Huge Imbalance In Crude Oil Positions

***e*Research Corporation** is pleased to provide a weekly commentary, authored by Tom McClellan, entitled "The McClellan Chart-In-Focus", which is a free technical analysis article published each week.

In this article, Mr. McClellan warns that there is a large short position that has been built up by commercial traders, which portrays the likelihood of a further decline in the price of crude oil, perhaps significantly so.

The article is reproduced below, beginning on the next page, or you can use this link to go to the article directly:

http://www.mcoscillator.com/learning_center/weekly_chart/huge_imbalance_in_crude_oil_positions/

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Bob Weir, CFA
Director of Research

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The McClellan Chart-In-Focus

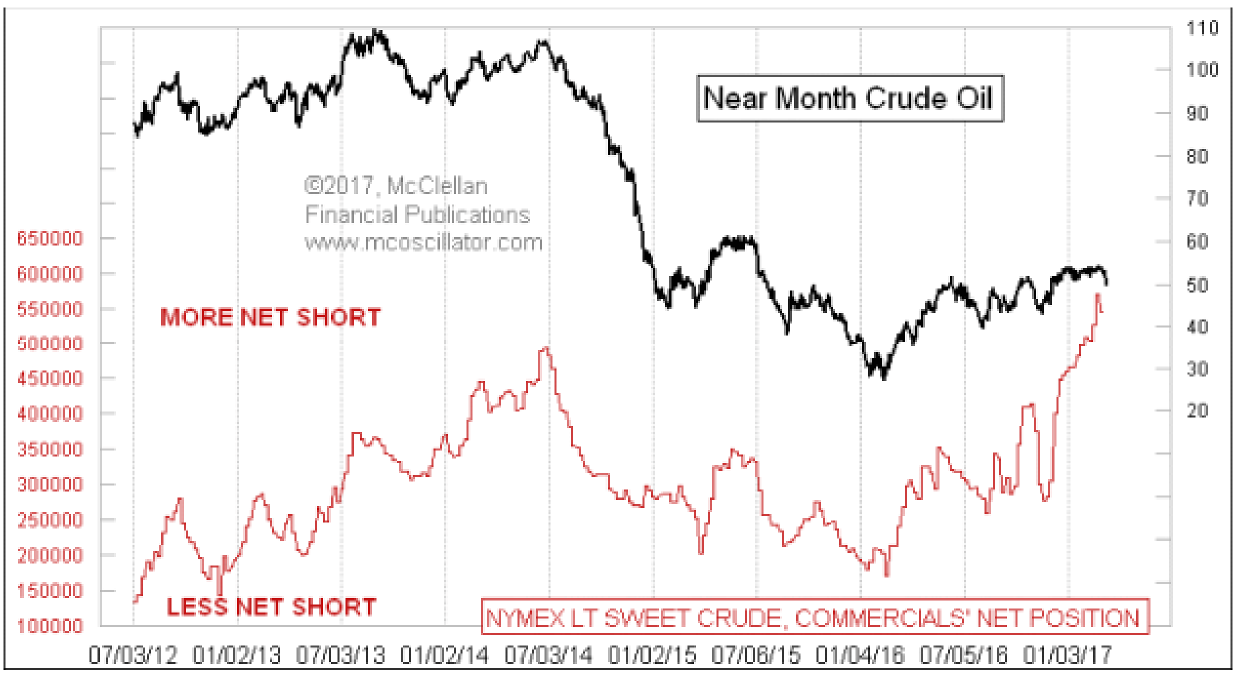
by Tom McClellan (bio at end)

There is a giant wall of short positions held by the smart-money "commercial" traders in crude oil futures, and it is going to lead oil prices to come crashing down.

Each week, the CFTC reports on the numbers of long and short positions held by futures traders. They are broken down into 3 separate groups:

- **Commercials** – Those engaged in the business related to that commodity. They are the big money, and thus presumably the smart money. Think Cargill for grains, or Goldman Sachs for financial futures.
- **Non-Commercials** – Large speculators. Think hedge funds.
- **Non-Reportables** – Those whose positions are too small in number for the CFTC to bother tabulating them individually.

This week shows the commercial traders net short position, expressed in numbers of contracts. They just reached an all-time (since 1986) record for the number of contracts that they are net short, i.e. short positions minus longs.



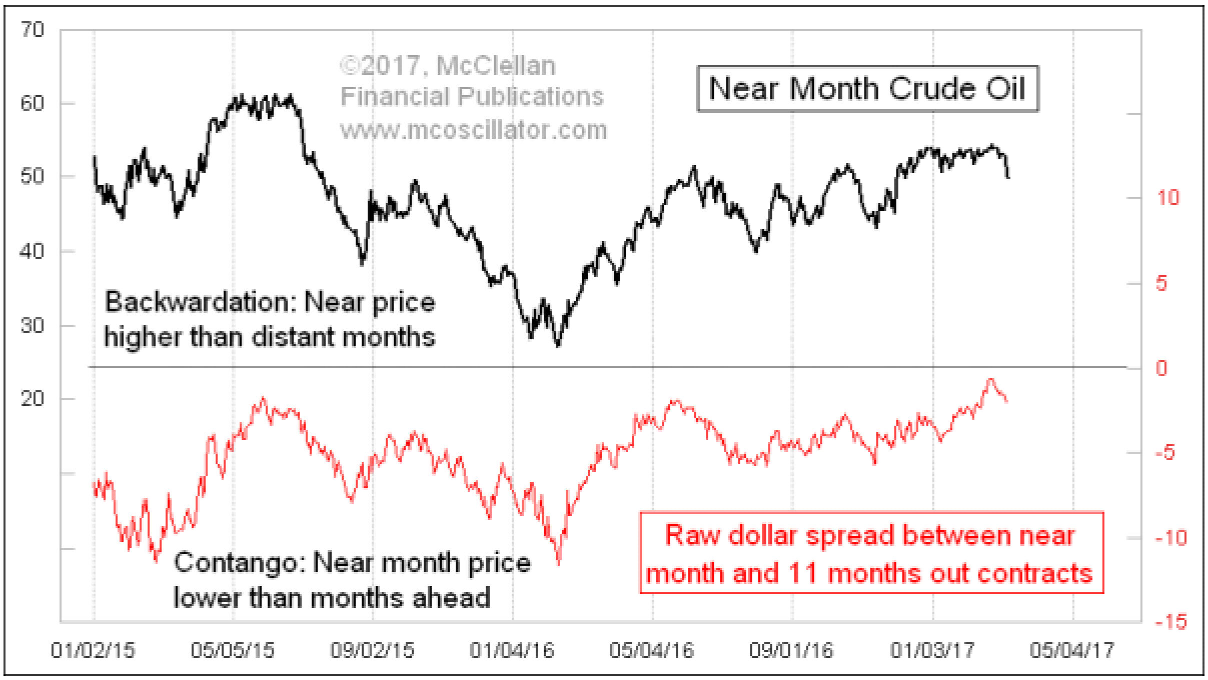
Every futures contract is simultaneously a long and a short position, with the two sides of that contract held by different parties. The short side is the one that has to deliver the product, and the long side wants to take delivery or, at least, that is the design. Speculators also play in the futures markets, never intending to take or make delivery.

In the crude oil market, the commercial traders are often the producers, using futures markets for their original intended purpose, which is to be able to lock in prices now for sales of future production.

So, the direct message of seeing the commercial traders reach an all-time net short position is that the smart producers think that recent prices have been a great deal to lock in for their future production. If oil prices were going to rise, then locking in now would not be a great deal. But, if oil prices are about to fall, then smart traders would want to lock in prices before that happens. This seems to explain what we have just seen. Understand that the speculators, large and small, have taken the opposite site of that big imbalance in positions.

The last time that the commercial traders came even close to this big of a net short position was back in June 2014, just before crude oil prices were cut in half. I cannot forecast the magnitude of the coming move down, but the message here is that it should be substantial.

The notion of a down-move for oil prices is confirmed by the spread between near and far month futures prices, known as "contango".



That spread recently narrowed to its smallest point in over 2 years, a sign that near-month crude oil prices were topping. When there is a big contango, then a trader could buy cheap oil in the spot market, rent a place to store it, and sell a more-expensive futures contract. Then all he has to do is wait a few months to deliver at that higher price. As long as the spread is big enough to cover the cost of storage, then there is a lot of money to be made.

But, when contango gets really small, at close to zero, then the cost of storage eats up all of the profit margin from that game, and traders look to dump that supply on the market and stop paying rent. This is the sort of condition we are entering now, with a glut of oil coming onto the spot market.

The point is that prices for crude oil are likely to fall for a while. We will probably know that they are done falling only when we see the commercial traders covering their shorts in a big way.

Tom McClellan

Editor, The McClellan Market Report

BW: Information on Tom McClellan and *The McClellan Market Report* and *The Daily Edition* follows on the ensuing page.

ABOUT THE AUTHOR

Tom McClellan

Tom McClellan has done extensive analytical spreadsheet development for the stock and commodities markets, including the synthesizing of the four-year Presidential Cycle Pattern. He has fine-tuned the rules for inter-relationships between financial markets to provide leading indications for important market and economic data.

Tom is a graduate of the U.S. Military Academy at West Point, where he studied aerospace engineering, and he served as an Army helicopter pilot for 11 years. He began his own study of market technical analysis while still in the Army, and discovered ways to expand the use of certain indicators to forecast future market turning points.

Tom views the movements of prices in the financial market through the eyes of an engineer, which allows him to focus on what the data really say rather than interpreting events according to the same "conventional wisdom" used by other analysts.

In 1993, he left the Army to join his father in pursuing a new career doing this type of analysis. Tom and his Father spent the next two years refining their analysis techniques and laying groundwork.

In April 1995 they launched their newsletter, The McClellan Market Report, an 8-page report covering the stock, bond, and gold markets, which is published twice a month. They utilize the unique indicators they have developed to present their view of the market's structure as well as their forecasts for future trend direction and the timing of turning points.

A Daily Edition was added in February 1998 to give subscribers daily updates on their indicators and also provide market position indications for stocks, bonds, and gold. Their subscribers range from individual investors to professional fund managers. Tom serves as editor of both publications, and runs the newsletter business from its location in Lakewood, WA.

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