



10<sup>th</sup> February 2015

the technical analyst  
AWARDS 2011  
F I N A L I S T

# Market Update:

## Oil – a rally or correction?

UPDATE  
Technical  
Fundamental

[Full performance of  
our Key Trades  
recommendations  
2006-14 here](#)



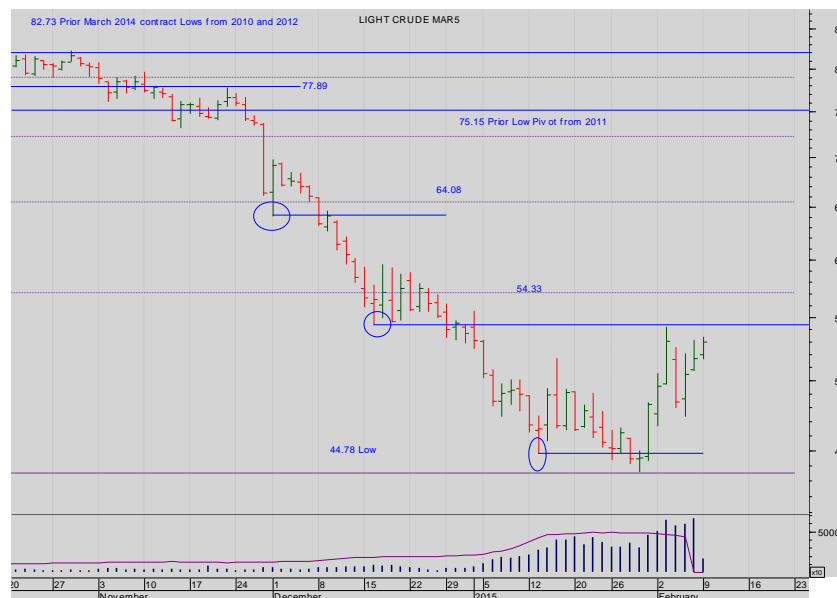
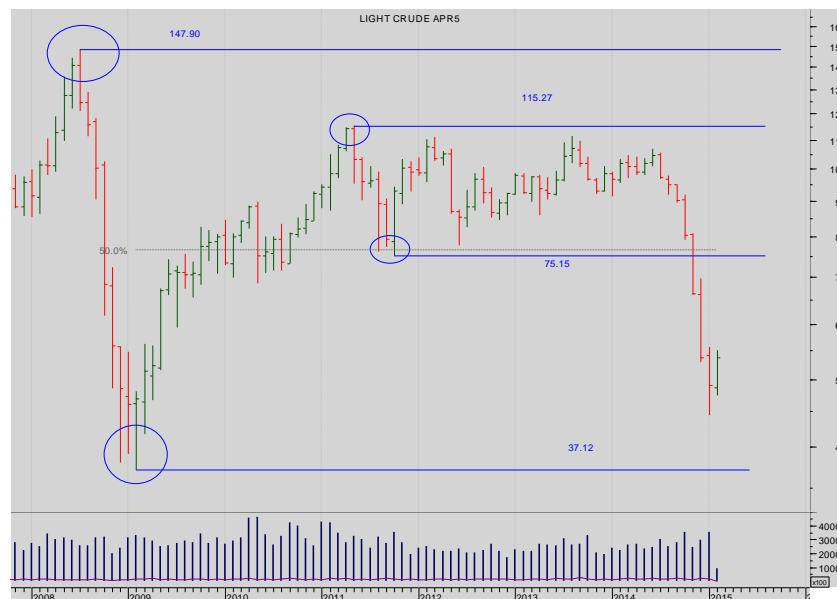
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## The bullish Bund



## Weekly Bund chart

The context of the monthly chart shows that the rally thus far is not at all impressive. Moreover, the market hasn't yet plumbed the depths of the recent range...

## Daily Bund chart

Yet short-term there is clearly a small Double Bottom in place.

That may yet drive the market up through the resistance (where it have already failed once) at 54.33.

But there is massive resistance higher up...

A great deal more price action looks to be needed before a rally can be sustained.

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## FUNDAMENTALS:

After a relentless sell-off over a six-month period, the last two weeks have seen the market bounce. The question arises then, “is this a correction or has the market bottomed and turned?”

To try to understand the recent price action let's look at the dynamics behind the sell-off and see if anything material has changed.

The oil price began to slide as it became clear shale reserves were plentiful on a global scale, with the US in particular, developing shale oil reserves at such a pace that it was set to become the world's largest producer. This challenged both the dominance of OPEC and cut her reliance on oil imports to an extent not seen for at least 30 years.

This was exacerbated by Saudi Arabia's refusal to cut production to stabilise the oil price, preferring to focus on market share.

Add in the weakness of the Euro zone and both the Japanese and Chinese economies (anyway increasingly sluggish) and a large oil glut quickly developed. But as the oil price continued to slide, OPEC again refused to cut production; why?

The production of Shale oil is relatively expensive compared to conventional oil production, so as the price slid, shale production reached a point where it became uneconomic. Some production facilities were mothballed and oil companies began to cut back on new exploration projects.

So although a glut still exists traders began taking profit as they judged supply and demand could soon come back into balance.



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## FUNDAMENTALS: CONTINUED

However, to simply assume that the oil price could now begin a new rally misses a crucial point. As soon as the oil price rises to a level where shale becomes profitable, mothballed facilities would be put back in production, thereby capping the price. Unless OPEC/Saudi Arabia changed stance and accepted a smaller market share, the oil price would again begin to slide.

Additionally, the Saudi King died a couple of weeks ago and although a smooth transition took place with the Crown Prince assuming the thrown, an element of uncertainty entered the market, even though the new King pledged stability and to follow the same policies as under his late Brother.

But there is yet another variable to consider. The ECB has pre-announced the start of a substantial QE program set to begin in March and run for an initial 18 months. At E1.1TRN traders obviously expect the Euro zone economy to revive. Yet relations between the West and Russia are currently very poor, so energy supplies from Russia could be interrupted.

This could prove a double-edged sword. On the one hand it would support higher prices, but the damage it could potentially inflict on the still fragile Euro zone economy would be bearish.

In the event, we judge the ECB's QE is a minor consideration for oil prices since Euro zone governments still need to enact economic reforms to get the Euro zone economy moving.

So what is behind the most recent price action in Oil? We judge profit taking, meaning a correction which once exhausted around or just above current levels will leave the way clear for the oil price to resume its fall, but perhaps at a more steady pace.



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#### SEVEN DAYS AHEAD

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