

BIZ INSIGHT

Risks of the oil game

SPECIAL TO THE NATION

THE WEST TEXAS INTERMEDIATE (WTI) CRUDE oil price rapidly rose to US\$48.37 (Bt1,687) a barrel last week for a 8.45 per cent jump. Correspondingly, the price of Brent crude oil surged to \$49.06 a barrel – a 6.9 per cent gain.

This surge is a response to the event that occurred on September 28. The shocking news consisted of OPEC's agreement to cut output for the first time since 2008. The new deal will limit production to just 32.5 million-33 million barrels a day, while the current output is 33.7 million barrels.

This may be the news everyone has been waiting for, potentially signalling the oil market recovery due to better fundamentals. But it is much more complicated than that.

When dissecting the oil market, investors would have noticed an ongoing pattern – producers desire a surge in price, while speculators pray for a downfall. Hedge funds and many others have shorted their positions in futures of WTI and the US crude oil benchmark, merely to find out that the OPEC oil cartel and Russia have froze production.

This resulted in chaos for many funds, with their short positions affecting spot oil prices.

Since September 28, the oil price has increased 5.32 per cent and there have been 24,131 new contracts going long in NYMEX crude oil, according to *Bloomberg*.

The important message is that the oil market is full of speculators, leading to high volatility. Therefore it makes the market more attractive. Furthermore, people forecast a bull market to make short-term profits.

However, there are only a handful of people who are willing to focus on the fundamental issues of supply and demand, which will have a significant impact in the long run.

The factor of uncertainty that requires an investor's attention is the determination level of OPEC's policy

to limit production. As we experienced in the recent violation of OPEC's agreement of overproduction. However, there is a likelihood of internal conflict among OPEC members arising from some countries being exempted from the production-limit agreement, such as Iran, Libya and Nigeria.

Another concern that may prevent oil prices recovering is the volume of the US's aggregate inventory and shale oil. The abolition of the law prohibiting crude oil export has established America as a new oil exporter.

Regarding the uptrend in oil prices, the US has emerged with its production, once again due to a favourable environment in shale oil production. Correspondingly, this reflects the rise of Baker Huger Rig Count from 404 in June to 522 (source: Baker Huger).

Russia is the only other country other than the US which produces a record of 11.11 million barrels a day, but there is still optimism to produce more as the ruble weakens and tax benefits are offered to oil producers.

Moreover, the fragility of the world's economic recovery has restricted the demands for oil at an unfavourable level. This increases the possibilities of a negative impact on oil prices caused by exchange rates associated with the uncertain monetary policies of major central banks around the world. However, developments in these factors are yet to be thoroughly observed.

Asset Plus's year-end oil price forecast will be within the range of \$45 and \$55 a barrel. We anticipate certain implementations of OPEC's agreement to limit production and the tendency of US and Russian production increase to become the two major price influencers.

Investment contains risk. Investors should study prospectuses, product features, return conditions and risk before investing.

Contributed by Asset Plus Fund Management