THE CRUDE OIL SUPER CYCLE

> "While the general outlook in 2013 was bearish, no one called for crude oil to drop much below $90 per barrel; and they were right."

The current bear market in crude oil has gone through many stages. In fact, one could compare it to a 12-step program; and many a trader and analyst have probably entered one as they have been driven to drink while trying to figure out where the oil market would go.

In "What went wrong with oil? You listened to the Street" (page 82) Features Editor Garrett Baldwin takes issue with the Wall Street investment analysts who failed to see it coming. But going back to our October 2013 energy outlook ("USA: Energy producer to the world") we discussed the burgeoning U.S. crude oil production thanks to shale and the fracking revolution. Back then the question wasn't 'why is crude oil so low,' but 'if U.S. production is increasing so much, why isn't the price of crude coming down more?'

While the general outlook in 2013 was bearish, no one called for crude oil to drop much below $90 per barrel; and they were right. The situation in Syria was heating up at the time as well, causing some analysts to hedge their bearish bets.

Five months later, the next time we looked at the sector (see "The new world of energy "February 2014), things had gotten more interesting. There was talk of a deal with Iran, and we pointed out that geopolitical risk had become a two-way street. Analysts now had to calculate the effect of peace as well as the potential for war. U.S. crude oil production had continued to increase. Once again, most analysts we spoke to were bearish, but not prepared for oil to move below $80 (it actually rose close to 20% in the following months).

An issue brought up at the time for why the market wasn't responding more to bearish fundamentals was logistics. We had an energy infrastructure built to move oil up from the Gulf of Mexico to the North, but much of the new production had to move in the opposite direction.

Also, the market share argument had begun as many analysts expected the Saudis to cut production (crude was trading at roughly $95 at the time) to prevent the price from dropping too far, though some analysts pointed out that OPEC had less leverage because of new U.S. production.

At the time, we asked the question why $80? Why not $40? Only one analyst acknowledged that possibility, and not for a long time. A year later, $40 crude oil was a reality. All the bearish scenarios played out and none of the bullish ones. We were learning that U.S. shale producers were not only sitting on a lot of oil, but had also gotten more efficient. Assumptions regarding costs of production had been over-stated and those figures were coming down as most of the heavy investments were already made. Saudi Arabia did not believe it and on Thanksgiving 2014, OPEC decided against cutting production, setting the bear market into hyperdrive.

In this issue we take on the crude oil trend from all angles (see "Crude behavior," page 16). Our experts discuss the factors pressing on the crude oil market and explain why crude may stay "lower longer."

Sean Levine provides a yearlong outlook in "10 decisive oil forecasts for 2016," (page 28) and Hilary Till asks "Does OPEC spare capacity matter" (page 36).

In "Crude cause and effect," we talk to Donald Luskin who explains why the crash in crude oil prices has been a drag on the global economy. It is a perspective shared in Levine's piece, though both acknowledge that low crude oil prices should (and will) be a driver of economic growth in the long term.

That is why it is difficult to forecast markets. As many traders know, it does you no good to be right on a market call if you are wrong on the timing. The fundamentals for the bear market in crude oil were in place more than a year before the move started in earnest. But there were issues that needed to be worked through, like logistics and geopolitical risk.

All this is not to highlight when we got it right, but to point out the nature of trading. All the information traders needed to call this market was in front of them. If there is a lesson here it is one of patience. Fundamentals often take a while to work themselves into price. When crude made a bottom in early 2015, there were a lot of analysts calling for a massive rebound. They got one but the bear market was not done. Now as we note in our story, the seeds of the next move higher had been sown, but these things take time. Usually, more time than you expect.

Daniel P. Collins

Daniel P. Collins
Editor-in-Chief, Modern Trader
@moderntradered

Send your comments, criticisms and suggestions to openoutcry@moderntrader.com