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## Oil rout threatens to spill over into stock and credit markets

◆ **West Texas Intermediate for May delivery traded below zero for the first time as speculators were unable to take physical delivery and became willing to pay others to buy their contracts.**

◆ **The move has spilled over to other oil contracts with WTI for June delivery dropping 36% in the past two days and Brent falling 25%.**

◆ **Rising speculative positions in oil futures suggest the rout in the commodity prices could spill into other markets.**

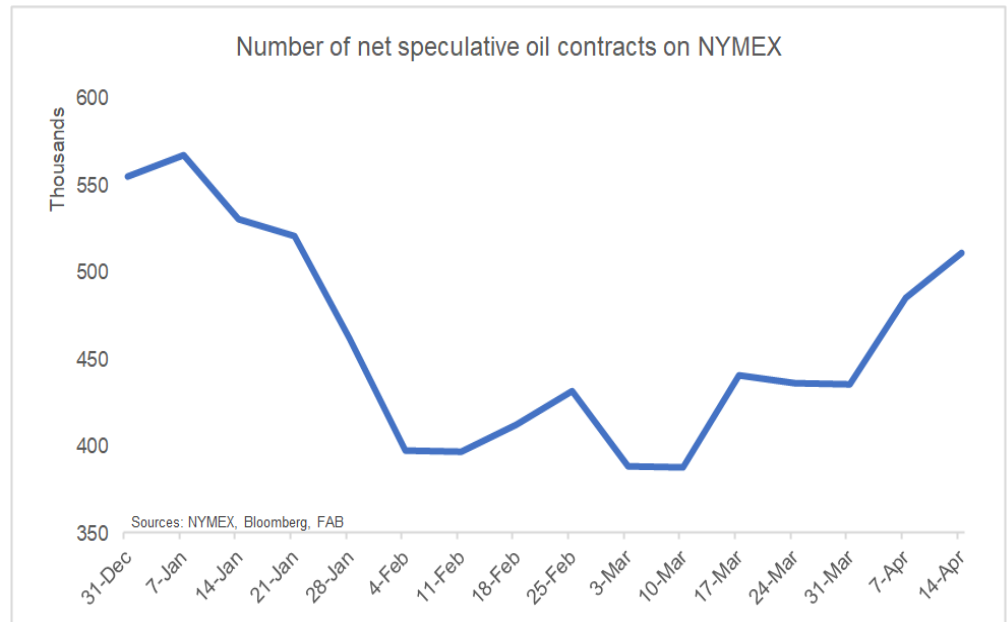
◆ **Stocks drop across the world in the wake of the oil drop, while dollar rises.**

◆ **FAB AAC remains underweight in equities and overweight in gold.**

The reality of supply and demand for crude oil took an extreme shape yesterday as future contracts for West Texas Intermediate crude to be delivered in May settled below zero for the first time in history. The move was the result of technical issues, but reflected the dire situation of the oil market.

New York Mercantile Exchange future contracts for oil have to be rolled over (exchanged for a new contract expiring further into the future) or be canceled through the delivery of crude at the expiration. Two reasons challenged that seemingly rational system yesterday, at the May delivery expiration date: large amounts of purely speculative investment and the lack of storage space.

Exchange-traded funds and hedge funds use futures to take advantage of the moves in oil prices. Neither of these want



physical delivery of oil, since they will not be selling the commodity to refineries. Sometimes they may even take the physical delivery, store the oil, and resell it at the next expiration date, but that is rare.

The point of delivery for the NYMEX contracts is Cushing, in Oklahoma, which can store up to 76 million barrels of oil. As of 14 April, the latest data available from the Department of Energy, Cushing's tanks were 72% full.

Given the recent pace of storage, Cushing would have been roughly at 80% of capacity yesterday, very close to the safety limit. Hence, it was difficult to take physical delivery of the May WTI contracts according to their terms. This pushed investors to pay for others to take the May futures contract off their hands, and drove oil to the aforementioned negative price. The danger is that Cushing is not being emptied and now the pressure has moved to other contracts, including Brent.

### The long speculative position of funds in WTI oil futures increased 17% in two weeks

The sudden and sharp oil drop also raises the specter of renewed selling in other markets. Credit spreads widened and stock markets dropped yesterday on the back of oil. This could be because some funds that had speculative positions on oil may have been forced to sell other assets to meet margin calls and liquidations from the crude investment.

Such a sell-off could trigger further margin calls and initiate another spiral down. To be sure, this time there is a lot more money slushing around after the world's central banks unleashed unprecedented monetary stimulus. Yet, with the economic news remaining bad and the end of a global lockdown still elusive, caution is still the key word to remember.

## Investment Strategy Update

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