Investment Strategy Update

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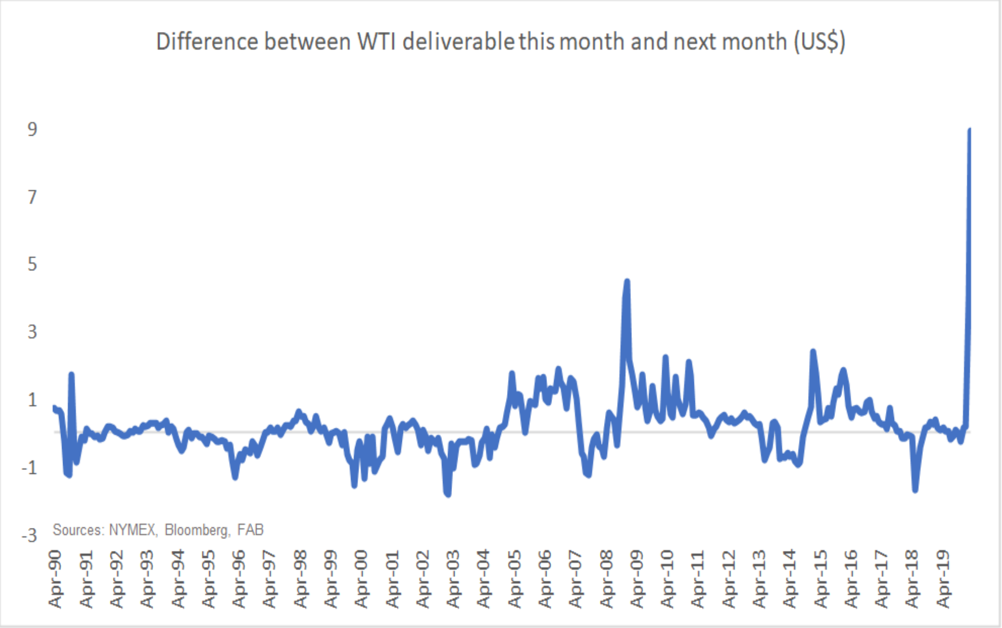
Oil markets hit a perfect storm

- ♦ **West Texas Intermediate crude drops 28% to the lowest in 20 years.**
- ♦ **Move comes as futures contracts expire while storage in the US nears full capacity.**
- ♦ **Difference between future contract expiring first and one month later hits the highest since at least 1970.**
- ♦ **Bankruptcy of Singapore oil trader adds to the pressure on the futures market.**
- ♦ **Meanwhile, number of active rigs in the US plunges 36% in a month, suggesting rapid output cuts.**
- ♦ **FAB AAC remains underweight in equities and overweight in gold.**



The crude oil market hit a perfect storm this Monday as technical positions joined with fundamental issues and prompted prices of the US benchmark to plunge more than 28% in a day. West Texas Intermediate crude for delivery today was trading at US$13.10 around 15:00 Abu Dhabi time, its lowest since 1999.

The sharp drop coincided with the expiration of futures contracts, which normally adds to volatility as investors roll over positions into next month's contracts. Exchange-traded funds and hedge funds are among those who take positions in oil using the futures contracts. These funds have to pay up when the next month futures price is higher than the expiring one, a situation known as 'contango' in the commodities market. The plunge in the spot price caused that contango to hit more than US$9, the highest since at least 1983, according to Bloomberg.

Such a high cost of 'rolling' may prompt losses for some funds that were dealing in oil, particularly those with leveraged positions. That could drive more volatility in the oil market. In fact, the bankruptcy of an independent oil trader in Singapore, which had large futures positions, may be part of the reason why the crude market has gone haywire.

To be sure, that issue and the 'roll' pressure have also come at a time when oversupply remains an issue, with oil demand having dropped by about 35 million barrels/day. OPEC+ nations have already agreed to cut output by nearly 10 million barrels/day to help reduce the excess supply and today Saudi and Russian officials suggested they could cut further if prices continue to fall.

Production is also dropping in non-OPEC countries. The number of active oil rigs in the US has dropped by 36% since the start of March, for instance.

Deep contango: the difference between oil contracts one month apart, hit a record today

Cuts in Brazil and other countries that are not part of the oil producing nations group add up to more than 3.5 million barrels/ day. On the flip side, Germany began to reopen their economy, allowing smaller shops to start receiving customers, and France said it will reveal a plan to reopen its own economy within two weeks.

The cuts and the prospects of the global lockdown being lifted have prompted many investors to look at oil, with crude exchange-traded funds seeing record inflows in the past week. However, in a similar vein to what is happening in the stock markets right now, taking a position in oil may be perilous. For now, volatility is likely to remain high.

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First Abu Dhabi Bank

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