Bullish Hedge Funds Bet Big on Crude Price Rises

Stockholm (HedgeNordic) – Hedge Funds are making a massive collective bet on rising oil prices, according to the most recent data from regulators and exchanges.

Having added an extra 41 million barrels to net long positions in the seven days ending in January 31, hedge funds now have long positions equivalent to almost 1 billion barrels across contracts with the three main Brent and WTI (West Texas Intermediate) futures and options contracts, Reuters reports. This is in contrast to short positions amounting to 111 million barrels, with combined short positions across Brent and WTI at their lowest level in 7 months, creating a ratio of almost 9:1.

The extremely bullish position, which on paper is equal to nine days of global oil demand, has also prompted traders "to express concern prices could fall if funds move to take profits by selling positions en masse," according to the Financial Times. John Kemp, a market analyst with Reuters, agrees, suggesting the bullishness has become a key source of risk in oil markets due to its lopsided nature, with the crude market starting to resemble "the classic crowded trade in which speculators attempt to position themselves in the same direction in anticipation of a big price move." Brent prices have risen close to $55-$60, which energy market professionals expect to be the average for 2017, he adds.

It follows that fund managers are convinced output reductions by OPEC, Russia and others in the global supply pact last year to curb supplies and raise prices will contribute to draining excess inventories globally, and therefore push prices higher. The massive oil bet could also reflect the involvement of large macro funds, which sometimes trade oil as a hedge against moves in other sectors. One reason might be protection against higher costs stemming from anticipated inflation as a result of U.S. President Donald Trump's plans for lower taxes, deregulation and infrastructure spending, the Financial Times suggests.

Rush for the Exit?

However, hedge fund managers appear to be discounting renewed drilling in the U.S. and a likely increase in shale production output, according to Mr Kemp. Most importantly, it remains unclear how and at what price fund managers will manage down positions and try to take profits.

"The enormous concentration of hedge fund long positions has emerged as an important source of price risk in the near term. One-way markets, when traders attempt to position themselves in the same direction, often precede sharp reversals in prices," Mr. Kemp warns. "The previous record net long position in oil markets, set in June 2014, preceded the deepest and most prolonged slump in prices for almost 20 years. And in the last two years, large concentrations of short positions have normally preceded a sharp short-covering rally as managers raced to lock in profits when prices stopped falling. With so many fund managers now positioned in the same (long) direction, the risk of a rush for the exits, a disorderly liquidation of positions and a correction in prices has risen significantly," he adds.

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