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MONTHLY OIL REPORT

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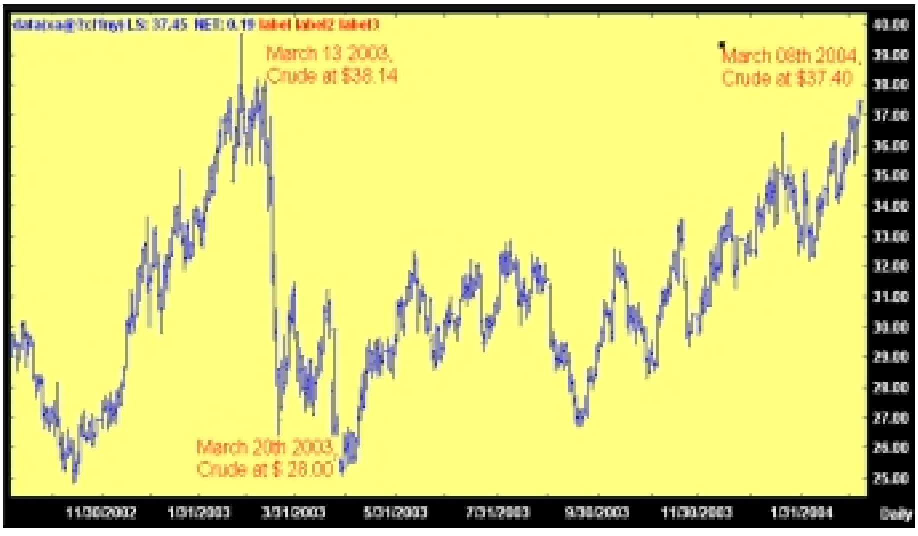
Do you enjoy March Madness?

People usually enjoy "March Madness". It is the big celebration of US college basketball, where fans can watch their favorite NCAA teams fight their way up to the finals while enjoying fresh pop-corn and soda. Since last year along with college basketball finals, petroleum market participants have been experiencing their own "March Madness" where high adrenaline is guaranteed but fresh pop-corn and soda is not always on the menu.

In March 2003 the petroleum market was experiencing extremely high prices above $38 (basis WTI) that had reached a peak of $39.99 the previous month due to the combined effect of a pending military operation against Iraq and the aftermath of a two month National Strike in Venezuela that had stalled production of more than 3.00 million barrels per day in December and January. The combined production of Iraq and Venezuela was around 5 million bpd and a few more millions barrels per day were threatened from the pending war if neighboring countries such as Kuwait were forced to enter the coming conflict. United States had at the time substituted Iraqi imports with Russian and African oil but was struggling to substitute the Venezuelan lost imports of crude and gasoline.



As we can see in the chart from the end of February until mid March 2003 prices were fluctuating between $37-$40. Traders were forecasting prices well above $40 and reports were talking of $50 or even $60 in the event that the war against Iraq was long and oil infrastructure was sabotage from Saddam Hussein's regime. On March 17th US President Bush gave a 48h ultimatum to Saddam Hussein to surrender. On March 18th, one day before the commencement of the war and against all market analysts' expectations crude dropped by 9.3% in one day and by March 20th had dropped to $28.00, almost $12 lower from recent highs.

A similar behavior of the market can be observed today. Prices have once again spiked to last years highs above $37 as US commercial inventories have once again fallen to very low levels, a result of accelerating demand due to higher than expected economic growth in China and the US and the Venezuelan oil production is threatened by internal turmoil triggered from a pending decision on a referendum vote against current President Hugo Chavez.

One would however wonder, what has pushed prices to reach last year's levels without having to price in any war premium?

We tried to map-down the market and compare the key price-driving factors in March 2003 Vs March 2004 in order to find the answer:

(1) US Inventories:

	Beginning of March 2004 (mbbls)	Beginning of March 2003 (mbbls)	CHG %
CRUDE	**275.8**	**270.6**	**+1.9 %**
DISTIL.	**111.3**	**98.2**	**+13.3 %**
MOGAS	**202.0**	**203.8**	**-0.9 %**
Total stks (exc. SPR)	**898.6**	**863.4**	**+4.1%**
SPR	**646.6**	**599.2**	**+7.9%**

As we can see from the table US inventories this year are in slightly better shape than last year without taking into consideration the huge increase of the Strategic Petroleum Reserve (SPR) by 47.4 million barrels in one year. It is clear that looking at this single factor prices are not justified at this price level.

(2) Weather:

The National Weather Service reported last week that season-to-date temperatures have been 2% warmer than last year and 2% warmer than normal. Especially for last week, temperatures were 25% warmer than last year and 4% warmer than last normal. A milder winter than last year does not justify prices at current levels.

(3) Supply/Demand Balance for Q1:

From the demand side call on OPEC for Q1 2003 was 26 million barrels per day according to Paris based IEA, while OPEC was producing an average 26.6 mbpd leading to a surplus of 600,000 barrels per day. So far in Q1 2004 the call on OPEC has been set to 25.5 mbpd and OPEC is producing around 28 mbpd, leading to a surplus of 2.5 million barrels per day!

In addition to this, news from Iraq point to an increase of exports between 600,000 – 1,000,000 mbpd in March due to the restart of the northern Kirkuk-Ceyhan twin pipelines, the resumption of exports from the Khor Al-Amaya terminal in the Persian Gulf that was idle since 1981 and the resumption of exports from the Iraq-Syria pipeline to the west.

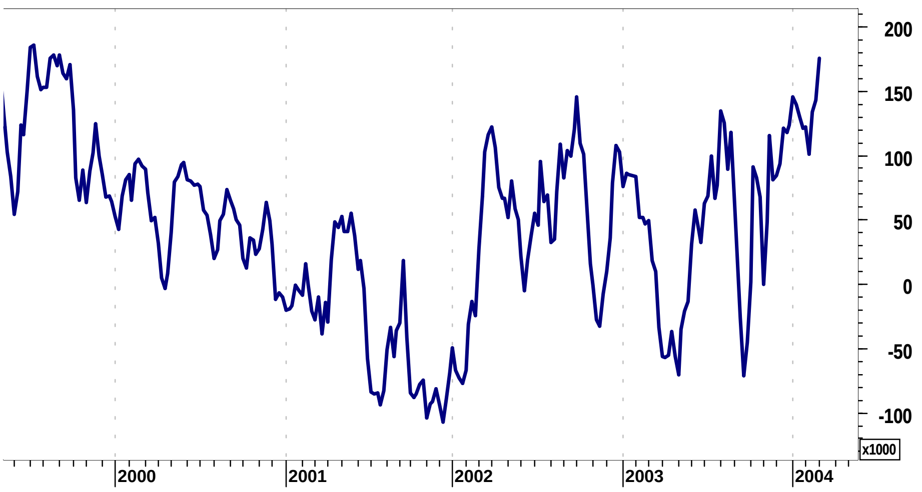
It is obvious that current supply-demand balances do not justify prices at these levels either.

(4) Spec-Fund Activity

Spec-funds in the petroleum market are very active and can add to existing price strength or price weakness exaggerating upside or downside moves as much as $5 to any direction depending on the size of the acquired positions. Nevertheless funds hardly ever move against fundamentals, which means that they usually increase the strength of a fundamentally strong market or add to the weakness of an already weak price environment. What happens though at the moment when a bull market has ended?

Spec-Funds is smart money. They usually get out a little before the end of a bull market is common knowledge. They usually create a "false perception" of a continuing bull market to trap small investors and then get out with an impressive sell-off on the expense of "doctors & dentists". They operate as if they are at the ending 5th wave of an Elliott Wave cycle.

Below is the net Spec-Fund position of the petroleum market:



As it is clear in the charts, Spec Fund net-long positions this March have reached record high levels at 175,000 lots compared to only 18,000 lots last year the same date. This is the first good reason to justify current inflated petroleum prices. Analysts estimate that such an extended net long position may have added more than $5 to prices, which is equivalent to the last year’s war premium.

(5) Venezuela

Venezuela is a country with fragile political environment. The country’s President Hugo Chavez is waiting the results this week of a petition vote against his government, which has been elected until 2007. If the Venezuelan Electoral Council rules within the next days that the opposition gathered more than 2.4 million valid signatures then the President must hold a referendum against his Presidency in the following weeks and if he loses must step down. The problem with this procedure is that the country is deeply divided between those who are with the President and those who are against him. A military coup attempt last year against him raises concerns that either decision of the Venezuelan Electoral Council could lead to violent clashes between people that could create a dangerous domino effect. Consequences of political instability would very likely include disruptions of the Venezuelan oil flows to the US. US is importing around 2 million barrels per day of crude oil and products from Venezuela and such a disruption would be very hard to be substituted from other sources. The low level of US inventories have made traders very sensitive to any news of political turmoil in this Latin American country and this week might be the crucial on this matter.

Overview

Analyzing all the above one can clearly see that this year’s market is much better supplied from last year, with a milder winter, no war pending ahead and a steady increasing flow of Iraqi exports under the new US controlled government. Spec-Funds have taken advantage of seasonal low inventories and global economic growth and have led the market in last year’s pre war levels. It is very likely that Spec-Funds have now reached their upside target and could be preparing for their “adrenaline raising” and usually unanticipated exit from the petroleum market.

Don’t be surprised if prices drop before the Venezuelan decision is out, or don’t be surprised if Spec-Funds exit on the back of bullish developments instead of bearish, it is March Madness and it usually is very hard to find who will be at the finals!

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