Weekly Market Summary

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The Oil Rout Simply Can't Go On Forever!! At Least, One Can Hope So?!

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Latest Update on Coronavirus: Confirmed cases last at 2.747 million (versus 2.197 million last Friday), 191,900 deaths (versus 147,500). The COVID-19 is now affecting 210 countries and territories around the world (same as last week). A Stat News report - released by accident yesterday – suggests that trial results for Remdesivir showed that the experimental drug being tested as a treatment for Covid-19 did not speed up improvement in patients in China or prevented them from dying! Additionally, President Trump's comments on injecting bleach to kill the coronavirus have sparked concern among experts who are calling it a "ridiculous concept" that would damage the lungs. On the positive side, Spain (second hardest hit country after the USA) had its fewest deaths in five weeks and the US House overwhelmingly passed a $484 billion coronavirus aid package (4th bill) yesterday and sent it to President Trump, who will sign it later today.

The global economy is being hit by "three big shocks" -- a housing recession, a financial crisis and rising inflation -- making economic forecasting even more difficult than usual, according to economists at Lehman Brothers Holdings Inc. "The economic outlook at present appears to be unusually uncertain," writes Paul Sheard, global chief economist at Lehman in New York, in a recent commentary.

The above is not fiction! The date is late June 2008 and global markets are in a semi-panic mode, watching US foreclosures spike, credit conditions markedly tighten and inflation expectations move sharply higher on soaring commodities (yes indeed! There was a time – not long ago – when commodity prices would move higher 😊). Specifically, oil prices have doubled over the previous year as investors sought refuge from a declining US dollar, while reports are emerging that Israel carried a rehearsal for a potential bombing attack on nuclear targets in Iran (the latter – OPEC's second biggest oil producer – asserting that it would respond to an Israeli attack with a "heavy blow"!). Crude oil for July delivery was trading at a record US$ 139.89 on June 16th, and Saudi Arabia, the world's largest exporter of oil, was gathering producers, oil companies and consuming governments for an emergency meeting in Jeddah to discuss surging prices and possibly announce output increases of between 300,000 and 500,000 barrels a day, according to OPEC and media reports.

To make things worst (or a tiny bit more surreal), Goldman Sachs group Inc. analysts - led by Arjun N. Murti – have released a super-bullish report, stating "*the possibility of US$150-US$200 per barrel seems increasingly likely over the next six to 24 months, though the ultimate peak in oil prices as well as the remaining duration of the up-cycle remains a major uncertainty*," with Alexei Miller, the chief executive officer of OAO Gazprom – the world's biggest natural gas company – adding that such scenario may not be unimaginable and going further in predicting (on June 10th) that crude prices would soon climb to US$ 250 a barrel. In turn, some investors bet on Miller's forecast with at least 3,000 options contracts purchased that give holders the right to buy oil at $250 a barrel in December. (these options closing at 64 cents on June 13th!)

The rest is history! On September 15th, 2008 Lehman Brothers – the fourth-largest U.S. investment bank at the time of its collapse with 25,000 employees worldwide - filed for bankruptcy. With $639 billion in assets and $619 billion in debt, Lehman's bankruptcy filing was the largest in history, as its assets far surpassed those of previous bankrupt giants such as WorldCom and Enron. That in turn was followed by what is now perceived to have been the worst financial crisis since the Great Depression of 1929-1930! Oil had earlier peaked at US$ 147.30 (July 11th, 2008); Yet by late December, prices had collapsed some 70% and were hovering around US$ 40. Clearly, demand for the black gold had not fallen that much but did anyone really thought that prices of oil are solely set by the supply/demand curves?! They are the product of an extremely volatile mixture of speculation, oil production, weather, government policies, health of the global economy, geopolitical uncertainties, strength/weakness of the US dollar, investors' herd mentality, etc… After all, oil is so much more than a fuel. It is a force even bigger than its $3.4 trillion market. It is a weapon, a strategic asset, a curse. It is a maker and spoiler of fortunes, a leading indicator and an echo chamber!!

Fast forward to the 2010-2014 period: An improvement in global growth prospects and trillions of new money added to the financial system by central bankers (various Quantitative Easing programs) was resulting in a sustained jump in oil prices above the US$100 mark, even as China was starting to show tentative signs of an upcoming slowdown and as Americans and Europeans drove fewer miles in more efficient cars that curb consumption of gasoline, the biggest source of oil demand. Meanwhile, oil supplies had continued expanding as the higher prices made techniques such as deep-water drilling and fracking pay off (the flourishing US Shale industry). However, market fundamentals rapidly worsened in the summer of 2014, with Chinese imports sagging and European growth stalling, whilst a stronger U.S. economy made barrels priced in dollars relatively more expensive and resulted in a general drop in commodity prices. Instead of reducing the supply glut by pumping less oil, Middle Eastern exporters engaged in a price war to defend their market share. At its crucial November 27th 2014 meeting, the 12-nation Organization of Petroleum Exporting Countries ("OPEC") kept its output target unchanged even as oil was witnessing its steepest slump since the global recession, prompting speculation it had abandoned its role as a swing producer. "*We will produce 30 million barrels a day for the next 6 months, and we will watch to see how the market behaves*," OPEC Secretary-General Abdalla El-Badri told reporters in Vienna after the meeting. "*We are not sending any signals to anybody, we just try to have a fair price*." At the same time, U.S. shale output had proved resilient as drillers cut costs and focus on the best terrain, though their limits were also starting to show (idling rigs at a fast pace, cutting thousands of workers and tens of billions of dollars in capex spending).

Going into this week, Saudi Arabia and Russia had signalled their openness to further output cuts after an earlier OPEC++ deal to curb oil supplies had failed to stem crude's downward spiral. After all, oil had dropped close to 17% since the agreement to trim worldwide production by an unprecedented 9.7 million barrels a day was signed in place a week earlier (May and June WTI futures contract closing last Friday at $18.27 and $25.03 respectively, whilst June Brent finished the previous week at $28.08). The two nations will "continue to closely monitor the oil market and are prepared to take further measures jointly with OPEC+ and other producers if these are deemed necessary," Russian Energy Minister Alexander Novak and his Saudi counterpart Prince AbdulAziz bin Salman had noted in a joint statement published after a weekend phone call.

The Grand Finale: Black Monday, 20th April 2020!!

Of all the wild, unprecedented swings in financial markets / assets since the coronavirus pandemic broke out, none has been more jaw-dropping and bizarre than last Monday's collapse in a key segment of U.S. oil trading. The price on the May futures contract for West Texas crude that was due to expire Tuesday fell into negative territory, settling on Monday evening at minus $37.63 a barrel and implying that traders were willing to pay buyers to take those contracts off their hands! (the low on the day was -$40.32, although it rallied nicely the next day and finally settled at +$10.01). With the coronavirus pandemic bringing the global economy to a standstill, there was so much unused oil that American energy companies were starting to run out of room to store it; And if there is no place to put the oil, no one wants a crude contract that would soon come due for physical barrels' delivery.

The main issue at this point in time is that few believe the sharp slowdown facing the global economy as a result of the coronavirus will soon go away. It was just over a week back that the IMF had forecast the worst global downturn since the Great Depression. "*There is little to prevent the physical market from the further acute downside path over the near term*," said Michael Tran, managing director of global energy strategy at RBC Capital Markets. "*Refiners are rejecting barrels at a historic pace and with U.S. storage levels sprinting to the brim, market forces will inflict further pain until either we hit rock-bottom, or COVID clears, whichever comes first, but it looks like the former*."

With no end in sight, and producers around the world continuing to pump – albeit at a slower pace in coming months - fire-sale among traders who do not have access to storage can be expected to continue. "*The background psychology right now is just massively bearish,*" Michael Lynch, president of Strategic Energy & Economic Research Inc said in a phone interview. "*People are concerned that we are going to see so much build-up of inventory that it is going to be very difficult to fix in the near term and there is going to be a lot of distressed cargoes on the market*".

At this point in time, one can only hope that the worst is behind us when it comes to the coronavirus pandemic and that economies will ease existing lockdowns over the coming months. Even if true, however, it is unlikely the economy will bounce back to "*normal*" with the flick of a switch and surely more likely that the virus will reshape sectors that make up the majority of oil demand (air travel, public transport, online activities, etc..). As a result, a sharp rally in oil prices from current depressed levels seems unlikely in the cards – at least not over the near future.

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