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MARKETS

How Low Can Oil Go? Traders Balk at Making the Call

As Crude Extends Slide, Even Those Who Bet on Lower Prices Are Getting Nervous; 'It's Bloody Nuts'

By **NICOLE FRIEDMAN** And **ROB COPELAND**

Jan. 19, 2015 8:26 p.m. ET

The collapse in the oil market has been very good for Anuraag Shah. His hedge fund, Tusker Capital LLC, last spring made a bet that oil prices would fall and has since reaped big profits from their nearly 60% decline.

But last Tuesday, Mr. Shah decided he had seen enough. He cashed out all of Tusker's bets against oil, walking away for the moment from a market that has already fallen 8.6% this year. Tusker, which manages roughly $100 million from Manhattan Beach, Calif., saw returns of 17% in 2014 and 10% this month alone through the middle of last week.


RYAN ETTER

Oil prices have plunged from north of $100 a barrel in June to less than half that level now, the victim of a growing surplus brought on by booming U.S. production and weaker-than-expected demand. As prices have careened toward six-year lows, the market has become more volatile. That has given investors opportunities to score big profits by betting on further declines. But some traders say the market has fallen too far, too fast—creating the potential for an equally sharp rebound.

"It's bloody nuts," said Mr. Shah, a veteran of trading giant Louis Dreyfus Commodities BV. He isn't putting a figure on it, but after oil's historic plunge, he doesn't see much further room for bearish bets to go. "I'm not saying this is the low, but we're not going to $20 or even $30 in the next month or two."

Seven months into a swoon that few saw coming, investors such as Mr. Shah are reluctant to call a bottom for oil prices. Analysts who were slow to recognize the magnitude of the decline are now competing to put out the most bearish forecasts. J.P. Morgan Chase & Co. on Monday predicted U.S. oil prices would average $46 a barrel this year, while last week, Goldman Sachs Group Inc. called for an annual average of $47.15 a barrel.

For investors, this presents a quandary: Falling oil prices recently have been one of the most consistently profitable bets in commodities. (Hedge funds that focus on commodity markets in general have lost nearly 10% over the past three years, according to trade publication Absolute Return.) But the oil market is increasingly volatile, with U.S. prices snapping a seven-week losing streak last week before falling again in electronic trading Monday.

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On Friday, U.S. oil prices rose 5.3% to $48.69 a barrel on the New York Mercantile Exchange. The Nymex market didn't settle Monday because of the U.S. holiday. Brent, the international benchmark, on Monday declined 2.7% to $48.84 a barrel.

The sudden realization that the world has more oil than it needs sent analysts and traders scrambling to figure out how low prices need to go to rebalance the market. Analysts estimate the global market is oversupplied by anywhere between 1 million and 2.5 million barrels of oil a day. The Organization of the Petroleum Exporting Countries decided in November to maintain its production quotas rather than cut them in a bid to support the market, causing prices to plummet. Total crude-oil and fuel stockpiles in the U.S. hit a record high last week and traders are booking tankers to store oil at sea until they can find a buyer. Some energy companies have cut spending and laid off workers, but it could take months or even years for production to fall enough to erase the glut.

Many money managers are staying on the sidelines, searching for clues that could mark a turning point for the market. These can range from economic growth forecasts for major oil consumers such as China, to retail gasoline prices and auto sales in the U.S., which could drive future demand. Lately, the market has become particularly focused on a survey of drilling rigs operating in the U.S. that is released each Friday by oil-field-services company Baker Hughes Inc., which can be an early indicator of how quickly production will grow in the future. The number of oil rigs operating in the U.S. has fallen for six weeks in a row.

Some of these markers point to an easing in the global supply glut that has driven prices lower. On Thursday, OPEC slightly raised its demand outlook for 2015. U.S. fuel demand has risen as prices at the pump fall.

That hasn't convinced many investors to wade back into the market.

"The market is quite irrational" right now, said Alessandro Gelli, an analyst at Diapason Commodities Management SA in Lausanne, Switzerland, which manages $5 billion. "It's only moving with negative news—all the positive-news aspects have been completely forgotten."

Diapason has taken positions in the gasoline market that benefit from growing crude supplies, Mr. Gelli said, but he thinks it is too soon to say whether oil prices have hit their bottom. He is looking for signs that more panicky investors are piling in to bet on lower prices and for solid evidence that the supply glut will shrink, such as U.S. oil producers filing for bankruptcy.

One hedge-fund manager said last week he saw little chance for a quick recovery, even if there are cuts to production. If Saudi Arabia or another producer cuts output, it would be "an entirely self-sacrificing gesture," because others would use the higher prices as an opportunity to produce more, Michael Hintze , founder of $14 billion CQS LLP, wrote in a letter to investors viewed by The Wall Street Journal. "The 'new normal' in the price of oil is a structural shift that is unlikely to be reversed over the next decade," Mr. Hintze wrote. "I believe we will have to become accustomed to a lower oil price for longer than most might think."

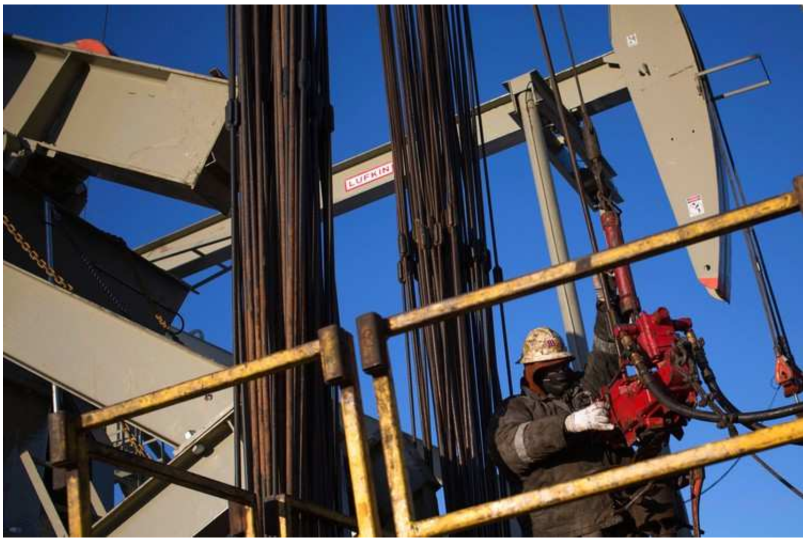
There are some investors who see the rout in oil prices as a good long-term opportunity. Many market watchers expect prices to rise somewhat by year-end, with further gains in 2016 or 2017, even if they aren't sure when or at what level the market will turn around.

MV Financial Group Inc. is planning to add commodities investments to its wealth-management assets for the first time in five years, said Katrina Lamb, head of investment strategy and research. The fund, which oversees $500 million, plans to place as much as 5% of its wealth-management assets in commodity exchange-traded funds, mostly energy funds, in the first three months of the year.

"We have a nice entry point, price-wise," said Ms. Lamb, who thinks prices are unlikely to go far below $40 a barrel.

But finding ways to profit in today's market can be stressful.

Tariq Zahir, who oversees about $3 million as managing member of Tyche Capital



Many money managers are staying on the sidelines, searching for clues that could mark a turning point for the market. These can range from economic growth forecasts for major oil consumers such as China, to retail gasoline prices and auto sales in the U.S., which could drive future demand. Above, an oil rig near Williston, North Dakota. *REUTERS*

Advisors, said he routinely wakes up in the middle of the night to trade during European hours. Mr. Zahir has wagered that later-dated crude contracts will rise relative to near-term contracts.

"I never get sleep anymore," he said. "Instead of doing a trade and holding onto it for four or five days, sometimes we're getting out during the same session."

Michael Reeber of $230 million hedge-fund firm Andalusian Capital Partners LP, said his firm is buying shares in airlines, including American Airlines Group Inc. and Jetblue Airways Corp, which stand to benefit from lower jet-fuel prices. Shares in both companies are down this year.

Predicting oil prices is "a mug's game," he said, adding he had "no idea" how low oil will go.

—Juliet Chung and Timothy Puko contributed to this article.

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