is not expected to be implemented because there isn't a deflationary environment, while the IOER and communication options aren't expected to be very helpful for the economy. The most likely option is "Operation Twist," which is expected by 15 of 17 primary dealers surveyed by Reuters last week. The maneuver will sell short-term securities held by the Fed and replace them with long-term securities. The result would be that the size of the Fed's balance

sheet would not change, while the yield curve would be expected to flatten. The maneuver was carried out in the early-1960's in order to both stimulate the economy and prevent further outflows of gold which backed the dollar at the time. The impact of such a move at the current juncture could be to support the dollar, which may pressure energy prices. Pressure could also come from the fact that the size of the Fed's balance sheet won't change, thereby failing to add any likelihood of additional debt monetization and a move to hard assets.

The risks to the policy helping the economy come from the size of the effort and its effect. We've seen several estimates on the size, with a CNBC poll showing a consensus somewhere around \$391B. Another risk comes from the degree that the move has already been discounted by the market. The chart below shows that the spread between 10-year and 3-month yields has shrunk from around 3% in early-July to near 2% currently. Expectations of Twist increased over that period as did the expectations for QE3. Oil prices have traded flat since QE3 was not suggested by Fed Chairman Bernanke in his August 26th speech at Jackson Hole. The chart also shows that Twist may be priced in already, and disappointingly, the economy has gotten worse during the 2 1/2 months that the yield curve has flattened. Some refinancing of mortgages has taken place, but rates have only fallen to levels that existed a year ago during the last wave of refinancing. It may take a more significant decline in long-term rates to spark a second wave of refinancing. Another risk to Twist being a success may come from Fed members that don't want to add any additional stimulus. Several have made the suggestion that monetary policy is an ineffective tool in promoting employment and that fiscal policies need to be changed. In the end, Twist may in fact occur, but we don't anticipate that it will offer much impact on oil prices. If anything, it may be negative if the prospects of Twist have been lifting oil prices recently.



TRADE: Short Nov Brent-WTI at \$24.50, target \$10.00, risk \$26.00 (entered on Aug 25th)

Upcoming Energy Events

Wed - Oil Inventories 10:30 am EST
 Thu - Natural Gas Inventories 10:30 am EST
 Tue - API Weekly Stats 4:30 pm EST
 Sep 29th - October Products Rollover
 Dec 14-15 - OPEC Scheduled Meeting

Global Economic & Dollar News

The dollar traded fairly flat yesterday as the euro oscillated between recovery and weakness. The Greek government was expected to meet with the troika yesterday to discuss spending cuts and its next tranche of aid. An announcement is anticipated today.

- » **The Libyan War** may take years, as Gaddafi has enough arms and is willing to fight for that long, according to a Gaddafi spokesman.
- » **Greece** is expected to announce the results of the troika meeting on Wednesday. Greece made a €769M coupon payment on Tuesday.
- » **Greek Prime Minister Papandreou** is considering holding a referendum on whether Greece should exit the Eurozone. Papandreou hopes it will give his government a new mandate. The gov't also denied the report.
- » **German ZEW Index** fell to -43.3 from -37.6 previously and vs. -45.0 expected.
- » **Italy's Debt Rating** was downgraded one notch by S&P to A.
- » **The IMF** cut its U.S. growth forecast to 1.5% in 2011 from 2.5% forecasted in June. Its 2012 forecast was cut to 1.8% from 2.7%. Its forecast for advanced economies for 2011 was downgraded to 1.6% from 2.2% while 2012 was cut to 1.9% from 2.6%. Emerging economies were downgraded slightly to 6.4% from 6.6% for 2011 and to 6.1% from 6.4% for 2012.
- » **U.S. Housing Starts** were -5.0% to 571K vs. 590K expected and 601K previously. Permits were +3.2%.

Energy News Stories

- » **Azeri Oil Exports** via Russia will fall to 1.7 mln tonnes in 2012 from a planned 2.0 mln tonnes this year. The decline was based on the need to ship to Azerbaijan's domestic refineries.
- » **The ICE** said that it plans to hold a formal consultation on the Brent market in coming months.
- » **Nigeria's Crude Oil Reserves** will reach 45 bln bbls by the end of 2012 compared to 36-37 bln bbls currently.

ANALYSIS

EIA Oil Inventory Preview

The EIA's oil inventory figures are expected to show a recovery from last week's sharp 6.7 MB decline and fall only 1.0 MB this week. The five-year average shows that inventories typically fall 4.1 MB this week, however, sharp declines in 2007 tied to Hurricane Humberto and in 2008 tied to Hurricanes Gustav and Ike are mostly to blame for the sharp drop. After this week's typical 4.1 MB decline, the five-year average shows a build of 0.8 MB next week. We think that this week's inventory figures will be buoyed by a recovery in imports following Hurricane Irene on the Atlantic Coast and from TS Lee on the Gulf Coast. Imports have fallen 1.07 mb/d over the last two weeks due to the storms, but the Atlantic Coast began to show signs of recovery last week. Last week's data also showed sharp builds in product inventories which could be repeated this week due to poor demand. We anticipate builds in products of 1.0 MB apiece, but a risk comes from last week's 2.0% drop in refinery utilization which argues for lower refinery output.

Natural gas inventories are expected to build 95 bcf as temps continued their seasonal cool-down last week. The CDD forecast is 44.7, which would generate a build of around 101 bcf according to our model. We biased that downward however, as the CDD forecast is close to the 10-year normal of 44.5 while the five-year average this week is only +73 bcf. A similar CDD reading at this time last year resulted in a build of 103 bcf, however it was 45 bcf above the prior week's level and 30 bcf above the following week's and thus appeared as an outlier. Temps become colder-than-normal in the eastern third of the country going into this week and produces a CDD reading of around 30.5. Such a reading should result in an inventory build of around 122 bcf.

| EIA Inventories - w/e September 16th | | | | | | API Inventories | | |
|--------------------------------------|--------|-----------------|---------------|-------------------|-----------|-------------------|----------|----------|
| | Actual | Market Estimate | MFGR Estimate | Five-Year Average | Last Week | Converge with EIA | Actual | Previous |
| Crude Oil | | -0.7 MB | -1.0 MB | -4.1 MB | -6.7 MB | +0.3 MB | +2.6 MB | -5.1 MB |
| Gasoline | | +1.0 MB | +1.0 MB | -0.5 MB | +1.9 MB | +2.0 MB | +0.06 MB | +2.8 MB |

| | | | | | | | | | |
|-------------|--|---------|---------|---------|---------|--|---------|----------|---------|
| Distillates | | +1.2 MB | +1.0 MB | +1.3 MB | +1.7 MB | | -1.3 MB | +0.08 MB | +0.1 MB |
| Utilization | | -0.9% | +0.2% | -0.5% | 87.0% | | -2.5% | 84.4% | 83.9% |
| Natural Gas | | +90 bcf | +95 bcf | +73 bcf | +87 bcf | | | | |

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

