Written by **Bob Adelmann** on January 15, 2018

Record Bullish Bets on Crude Oil Raising Red Flags

Traders in oil futures have just set a new record: The bets they have placed that crude oil will move even higher just set a world record. As of last week, there were 432,000 net long positions reflecting that optimism. That optimism could be short-lived. As analysts from JBC Energy consulting told its clients on Monday: "From a fundamental perspective, the surge in U.S. managed money raises a clear red flag for us."

Since the low in June, the price for the future delivery of U.S. crude oil is up almost 50 percent, from $44 a barrel to $64 on Friday. In London, Brent crude traded above $70 for the first time since December 2014.

Their optimism is based on indisputable facts. A weaker U.S. dollar makes it cheaper for foreign buyers to purchase U.S. oil. Rig counts in the United States are still about half where they were two years ago. Venezuela's production is collapsing along with the country's economy. U.S. shale companies are being pressured by stockholders to start paying some dividends instead of forever chasing new production through deficit financing. OPEC compliance, even among non-members, with its production-cut agreement has remained surprisingly high with few defections. Worldwide demand for energy had exceeded expectations, as the global economy largely reflects what's happening in the United States. Finally, inventories in the United States and among OPEC members have been coming down steadily for several months to levels not seen in years.

In the energy business, nothing is constant but change. The U.S. rig count, although still low compared to a couple of years ago, is bouncing back, with 10 new rigs coming online just last week, bringing the total operational to 757. Each rig coming online adds new production within weeks instead of months, with breakeven costs low enough to make them increasingly profitable with oil in the 60s.

Energy-industry reporting agencies (IEA and EIA) are raising their production forecasts for the United States in 2018 to nearly 11 million barrels per day (bpd), up from 9.6 mbd last year. Specifically, the IEA (the International Energy Agency) expects new supply in the New Year to exceed the world's strong demand by 200,000 bpd, adding back to inventories what has been drawn down from them recently. Another influence rarely mentioned is that refineries worldwide go offline in the spring for maintenance and refurbishing, reducing further demand for crude, at least temporarily.

And then there's the upcoming OPEC meeting in June, where there is much speculation about whether the present production-limiting agreement will be extended beyond the end of the year, or not. For Eugen Weinberg, the head of commodities research at Commerzbank AG in Frankfurt, Germany, the result is clear: "Seventy dollars [a barrel] is too much. It's not completely unexpected, given the price momentum [over the last few months]. But there will be a reaction to U.S. shale, and OPEC's strategy will backfire massively."

If Weinberg is right, lower oil prices, perhaps much lower, will hit just in time for summer vacation and driving season, bringing gasoline prices down from their recent highs.

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