Philequity Corner (March 2, 2009)
By Valentino Sy

Crude oil: forming a bottom

After hitting a four-year low of $32.40 a barrel on December 19, crude oil has now rebounded 38 percent. Most investors may not have noticed this because retail gasoline prices have only nudged up a bit since December. In fact, in the case of diesel, prices have even declined by 18.5 percent since over the same period.

	Unleaded Gasoline Price/liter	Diesel Price/liter
24-Feb-09	35.71	28.45
30-Jan-09	34.21	30.2
16-Dec-08	34.96	34.94
30-Nov-08	35.96	35.94
28-Oct-08	46.96	45.94
30-Sep-08	49.96	48.94
29-Aug-08	54.96	53.94
30-Jul-09	60.46	60.02

Source: DOE Oil Monitor

But while crude oil remains vulnerable to further disappointment in global economic conditions, there is a potential that a price base is forming. So, enjoy the low gasoline prices while it lasts.

OPEC curtails production

One reason why the oil prices have held up is that the OPEC production cuts may already be taking effect. Back in December, OPEC agreed to reduce production by 2.2 million barrels a day, starting from January 1, adding to previous cuts of 2 million barrels.

Overall, the reduction is equal to about 5 percent of the world's oil demand. This would easily offset the drop in demand of 1 to 2 percent this year as expected by most energy agencies, including the US Energy Information Administration (EIA) and the International Energy Agency (IEA).

Crude inventories rise less than expected

Another reason why oil prices rallied strongly last week (up 11.8 percent) is because of the US EIA report that showed demand for gasoline is on the rise and that crude inventories have not grown as fast as was thought.

According to the report, US commercial crude oil inventories rose 700,000 barrels for the week ending Feruary 20. Analysts surveyed by Platts were looking for a gain of 2 million barrels. Meanwhile, gasoline inventories fell by 3.4 million barrels, more than analysts expected.

A tradable bottom in oil

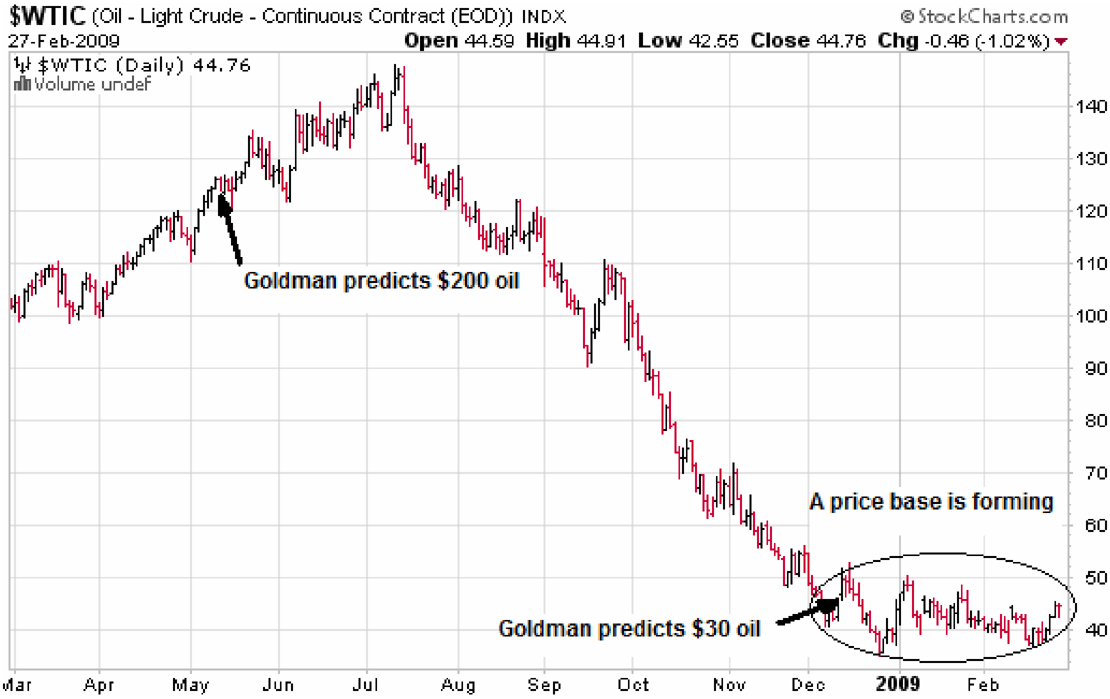
Despite the rally from December lows, the price of crude oil is still down more than $100 per barrel from its peak in July 2008. At the current price level, we believe that investors are getting a good reward-to-risk trade-off by owning oil. The risk for oil is that it can fall by $10, or $15, or as much as $20. However, it can also rise by $20, $30, or even $40 from current level. In fact, when the inflation scare comes back in a few years, it is not far-fetched to see oil trading above the $100 per barrel level again.

From $200 to $25

We all remember back in May 2008 when Goldman Sachs issued a report predicting that oil's "super spike" would likely send it to $200 per barrel over the 6-24 months (refer to previous chart). Two months later, in July, oil peaked.

Meanwhile in December, Goldman reversed their previous call and predicted that oil will reach $30 per barrel over the next three months. Merrill Lynch outdid Goldman a few days after by predicting oil to hit $25 per barrel. But two months after those calls, oil now appears to be bottoming out.

If the call for $25-$30 oil is as accurate as the call for $200 oil, investors may want to load up on oil and lock-in the cheap prices.



Investment options

Just like with gold (which we discussed last week), investors can invest in oil thru exchange traded funds (ETFs). The most popular is the US Oil Fund (symbol: USO), which holds oil futures contracts and trades on the New York Stock Exchange. Other avenues include holding energy sector ETFs such as the Energy Select Sector SPDR (symbol: XLE) and the Oil Service Holders Trust (symbol: OIH).

Investors can also buy individual oil stocks such as Exxon-Mobil (symbol: XOM) and Chevron Corp. (symbol: CVX) in the US, Petrobras (symbol: PBR) in Brazil, CNOOC Limited (symbol: CEO) in China and British Petroleum (symbol: BP) in the UK.

In the local context, we have oil companies trading on the Phil. Stock Exchange but they are not liquid and their oil reserves are small. An alternative for oil would be geothermal energy, in which case PNOC-EDC (symbol: EDC) is a good proxy because of its size and liquidity.

For comments and inquiries, you can email us at info@philequity.net. You can also view our archived articles at www.philequity.net or www.yehey.com/finance.