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OIL SHOCKU

The following pages outline our strategy and tactics on what was thought to be the potential for a cyclical high in crude oil prices.

Coming out of the stock and lower grade bond panic of October, 2002, a cyclical bull market and a cyclical recovery for business was possible. Since earlier in the year, we have identified the speculative highs as they occurred for the senior stock indexes as well as the sequence of commodity blowoffs starting with nickel in January, with the latest being crude oil at 49.40 on August 20.

COMMENTS FOR ENERGY PRODUCERS

August 11, 2004

The seasonal model has served well this year. An intermediate low for crude was possible in the late June – early July window and the low was 35.66 on June 29.

The rally since has been likely to run until early October, but there is something in the charts Ross sees that suggests that the intermediate high could be accomplished by the end of August.

Either way, no matter how compelling crude becomes, Mr. Seasonality can overwhelm most degrees of geo-political hysteria.

He has been doing a rather good job on natural gas with its usual high in June (6.58 June 17), from which an intermediate decline follows. So far, the low has been 5.59 on Friday, which amounted to an unheralded drop of 15%.

Technically, the ChartWorks needed strength in oil stocks to continue this week to accomplish a certain topping pattern. The success of this will be advised next week. That's on representative indexes in both Canada and the U.S.

ENERGY MARKET

August 18, 2004

- The August 11 Pivotal Events outlined the requirements for a top in the energy mania.
- Within this, oil stock indexes (both Canadian and U.S.) would need to extend their rally.
- These, as well as crude oil itself, have accomplished the "Sequential Pattern", from which significant declines have followed.
- As an inside target, Ross has had around August 23 as the topping day.

Wrap: Out of the probable low in the late June – early July target (low 35.66 on June 29), crude was expected to recover until early October.

On July 23, the possibility of a top by late August was introduced. This seems to be the case and, as some of the requirements have been met, traders and investors could begin selling.

INSTITUTIONAL ADVISORS

AUGUST 30, 2004

OIL SHOCKU ?

In the 1970s, Japan enjoyed a uniquely thriving economy that, in retrospect, was extremely vulnerable to soaring crude oil prices.

The setback, when it came, was severe and immediately described as the "Oil Shocku". The late and great political cartoonist, William McNeily, had a good one with various leading characters, all pointing fingers in every direction. The caption read in huge letters "THE BLAME".

Although the current decline in crude is becoming oversold, it is likely the start of a bear market that could be severe enough to be described as another "Oil Shocku" – only this time to producers rather than consumers.

Our chart on crude oil goes back to 1912 and there have been only three rapid collapses in price. Two were in the early 1930s and the most distinctive since started in late 1985.

In that year, our model expected base metals to suffer a cyclical decline well into 1986. However, with something entirely different in mind, the cartels were ramping up crude oil and tin prices. Both were quasi-government price-rigging adventures and were euphemistically called OPEC and the Tin Council.

At the time, these agencies enjoyed great regard and occasionally everyone was focused on the OPEC head Sheik Yemani. As some wag phrased it, his utterances attracted as much attention as a cross-eyed javelin thrower at the Olympics.

We have a hazy recollection that we made a good call on that oil plunge and this was confirmed by reviewing the key monthly publications. The following excerpts plot the course to crude's failure. One of the guides was the action in base metals.

***Base Metals:** As mentioned in the June/85 Comment, a pause in July and August was expected in the basic downtrend for base metals. Copper, lead, and zinc quotes have been steady. However, with a cartel, that lately has been more successful than OPEC, the Tin Council has engineered rather a good short squeeze in tin – so much so that a squabble has arisen between the Council and the London Metal Exchange. It seems that some members were caught on the wrong side of the market.*

As with any other commodity in a similar squeeze, the bids disappear once the crunch is over. A collapse in tin could create significant financial pressures within south-east Asia as well as upon London financial markets. Base metals will soon resume their downtrend to a cyclical low later in 1986.

– August 18, 1985

As it turned out, the Tin Council defaulted on October 24, 1985 and the Bank of England had to provide liquidity to the devastated LME. Our next publication in November concluded:

***Petroleum:** Nothing much to add to the past few Comments about short supplies at the refined end and a compelling need to sell at the producers' end. Should the fallout from the tin crisis be severe, patience with other pricing agreements [i.e. OPEC] could diminish. With the probability of resumed strength in the dollar in the New Year and the end of the heating season, crude prices could come under pressure. With a cyclical [low] for most commodities not expected until the last part of 1986, perhaps this laggard will catch up and compress a couple of years of decline into a few breathtaking months.*

– November 18, 1985

Crude's price plunged from a high of 32 in late November, 1985 to the low of 9.75 in April, 1986. That's -70% in only 4 months.

On the same move, wholesale gasoline prices crashed 64% from 92 to 33 cents per gallon.

The speed of that crash had much to do with the sudden loss of belief that OPEC could hold prices at high levels and that base metals were already in a significant decline. That break was foreshadowed by the reversal in tin.

Nowadays, other than central banking, quasi-official cartels don't command the same respect as they did in the early 1980s. However, there are strong convictions that the Fed can depreciate the dollar "forever" and that China's boom as well as geo-political risks have not been fully discounted – yet. In the meantime, crude's August high was preceded by speculative spikes in nickel and the Baltic Freight Rate earlier in the year.

A choppy but nevertheless cyclical decline in energy prices seems likely. This will be set by the usual seasonal rebound into early October, which could be a dramatic "test" of the highs.

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