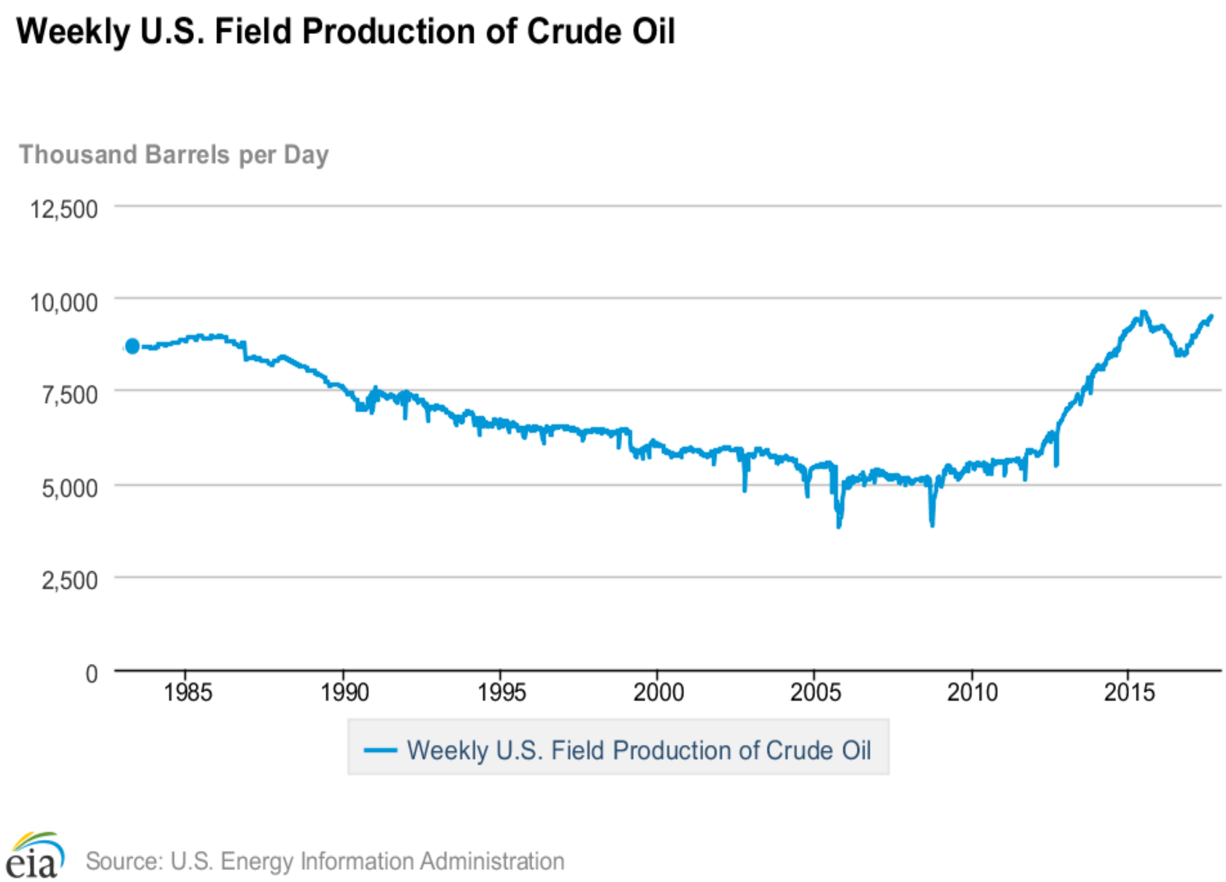
Archer Financial Services, Inc.

Crude Oil Divergence

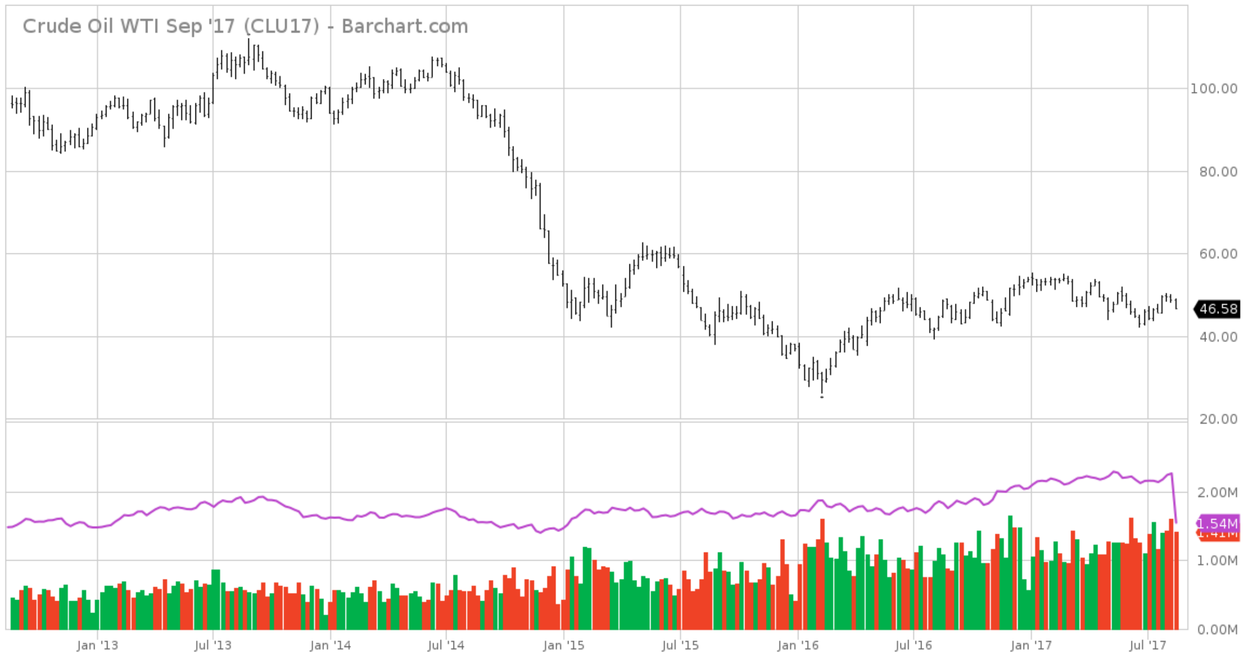
By Matthew Krupski (Aug 18)

Crude oil inventories and prices have exhibited interesting behavior over the past five months. Despite steadily declining inventories since March, crude oil prices are actually lower today. Let's examine recent crude oil supply/demand history to see if we can determine what's behind this divergence.

Since fracking technologies unlocked more domestic oil supplies, the United States has steadily increased its production.

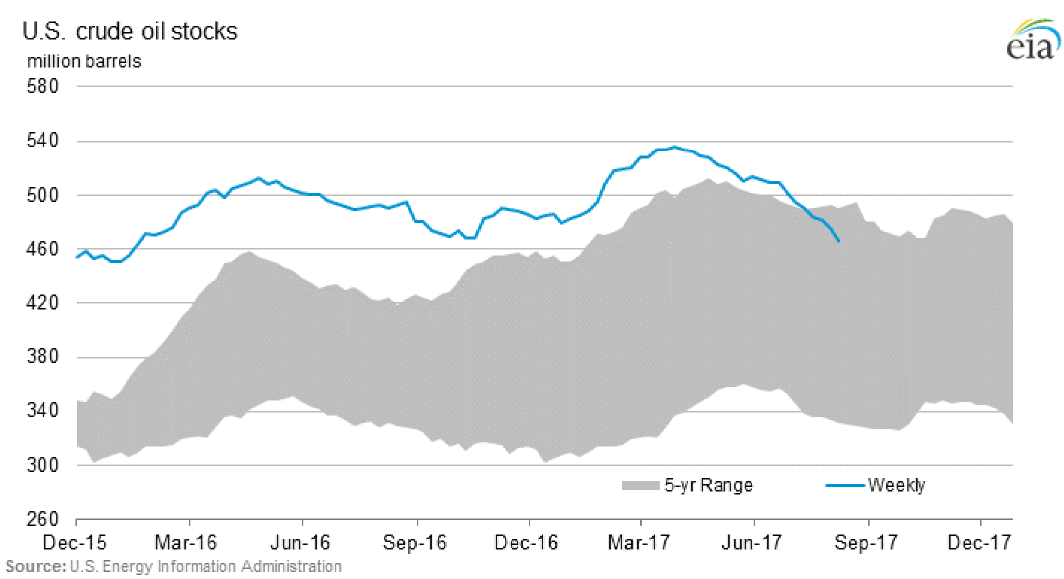


As production increased from 2010 to 2015, stockpiles began to build and prices eventually responded. Between 2014 and today, crude oil prices have been cut in half.

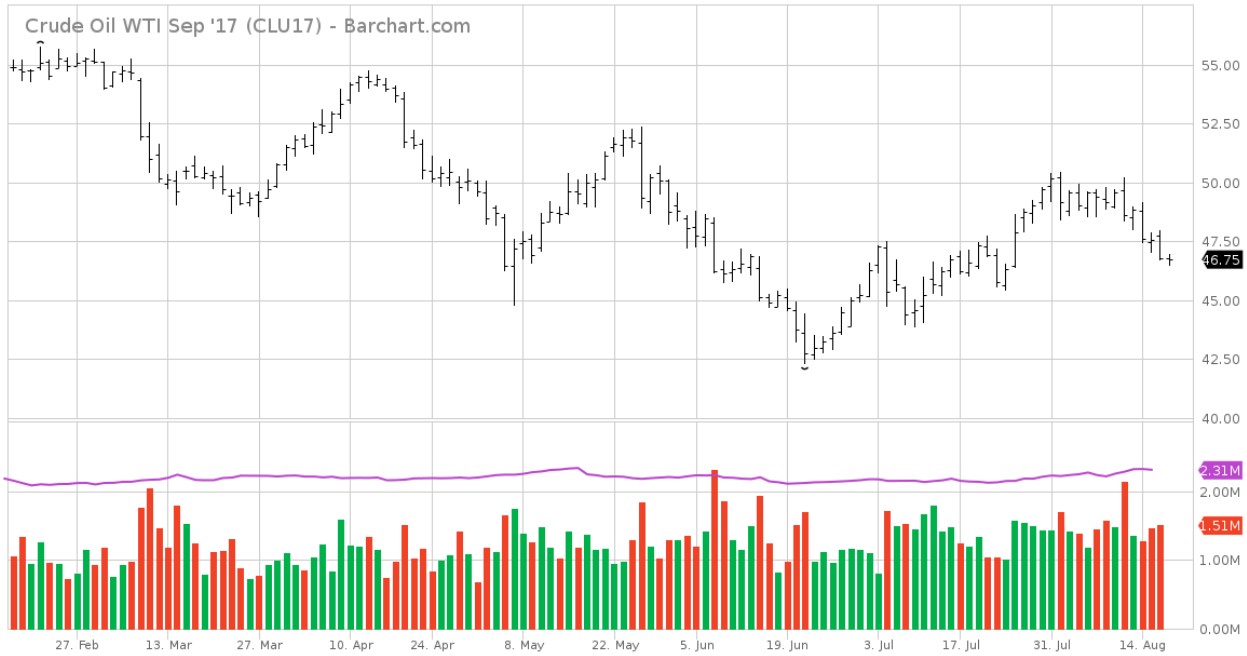


In response to the collapse in prices, OPEC cut production and many domestic producers did the same. According to Baker Hughes, the number of active U.S. rigs went from around 1600 in 2014 to just 400 in May of last year. This decline in domestic production was temporary, however, as domestic producer rig counts are now back to over 900 and daily production is nearing 2015's record levels.

Despite the recent uptick in production, domestic crude oil inventories have steadily declined from record levels this March, and are now back within their five year average.



Crude prices, meanwhile have been seemingly disconnected from the inventory drawdown and are now about 10% below where they were during March's peak inventories.



So, to recap: domestic inventories are depleting despite domestic production near record levels. This is indicative of an increase in demand. Despite an apparent increase in demand and declining inventories, oil prices are steady to lower over the last six months. Additionally, remember that oil prices are 50% below where they were in 2014, when we were producing just as much crude as we are today. The question is: given comparable levels of production was crude oil too rich in 2014 or too cheap today? It appears to me that consumers are absorbing the increase in production, and I would be surprised if crude oil moves significantly lower from here. The OPEC wild card remains, however, and should they abandon their production cuts then prices could press this year's lows.

There are several strategies available utilizing both futures and options to capitalize on the idea that crude oil may be nearing a bottom over the next 12-18 months. Please contact me to discuss what may be suitable for you. As always, remember that futures and options trading is not suitable for all investors. I can be reached at 312.242.7978 and via email at matthew.krupski@archerfinancials.com.

Would you like to open an account with Matt? Go to our interactive New Account application at Open An Account. It is fast, saves on postage and it's green.

Futures and options trading involve significant risk of loss and may not be suitable for everyone. Therefore, carefully consider whether such trading is suitable for you in light of your financial condition. The risk of loss in trading futures and options can be substantial. Past results are not indicative of future