

CRUDE OIL



WHY DID CRUDE MADE A HISTORY YESTERDAY?

This was because the futures contracts expired yesterday. Those not intending to take physical delivery had to square off their contracts before the expiry date. So, speculators who did not want to take delivery in May proceeded to unwind their “positions,” leading to the massive fall in prices.

WILL THIS DRASTIC FALL REPEAT?

The answer is may be NO, and that’s the reason crude prices are in contango. In other words, far month contracts are trading higher than the near and the current month. Contango trades happen when traders anticipate a surge or rise in demand and hence value the commodity higher for the future.

WHAT DID MARKET PARTICIPANTS DO IN PAST, WHEN SUCH INSTANCE HAD HAPPENED?

During Iraq’s invasion of Kuwait in 1990 when a trader took massive positions at cheap prices ahead of the invasion and sold them when prices rose after the invasion. Oil was stored in tankers floating on the sea and unloaded at considerably higher prices.

WHAT ABOUT THE DEMAND SCENARIO, AROUND HE HISTORIC LOWS?

The demand is rising slowly & steadily. Infact, the Year-long hiring contracts for VLCC (very large crude carriers) that can store up to 2 million barrels of oil are soaring through the roof. According to a report in the Wall Street Journal, VLCC hiring charges for year-long contracts are now at \$72,500 a day, compared to \$30,500 a day a year ago. This shows rising demand for such floating storage to take advantage of low prices now.

WHERE ARE THEY STORING?

These tankers are moored off the South African coast, which is equidistant to the American and Asian markets. According to some estimates, over 140 million barrels of oil are now floating in the high seas. The world consumed, at its heyday, about 90 million barrels of oil a day.

WILL CRUDE BE IN CONTANGO?

YES, the probabilities are higher. The reason behind is that the traders expect demand to recover by June as lockdowns are lifted across the world and economic activity resumes. Second, traders also expect that storage space may be created as existing inventory is drawn down. America is also talking of adding to their strategic storage by taking advantage of the low prices. This could create demand for oil. Infact, data from barchart shows that Crude Oil WTI is trading in contango from June 2020, trading near 20.38 till July 2028 50.12 dollars per barrel.

TECHNICAL ANALYSIS...GOING FORWARD



Source:Reuters

In this scenario, it is very difficult to identify the bottom of any commodity, but it is more difficult in case of crude when we are witnessing sharp downward rally. Based on monthly charts, it has formed the formation of higher high & lower low, where higher high is \$65.40 considered as strong resistance, whereas lower low is \$17.12 during 2001 is support as of now. But break & sustain below the level make the correction towards \$10.75, witnessed in 1998.

If we are taking a horizon of one year investment, then we can accumulate positions in the range of \$10-14 & expect a reversal till \$46.40. The RSI is showing a bearish divergence from 1998 which was 32 and now it is 27. Going ahead, we may witness more fall in the counter till the low level of 1998. There is no reversal signal as of now on charts, even on shorter time frame, which further confirms that this bearishness is likely to continue. Technical indicators also suggest that there is a huge volatility.

As mentioned above in the fundamentals, currently we are in contango, hence we can buy MCX crude June contract & Sell May contract for shorter time frame. For longer horizon, we can accumulate long positions in the range of \$10-14 for the target of \$56, keeping a stop loss of \$7 on monthly closing basis.Q

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