

Oil:

An invisible hand is going to work!



Oil price has fallen by over 75% since its peak during last summer. There seems nothing can stop the trend as the slowing global economy is taking a large toll on oil demand. Even in China, one of the countries that powered the global growth in oil demand up to 2007, the rise in consumption is expected to slow sharply. The International Energy Agency (IEA) on last Wednesday lowered its estimate for global oil demand in 2009 because of the worsening economic downturn, according to International Herald Tribune. In its closely watched monthly survey, the IEA cut its forecast for demand this year by 570,000 barrels to 84.7 million barrels a day — 1.1% lower than 2008. It said this was because the International Monetary Fund now expected the world economy to grow by only 0.5%. Although the global demand for energy may be slowing, the world oil reserves are declining at nearly double digits rates and the money supply is also

growing exponentially. The IEA also warned that sharp production cuts from the OPECs, the oil producers' cartel, would mean that by the end of the year there would need to be a substantial draw-down in oil stocks, unless demand weakens even further, or supply from non-OPECs turns out to be stronger than expected. The OPECs will cut shipments by 3.5% in February, the biggest monthly drop in at least five years, as the group implements a record production reduction to bolster prices, according to tanker-tracker Oil Movements. OPECs cut its agreed production levels by 4.2m b/d in the second half of last year, and could well cut production again at its next meeting on March 15 in a bid to raise oil prices from last week's levels below \$40. In the short run we have to see these cuts OPEC made starting to make a dent in

inventories. Crude oil prices won't rebound to the \$70 level until the OPEC production cuts are reflected in falling inventories. Eventually it will eat into inventories, and then there will be a psychological turn in the market and we will start to see prices respond. The most important thing to determine the price of a commodity is the cost of production. When the market price is below the cost of production, it's usually a good time to buy (i.e. uranium at \$7 per pound in the 90's while production costs were \$15 to \$20 a pound — it had to go up). So if the cost of production of every new barrel is \$65 a barrel, it would have to go up. Obviously, oil is still an attractive commodity. Anyone would like to produce it. When oil was around \$10 a barrel in late 90's, Exxon Mobil was still profitable at that time.

Microscope

Recent sharp declines in oil prices seemed to mark the end of what has been the most historic commodity price boom of the past century. Like earlier booms, this one was driven by strong global economic growth and has come to an end with the abrupt slowdown in the global economy precipitated by the financial crisis. Between early 2003 and mid-2008, oil prices climbed by 320% in dollar terms, and internationally traded food prices by 138%. But the prolonged boom is clearly over. Prices across the board have fallen, giving up much of their earlier gains, due to slower GDP growth, increased supplies, and revised expectations. However, oil prices still remain a lot higher than they were at the start of the boom, owing to tight supply. Concerns persist about long-term demand and supply, and the impact of high commodity prices on the poor. Despite OPEC's relative ineffectiveness to prop prices up, Saudi Arabia has confirmed they cut production by 300,000 barrels a day. So far other members have stuck to the OPEC quotas — more or less. Most importantly, the crude oil price is relatively cheaper against gold now, according to the GOLD/OIL ratio in the past 23 years.

MARKET BRIEFING

YTD % (local curr)

US DJ	7,850 (-10.6%)
Nasdaq	1,534 (-2.7%)
Euro Stoxx 50	2,228 (-9.1%)
HSI	13,554 (-5.8%)
Japan NK225	7,779 (-12.2%)
China Shanghai Composite	2,320 (27.5%)
Singapore	1,705 (-3.2%)
India BSE30	9,634 (-0.1%)
Brazil BOVESPA	41,673 (11%)
Aus All Ord	3,496 (-4.4%)
US-10yr Bond	Yield 2.89%

As at 13/02/09

Insight: "Recession Cycle"

The old adage "what goes up must come down" applies perfectly now. After experiencing a great deal of growth and success during 2003-2006, income and employment begin to decline. As the prices of goods in the economy are inflexible to change, they will most likely remain near the same level as in the peak period unless the recession is prolonged. The result of these factors is negative growth in the economy. The concern over recession eventually feeds recession. Understanding the recession cycle is crucial to improve portfolio returns. What's an investor to do during

recession? It really depends on what type of investor he is. First, remember that a bear market does not mean there are no ways to make money. A group of investors, called value investors uses recession much

like a sale at department stores. They look at a fallen stock not as a failure, but as a bargain. They know that better times will eventually return in the economy, picking up high-quality assets that are selling for cheap. Another type of investor barely flinches during recession, knowing that short-term problems will only be a blip on the chart when taking a 20-30 year horizon. This investor merely continues dollar-cost averaging in a bad market the same way as he or she would in a good one. Of course, many of us don't have the luxury of a 20-year horizon. The key is to pick a style that works for you.

A-Z Financial Tools

Leading Indicator can illustrate the economic status ahead. Examples of leading indicators include production workweek, building permits, unemployment insurance claims, money supply, inventory changes, and stock prices. The monetary authorities watch many of these indicators as they decide what to do about interest rates.



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