

## >: If You're Quick, You Can Still Get Into This Super Hot Market

Monday, June 15, 2009 / Barbara Cohen

A few weeks ago, I wrote an article for you, showing how we are all directly affected by [Crude Futures prices](#). To continue, let's look at actually trading Crude Oil Futures, one of the hottest Markets today.

If you think that Crude Oil has already made its move and it's too late to get in, you might just be very (pleasantly) surprised.

First, let's look at Crude Oil Futures basics. Unlike most other futures, which trade on the Chicago Mercantile Exchange, Light Sweet Crude Oil trades on the New York Mercantile Exchange (NYMEX).

As an individual investor, you'll probably be most interested in the QM. Like the S&P 500 ES, the QM is also an e-mini, or e-miNY. Also like the ES, the QM is available on the Globex trading platform. That means most desktop trading platforms will be able to allow you to trade over the internet.

There is another crude oil contract, the CL, but as an individual investor, the margin requirements would be too high. Moreover, there is significantly more volume / liquidity trading the QM than trading the CL. Lower liquidity generally means higher "slippage" entering and exiting trades.

Trading hours for the QM are from 6:00pm Sunday through 5:15pm Friday, with a 45-minute daily break between 5:15 and 6:00pm for swapping servers and settlement.

If you intend to daytrade the QM, you'll find many futures brokerages ready to service your account. Depending on the level of support you need as a trader, daytrading margin requirements / contract vary from \$500 to \$800/contract. That means you'll need at least \$500 in your account to trade 1 e-miNY contract as long as you exit your trade by 5:15. If you intend to hold the contracts overnight, it is far more expensive, roughly \$4000/contract.

Like the ES, the QM has a tick value of \$12.50. The ES trades in 25 cent increments. The QM trades in .025 increments, but still pays out \$12.50 / tick. Commissions vary depending upon the brokerage, but expect to pay somewhere around \$3.50-\$4.00 per contract.

So why is trading the Light Crude "Super Hot?" Two reasons ...

**First.** Every Wednesday at 10:30am EST, the Crude Oil report is released. For a few minutes, trading the QM is the hottest trade in town. And this happens every Wednesday.

**Second.** Crude Oil continues to rise. Two months ago I had lunch with a Crude Oil professional (he actually inspects and certifies oil rigs), who also trades Crude Oil Futures Options. He told me that Crude Oil would reach \$70/barrel by summer, and he was long Crude Oil Futures Options. Crude has already surpassed \$70 in June ... levels we hadn't seen since last October. The Energy Department revised its price estimate for Light Sweet Crude. At the end of May, the estimate was \$55 / barrel for the second half of 2009. The revised estimate is \$67 / barrel, and we have already surpassed that.

Why is Crude Oil rising so fast? Because of the money flow from Wall Street. Investors are using oil as a hedge against a weak dollar. With the US Government spending billions on bailouts, the Dollar has fallen against other currencies (EURO, Pound, etc.). A falling Dollar attracts investors to Crude. An analyst from a leading Futures clearing firm, Alaron Trading Corp, Phil Flynn, said that the Dollar "seems to be driving the price of oil again."

As the Stock Market recovers, Crude Oil is rising alongside.

And the predictions? Goldman Sachs is predicting \$85 / barrel for 2009. Goldman analysts Jeffrey Currie in London and David Greely in New York wrote "As the financial crisis eases, an energy shortage lies ahead."

Russia's Gazprom which supplies 1/4 of Europe's natural gas, expects crude oil to almost double within 18 months. Chief Executive Alexei Miller, at a presentation in France, said "We think it will reach \$250 a barrel in the foreseeable future." He said high demand, not speculation, would raise the price of crude. Crude oil demand is rising as China's manufacturing expands for a third month, and the nation raises fuel prices. This is the

second raise for China this year, enabling its oil refiners to pass on climbing crude oil costs.

With Crude rising quickly, if you think you missed this "*hot market*"... think again. We're only at \$71 / barrel and we have a long way to go.



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## **Economic Calendar for the Week of June 15 - 19**

### **TUESDAY, JUNE 16**

#### ***8:30 a.m. - Housing Starts, Building Permits***

- Importance (A-F): This release merits a B-.
- Source: The Census Bureau of the Department of Commerce
- Release Time: 8:30 ET around the 16th of the month (data for one month prior).
- Raw Data Available At: <http://www.census.gov/const/www/newresconstindex.html>.

Housing Starts are a measure of the number of residential units on which construction is begun each month. A start in construction is defined as the beginning of excavation of the foundation for the building and is comprised primarily of residential housing. Building permits are permits taken out in order to allow excavation. An increase in building permits and starts usually occurs a few months after a reduction in mortgage rates. Permits lead starts, but permits are not required in all regions of the country, and the level of permits therefore tends to be less than the level of starts over time.

The monthly national report is broken down by region: Northeast, Midwest, South, and West. Briefing recommends analyzing the regional data because they are subject to a high degree of volatility. The high volatility can be attributed to weather changes and/or natural disasters. For example, an unexpectedly high level of rain in South could delay housing starts for the region.

#### **Key Factors**

- The housing starts and building permits data were awful economically speaking.
- The only upside from the April data is that the reduced level of starts and permits means there will be less competition for existing homes currently on the market. Still, with the glut of unsold homes, any new starts are just going to extend the recovery process.

#### **Big Picture**

Housing starts are at extremely low levels and the outlook is not likely to improve any time soon due to high levels of inventories of unsold new homes. An uptrend in construction will require an improvement in employment and income, and then take some time as inventories need to be reduced. Government action to boost mortgage lending may also help, and starts might stabilize in the second half of the year.

### ***8:30 a.m. - PPI, Core PPI***

- Importance (A-F): This release merits a B-.
- Source: Bureau of Labor statistics, U.S. Department of Labor.
- Release Time: Around the 11th of each month at 8:30 ET for the prior month.
- Raw Data Available At: <http://stats.bls.gov/news.release/ppi.toc.htm>.

The Producer Price Index measures prices of goods at the wholesale level. There are three broad subcategories within PPI: crude, intermediate, and finished. The market tracks the finished goods index most closely, as it represents prices for goods that are ready for sale to the end user. Goods prices at the crude and intermediate stages of production often provide an indication of coming (dis)inflationary pressures, but the closer you get to crude goods, the more that these prices track commodity prices which are already available in traded indexes such as the CRB (Commodity Research Bureau).

At all stages of production, the market places more emphasis on the index excluding food and energy, referred to as the core rate. Food and energy prices tend to be quite volatile and obscure trends in the underlying inflation rate. Though the market reaction is determined by the month/month changes, year/year changes are also noted by analysts. The index is not revised on a monthly basis, but annual revisions to seasonal adjustment factors can produce small adjustments to past releases.

### **Big Picture**

PPI trends were highly volatile in 2008, mirroring the trends in global oil prices. In early 2009, the core rate will rise modestly if at all, while energy prices could stabilize. That would leave PPI near flat. Falling global commodity prices and weak economic demand will keep inflation in check at the producer level. If global economies remain weak in 2009, as is widely expected, inflation at the producer level will be insignificant. There may even be concerns about global deflation.

### ***9:15 a.m. - Capacity Utilization, Industrial Production***

- Importance (A-F): This release merits a B-.
- Source: Federal Reserve.
- Release Time: 9:15 ET around the 15th of the month (data for month prior).
- Raw Data Available At: <http://www.federalreserve.gov/releases/G17/Current/g17.txt>.

The index of Industrial Production is a fixed-weight measure of the physical output of the nation's factories, mines, and utilities. Manufacturing production, the largest component of the total, can be accurately predicted using total manufacturing hours worked from the employment report. One of the bigger wildcards in this report is utility production, which can be quite volatile due to swings in the weather. Severe hot or cold spells

can boost production as increased heating/cooling needs drive utility production up.

In addition to production, this monthly report also provides a measure of capacity utilization. Though the rate of capacity utilization is seen as a critical gauge of the slack available in the economy, the market does not completely trust this measure. Capacity is very difficult to measure, and the Fed essentially assumes that growth in capacity in any given year follows a straight line. One can therefore predict the capacity utilization rate quite accurately based on the assumption for production growth. The 85% mark is seen as a key barrier over which inflationary pressures are generated, but given revisions to these data and the difficulties with capacity measurement, the 85% mark should be viewed cautiously. It would be appropriate to look for corroborating inflation indications from commodity prices and vendor deliveries.

## **WEDNESDAY, JUNE 17**

### ***8:30 a.m. - CPI, Core CPI***

- Importance (A-F): This release merits a B .
- Source: Bureau of Labor statistics, U.S. Department of Labor.
- Release Time: 8:30 ET, about the 13th of each month for the prior month.
- Raw Data Available At: <http://stats.bls.gov/news.release/cpi.toc.htm>.

The Consumer Price Index is a measure of the price level of a fixed market basket of goods and services purchased by consumers. CPI is the most widely cited inflation indicator, and it is used to calculate cost of living adjustments for government programs and it is the basis of COLAs for many private labor agreements as well. It has been criticized for overstating inflation, because it does not adjust for substitution effects and because the fixed basket does not reflect price changes in new technology goods which are often declining in price. Despite these criticisms, it remains the benchmark inflation index.

CPI can be greatly influenced in any given month by a movement in volatile food and energy prices. Therefore, it is important to look at CPI excluding food and energy, commonly called the "core rate" of inflation. Within the core rate, some of the more volatile and closely watched components are apparel, tobacco, airfares, and new cars. In addition to tracking the month/month changes in core CPI, the year/year change in core CPI is seen by most economists as the best measure of the underlying inflation rate.

### **Big Picture**

Inflation trends have weakened and might weaken further as 2009 progresses. The decline in energy prices after the summer spike has taken CPI down to -0.7% on a year-over-year basis as of April 2009 data. Energy prices may not continue lower, but the core rate should ease from its 1.9% year-over-year rate due to weak demand. Low inflation rates are likely to continue through 2009 although deflation is not likely.

## **THURSDAY, JUNE 18**

### ***8:30 a.m. - Initial Claims***

- Importance (A-F): This release merits a C .
- Source: The Employment and Training Administration of the Department of Labor.
- Release Time: 8:30 ET each Thursday (data for week ended prior Saturday).
- Raw Data Available At: <http://www.dol.gov/opa/media/press/eta/main.htm>.

Initial jobless claims measure the number of filings for state jobless benefits. This report provides a timely, but often misleading, indicator of the direction of the economy, with increases (decreases) in claims potential signaling slowing (accelerating) job growth. On a week-to-week basis, claims are quite volatile, and many analysts therefore track a four week moving average to get a better sense of the underlying trend. It typically takes a sustained move of at least 30K in claims to signal a meaningful change in job growth.

There are two other statistics in this report -- the number of people receiving state benefits and the insured unemployment rate; neither is watched closely by the market. Some analysts track the number of people receiving state benefits from month to month as a guide for job growth, though this series has a poor track record in predicting the monthly employment report. The insured unemployment rate changes little on a weekly basis and is never a factor for the market.

### ***10:00 a.m. - Leading Indicators***

- Importance (A-F): This release merits a C-.
- Source: The Conference Board.
- Release Time: 10:00 ET around the third week of the month for the month prior.
- Raw Data Available At: <http://www.tcb-indicators.org/>.

The Leading Indicators report is, for the most part, a compendium of previously announced economic indicators: new orders, jobless claims, money supply, average workweek, building permits, and stock prices. Therefore, the report is extremely predictable and of very little interest to the market. Though this series does have some predictive qualities, it is a common criticism that it has predicted "nine of the last six" recessions.

The Commerce Department previously published the leading indicators series. The collection and publishing of these data is now done by the non-profit Conference Board, which also produces the Consumer Confidence index.

### ***10:00 a.m. - Philadelphia Fed***

- Importance (A-F): The Philadelphia Fed Index merits a B.
- Source: The Philadelphia Federal Reserve bank.
- Release Time: Third Thursday of the month at 12 ET for the current month.
- Raw Data Available At: <http://www.phil.frb.org/>

There are many regional manufacturing surveys, and they tend to be ranked in order of timeliness and the importance of the region. The Philadelphia Fed's survey is first each month, actually coming out during the third week of the month for which it is reporting. Several smaller surveys are then released before the Chicago

purchasing managers' report on the last day of each month. A few, such as the Atlanta and Richmond Fed surveys, are released after the NAPM and are of little value. The purchasing managers' reports are measured like the national NAPM - 50% marks the breakeven line between an expanding and contracting manufacturing sector. For the Philadelphia and Atlanta Fed indexes, 0 is the breakeven mark.

These surveys can be of some help in forecasting the national NAPM - particularly the Philadelphia and Chicago surveys which are more closely watched due to their timeliness and the fact that these regions represent a reasonable cross section of national manufacturing activities.