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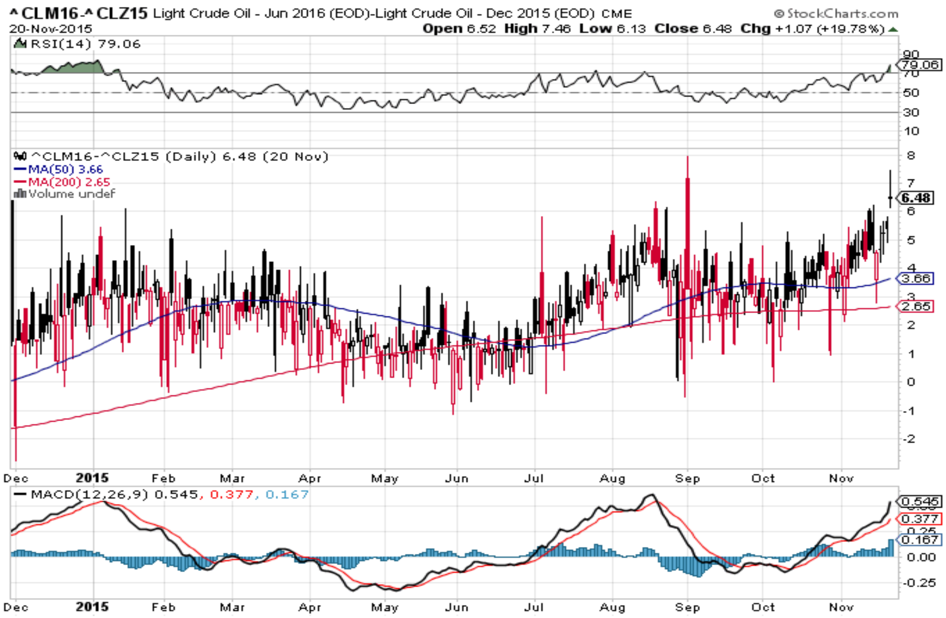
A Short-Term Trading Opportunity Emerges—Buy Oil in Front of Fed Decision

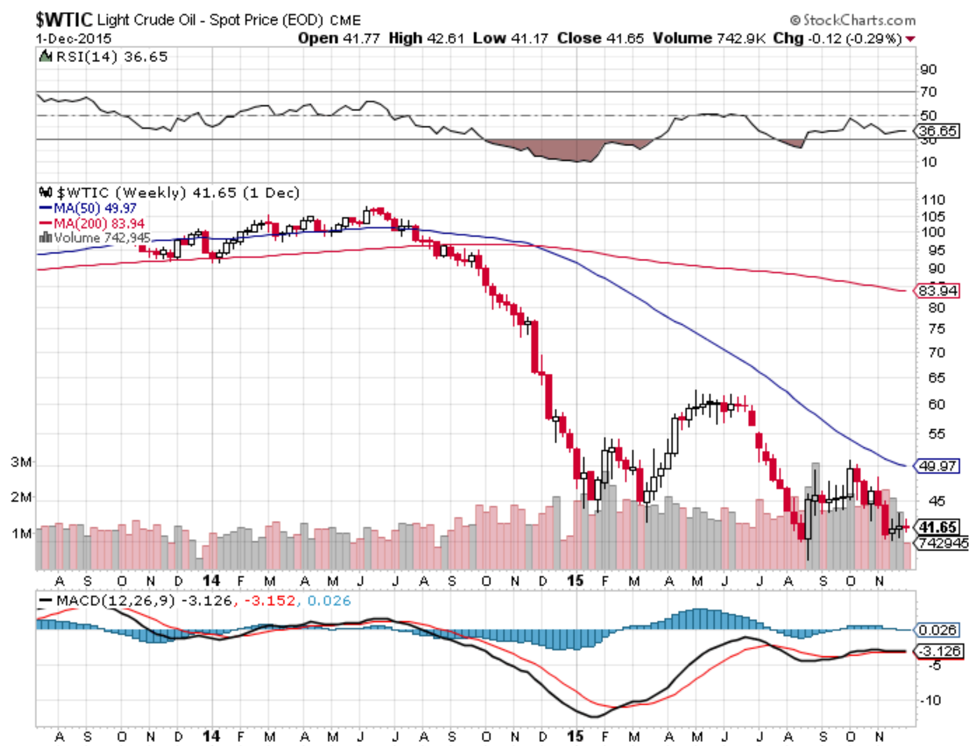
Near-term catalysts continue to propel the U.S. dollar higher, making the long dollar-short euro trade even more crowded. Along with most market participants, we anticipate that the European Central Bank will announce an increase in its bond-buying program when it meets tomorrow. This should add fuel to the fire as the dollar rally continues in the run-up to the Fed's rate decision on December 16th. Friday's nonfarm payrolls report should provide the Fed with added comfort to act in raising rates, although, in our view, a decision to hike is more about the Fed Chair retaining credibility than economic necessity. **Regardless as to whether the Fed raises or not, we believe that most, if not all, of the dollar's gains will have already been achieved by then, setting up the classic "sell on the news" as traders lock-in profits absent a new catalyst to drive the dollar higher.**

The subsequent short-covering euro rally should eliminate [at least temporarily] a large source of the downward pressure on oil as traders sell their dollar positions. The bounce in oil could be helped [potentially] by positive news from the December 4th OPEC meeting although as we wrote recently in our November 20th report we do not expect the Saudis to offer anything more than lip service regarding production cuts but hope often springs eternal among others. **Absent a new catalyst to drive oil lower through the end of the year, we anticipate a rally in crude and oil-related stocks to emerge and suggest establishing trading positions in the days immediately prior to the December 16th Fed rate decision.**

We emphasize that this is a "trading call". As the euro short-covering rally runs its course, the dollar is likely to recover and stabilize for several weeks, if not longer. **We anticipate a rally for oil and oil-related securities to resemble the sharp rise off the August bottom, which faded just as quickly as it began. Fears of rising production from Iraq, Iran and even Libya coupled with the lack of a new demand catalyst will likely return downward pressure on crude within weeks.**

There is another reason to believe that oil prices will quickly head lower again. Futures spreads have returned to higher levels. Despite lower spot prices, contango is back near the highs where oil prices previously failed.





As we've stated previously, those bulls hoping that the December 4th meeting of OPEC oil ministers will be a catalyst for higher oil prices are destined for disappointment. The outlook for higher oil prices ahead of Friday's OPEC meeting now espoused by the Saudis is nothing more than condescension (and political cover) to appease the weaker OPEC member nations. Ignore all the noise around the meeting—the Saudis certainly will. Non-OPEC producing countries will continue to plead for production discipline within OPEC, which is aimed at Saudi Arabia and its gulf allies. The weaker OPEC members (the loudest being Venezuela) will echo the call for cutbacks that would be borne predominantly by the Saudis. But without any bargaining leverage whatsoever, the weaker members will have no choice but to be patient and acquiesce to the Saudis**. Nonetheless, oil prices may still receive a temporary short-term boost as some market participants speculate by choosing to believe what they want to believe when accepting Saudi comments in support of neat-term higher oil prices at face value.**

Long speculation has risen over the last few weeks. Some believe that oil has put in a bottom (perhaps in anticipation of positive news out of the OPEC meeting) but we noted nothing fundamentally or technically to support such a view. To our point, the most recent EIA forecasts do not show a material drop in U.S. crude production from September. Today's crude inventory build of 1.177 mb (along with larger than expected build in distillates stocks) surprised the market expecting a decline of 0.471 mb, which should renew short-term downward pressure on crude. **Commercial oil traders, who should be in the best position to know, have been short.**

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