

March 23rd, 2011

MF Global Daily Report

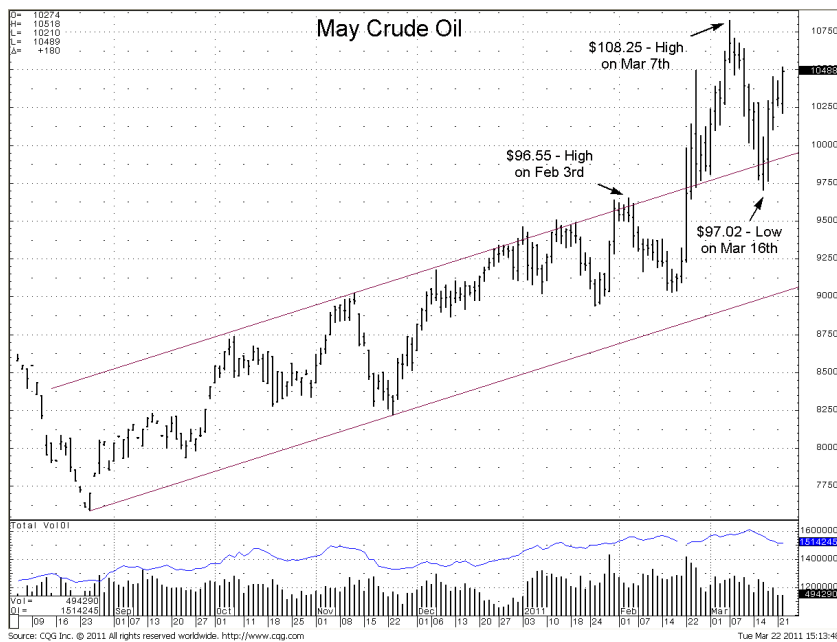
COMMODITIES | ENERGIES

Energy

MF Global
440 S. LaSalle
Chicago, IL 60605

Price Outlook

Energy prices could trade firmly again today, as focus remains on the Middle East and the potential that today's inventory numbers are supportive. Background support will be offered by European sovereign debt issues, tightening supplies of gasoline, and from the potential that elevated tanker rates imply that demand is still recovering. We look at tanker rates in the Analysis section below. Yesterday's API figures were positive and especially so for gasoline. The downside will look to the easing crisis at Japan's nuclear plant as a potential sign that fewer stopgap fuels will be needed, but it is still a tough call as to the actual impact, as increased risk-taking could give the appearance that the economy is recovering from the earthquake. Pressure could also come from fresh signs of demand rationing. Our favored trade is to maintain a short position in the May Brent-WTI spread from \$14.31 entered on Feb 24th. We would also be light buyers of dips in gasoline.



The market will remain focused on events in the Middle East for support today, where cracks are becoming evident in the coalition. Reports have surfaced recently that countries participating are sending only a handful of warplanes or are considering exiting. Reports surfaced yesterday that Norway and Denmark are considering cessation of operations, although they reversed the position by the end of the day. There was also a report in the UK's Daily Mail that U.S. Sec'y of Defense Gates rebuked the UK government over the suggestion that Gaddafi could be assassinated, and a second report that Italy may wish to 'take back control' of bases used by allies unless NATO leadership is put in charge of the mission. The Arab League's participation is still in doubt, and the U.S. Congress has been raising questions over the need to obtain their approval for military action. Uncertainty over developments in the Middle East could keep energy markets supported.

Background support could come from sovereign debt worries in the Eurozone, where Portugal is reportedly bracing for a potential collapse of the government. The AP report came after communist members of Portugal's parliament said that they would present a resolution against the budget plan. Worries over the safety of the euro could resume the push into commodities and hard assets as safe havens. Support could also come from recent gains in tanker rates. As we discuss in the Analysis section below, elevated levels of tanker rates show that U.S. demand for oil from the Atlantic Basin is strong and could soon be reflected in the EIA's demand series.

The negative argument centers on the possibility that high prices are rationing demand for energies. Four U.S. airlines announced yesterday that they would cut capacity in order to battle high fuel prices. Similarly, truck tonnage in the U.S. fell 2.9% on a m/m basis which signals that demand for diesel fuel could begin to falter.

TRADE: Short May Brent-WTI at \$14.31, target \$2.00, risk \$16.75 (entered on Feb 24th)

Upcoming Energy Events

Wed - Oil Inventories 10:30 am EST
 Thu - Natural Gas Inventories 10:30 am EST
 Tue - April Gasoline & Heating Oil Rollover
 Tue - API Weekly Stats 4:30 pm EST
 Jun 8th - OPEC Meeting

Global Economic & Dollar News

The dollar held in a relatively narrow range in yesterday's trade, with strength early in the session giving way to weakness in the second half.

- » **Japan Summary:** The Nikkei closed +4.4%. Press reports differed on whether there was progress made at Japan's stricken nuclear reactors. Kyodo news said that it's hard to say that the situation is improving while others reported that the start of electricity service to the reactors would enable cooling to resume and prevent further radioactive emissions. Sony cut output at five more plants and Toyota delayed restarting its assembly lines by a few more days due to a lack of parts. Toyota said that it has lost output of about 140,000 vehicles during the Mar 14-26 closure.
- » **Libya Summary:** Gaddafi's forces attacked the rebel towns of Misrata and Zintan. The U.S. reported that an F-15 crashed in Libya due to mechanical failure. U.S. Defense Sec'y Robert Gates told the Russian Defense Minister that significant fighting should recede in the next few days.
- » **Yemen's President Saleh** said that he would leave office at the end of 2011, but would not turn over the government to the military.
- » **Portugal's Communists** will present a resolution against the budget plan. An AP story yesterday warned that Portugal is bracing for collapse of the government.
- » **ECB Officials** signaled that a rate hike in Apr is still likely.
- » **UK Feb CPI** was +0.7% m/m vs. +0.6% expected and vs. +0.1% previously. The y/y rate was +4.4% vs. +4.0% previously. The higher readings increase the likelihood of a rate hike in May.
- » **Fed Pres Fisher** said that he's seeing signs of "all the intoxication" of cheap capital and that the current stock market rally is financed by ample liquidity. Said no further accommodation is needed after June and pointed to risks associated with it.

Energy News Stories

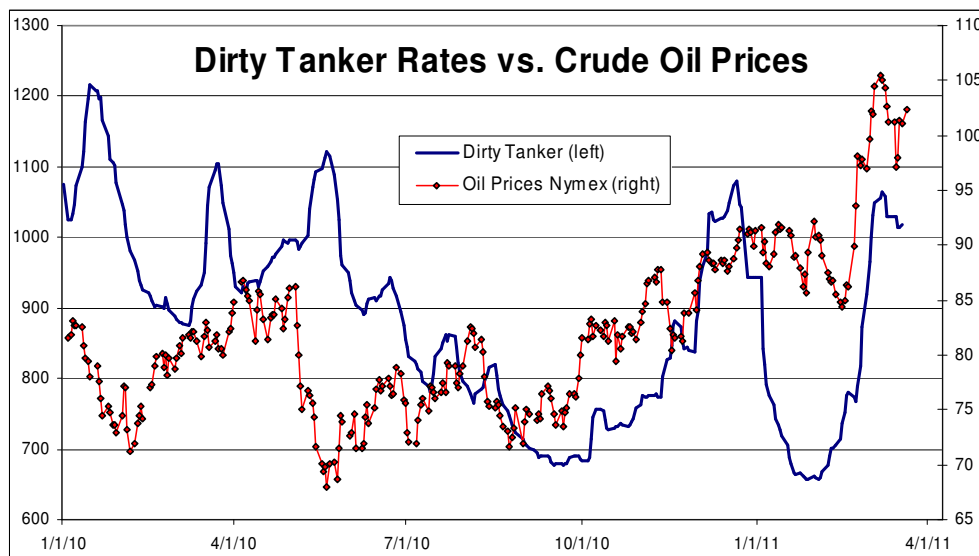
- » **Japan** will release an additional 22 days of crude oil from privately held reserves, according to its trade ministry. The country had 113 days of oil demand cover in gov't storage and 85 days in private storage at the end of Dec.
- » **JX Nippon Oil** restarted its refinery in Yokohama south of Tokyo, and produces 270,000 b/d.
- » **Saudi Aramco** said that rising oil demand from China will offset declining consumption elsewhere.

- » **Iraq's Oil Minister** said that oil prices are now moving toward \$120/bbl and that it is "an acceptable price" and one that will not harm global growth.
- » **OPEC** changed its June 2nd meeting to June 8th to allow all ministers to attend.
- » **Germany's Merkel** said that further decisions over nuclear plant closures should happen as soon as possible. Said that inspections of plants and waste storage sites will take place.
- » **Offshore Drilling Regulator Bromwich** said that the Deepwater Horizon accident was not an aberration and that the spill shows the risk in shallow water drilling as well. Regardless, he said that more drilling permits would be issued in the weeks ahead.
- » **The Interior Dept** approved its fourth deepwater drilling permit since the BP spill yesterday. The permit went to ExxonMobil.
- » **U.S. Airlines** announced that they would cut capacity in order to battle high fuel prices. Airlines cutting capacity include Delta, UAL/Continental, American, and US Airways.
- » **U.S. Truck Tonnage** fell 2.9% m/m according to the American Trucking Association. Levels are still 4.2% above those from a year ago.

ANALYSIS

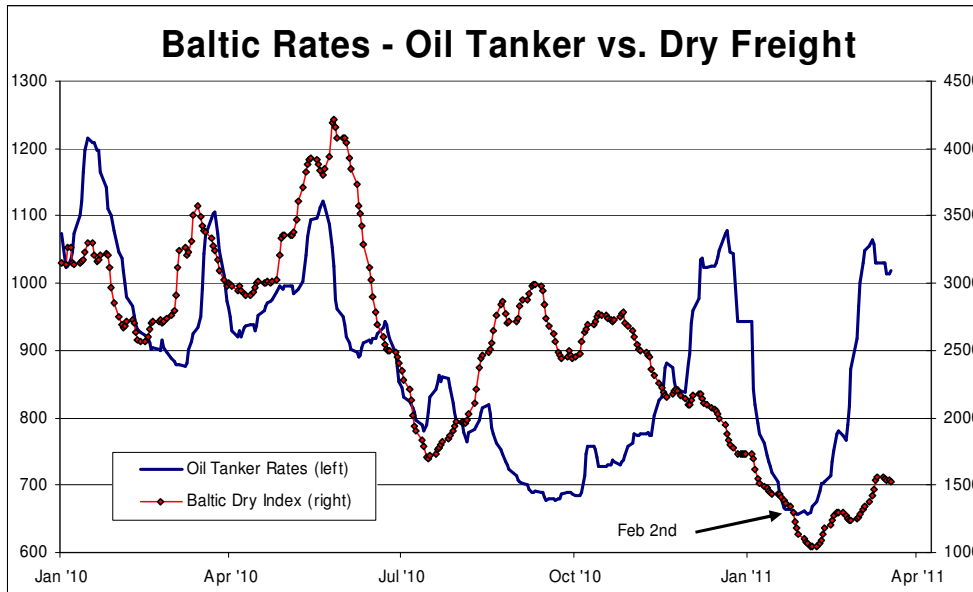
A Look at Tanker Rates

Oil tanker rates have soared since they formed a bottom on February 2nd, but have flattened somewhat since they made a peak on March 8th. Tanker rates have been a good indicator of overall demand for crude oil and usually provide a good indication on oil price direction (chart below). Of course, rates are sometimes influenced by factors not related to oil demand such as interest rates, demand for floating storage, or the number of excess ships in the fleet. The excessive number of ships can be used to explain the weakness in tanker rates through Oct '10 while the sharp widening of the crude oil contango may explain its dip in Jan '11.



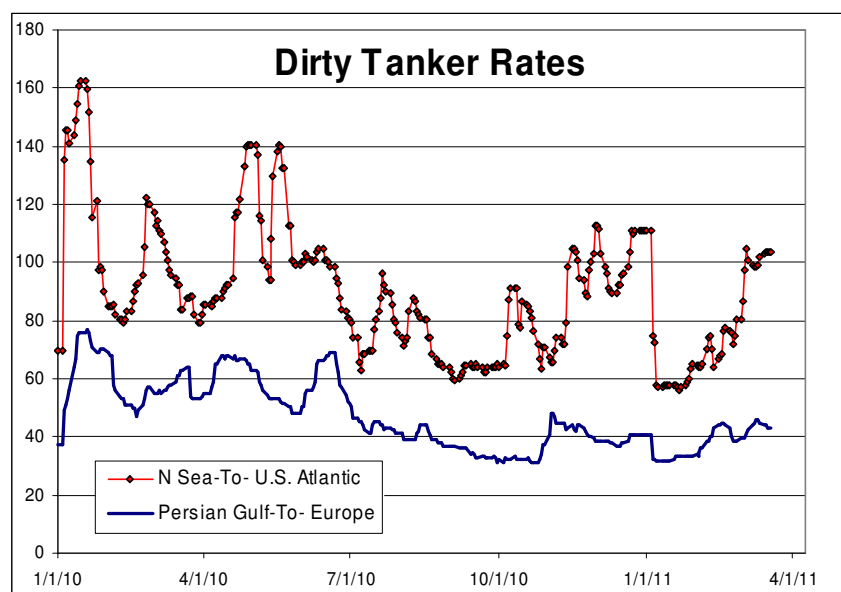
Tanker rates have advanced 57% off the Sep 20th low in Oct-Jan and 61% off the Feb 2nd low in Feb-Mar. The chart below shows that the series is volatile but also that it is somewhat correlated to trends in dry freight rates. The suggestion would be that the global economy is improving and thereby increasing demand for both oil and dry bulk. Indeed, the EIA's 2011 global oil demand growth estimates have been revised up in 12 of the last 14 monthly reports by a total of 1.55 mb/d since the original Jan '10 report. OECD demand has been raised 140 kb/d, while non-OECD

demand growth was revised 1.41 mb/d. Chinese demand has seen the biggest revision at 690 kb/d higher from the Jan '10 report. The recent volatility is more than just a function of China, however.

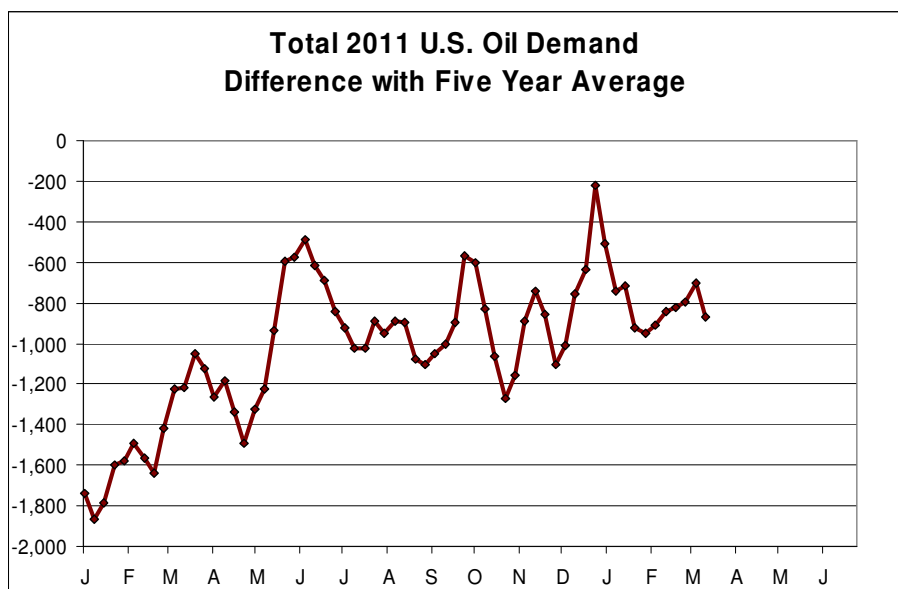


The table below looks at the biggest changes in tanker rates on a geographical basis, and shows that the largest gains have come from oil bound for U.S. destinations. The sources of the oil are generally from the North Sea and West Africa, which suggests that it is oil priced off the Brent benchmark. The increase in rates may be a function of the Brent-WTI spread trade as well as the possibility that oil demand in the U.S. has been on the increase. Tanker rates from the North Sea to the U.S. fell sharply in Jan when the Brent-WTI spread began widening and began strengthening appreciably in mid-Feb when the spread began contracting. The chart below separates one of the best performing routes, the North Sea-to-Atlantic, from one of the worst performing routes, the Persian Gulf-to-Europe.

Tanker Rates February 2nd-March 18th	
Black Sea to Mediterranean	+79.3%
West Africa to U.S. Atlantic	+63.2%
North Sea to U.S. Atlantic	+62.1%
Dirty Tanker	+54.9%
North Sea to U.S. Gulf	+47.9%
West Africa to U.S. Gulf	+47.6%
Baltic Dry	+43.9%
Caribbean to U.S. Gulf	+35.2%
Persian Gulf to Japan	+31.3%
West Africa to China	+31.2%
Persian Gulf to Singapore	+27.8%
Persian Gulf to U.S. Gulf	+26.5%
Persian Gulf to Europe	+24.6%



The difficulty in using tanker rates as an indication of demand is that it sometimes diverges from what is actually being reported by the EIA. The chart below shows that U.S. demand has been steadily improving since before the beginning of 2010. However, tanker rates fell through Sep '10 before they began creeping higher. The improvement in demand continued until a peak was formed in the w/e Dec 24th, which may have been the result of year-end shipments resulting from higher refinery utilization and the goal of reducing oil inventories to minimize tax obligations.



These data show that the oil market is once again at a key decision point. With strong demand expectations already being priced, weekly EIA data will soon have to confirm that the elevated levels of tanker rates aren't an aberration being caused by factors other than demand. Prices could remain elevated over the next week or two because stocks of gasoline are tight, but we wouldn't have strong expectations of prices remaining firm in the long-run given that OPEC production could respond accordingly, and given that demand is in the process of being rationed by high prices. Fresh signs of economic strength would be needed, in our opinion, to keep oil prices on an upward path beyond the next week or two.

EIA Oil Inventory Preview

Oil inventories are expected to gain only 0.8 MB this week compared to last week's build of 1.8 MB. The normal gain this week is +1.1 MB as shown by the five-year average, but we think that inventories will be pressured a bit by increased levels of refinery utilization. Surprisingly, high refining margins in the Midwest aren't boosting utilization in the region, but utilization in the Gulf Coast region has been increasing steadily over the last several weeks. Last week's data showed that refineries are processing 711 kb/d more oil than they were at a low point three weeks earlier. That has created a trend of diminishing stocks relative to their five year average, which is alleviating excess inventories of crude oil, distillates and gasoline. Oil stocks are 16.39 MB above their five-year average now compared to 22.26 MB above it six weeks earlier. Product stocks normally fall around 1.5 MB apiece, but we look for the numbers to decline by a lesser amount due to signs of weakening demand. The demand for gasoline fell 362 kb/d last week while distillates declined by 296 kb/d. Given the shrinkage in the heating oil-gasoline spread last week, we would also surmise that the potential for Japanese use of distillate fuels for power generation has fallen. That could keep U.S. exports down, and thus also contribute to inventories.

Natural gas inventories are expected to fall 5 bcf this week, which is below the five-year average decline of 15 bcf. The smaller-than-normal drop is the result of warmer-than-normal temperatures over the majority of the country,

which produces an HDD forecast of 126.3. That compares to a 10-year normal of 143.9. Warm temps are expected to shift slightly eastward, which could produce an HDD reading of 112.2. That would be below the 10-year norm of 128.7 and produce a drop in inventories of 7 bcf. That would be less than the 30 bcf decline seen in the five-year average.

EIA Inventories - w/e March 18th						API Inventories		
	Actual	Market Estimate	MFGR Estimate	Five-Year Average	Last Week	Converge with EIA	Actual	Previous
Crude Oil		+1.6 MB	+1.0 MB	+1.1 MB	+1.8 MB	+0.1 MB	+1.0 MB	+0.1 MB
Gasoline		-1.5 MB	-0.5 MB	-1.5 MB	-4.2 MB	-2.7 MB	-7.9 MB	-0.5 MB
Distillates		-1.3 MB	-0.5 MB	-1.4 MB	-2.6 MB	+2.4 MB	-0.6 MB	+0.5 MB
Utilization		+0.2%	+0.5%	+0.0%	83.4%	-0.8%	82.6%	82.3%
Natural Gas		-2 bcf	-5 bcf	-15 bcf	-56 bcf			

*The API convergence figures are the amounts that EIA data need to change in order to match the previous day's API figures

