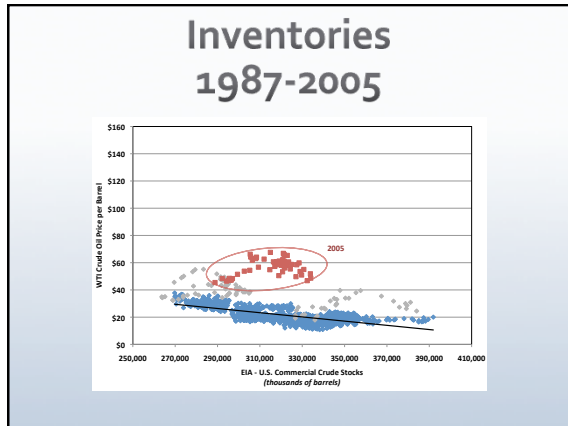
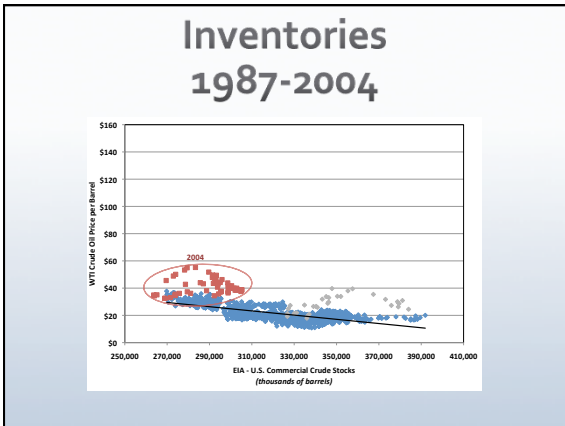
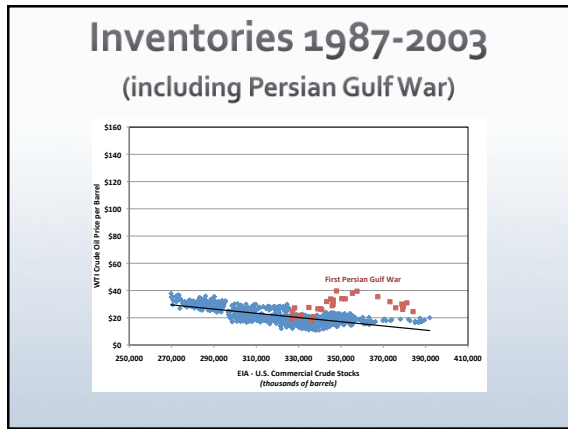
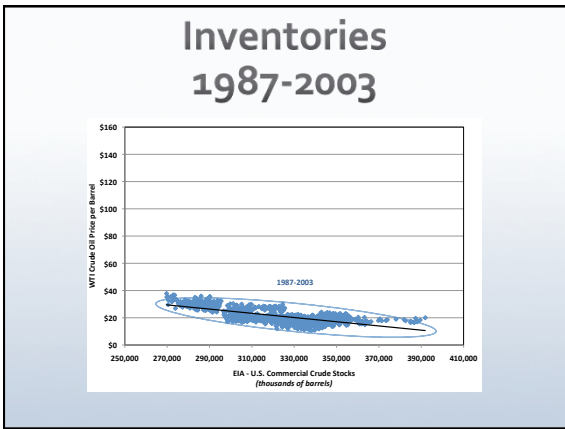


## Investors Dominate the Price Discovery Function For Oil Markets

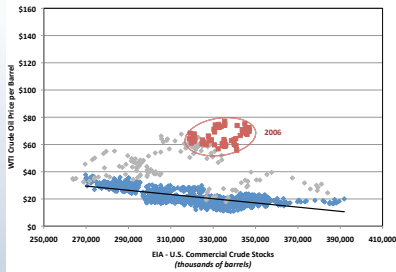
Presentation by  
**MICHAEL W. MASTERS**  
 Masters Capital Management  
 CONSUMER ENERGY ALLIANCE  
 March 18, 2010

## Supply & Demand No Longer Tell The Story

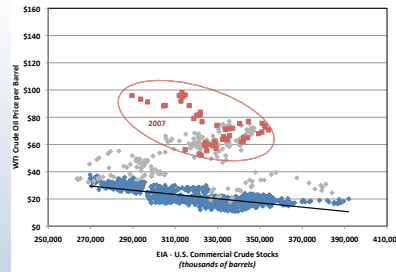
- Supply and Demand expressed as Inventories used to be a fairly good predictor of crude oil prices
- Since 2004, Supply and Demand have become increasingly irrelevant at predicting crude oil prices



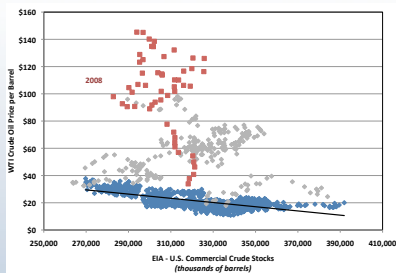
### Inventories 1987-2006



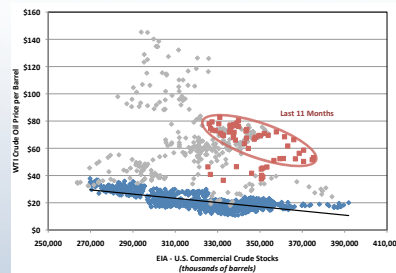
### Inventories 1987-2007



### Inventories 1987-2008



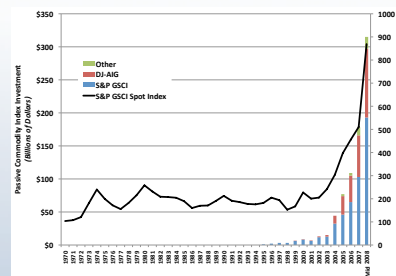
### Inventories 1987-2010



### Wall Of Investor Money

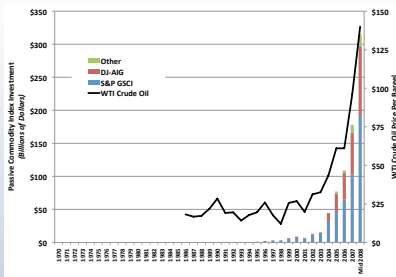
- Large amounts of institutional investor money flowed into commodities futures generally, and oil futures specifically beginning in 2004
- The pace of inflows accelerated substantially at the beginning of 2008
- This created a speculative bubble in oil prices which popped in the middle of 2008
- Since March of 2009 this echo-bubble has been steadily re-inflating at an even faster rate than 2008

### Passive Commodity Index Investment



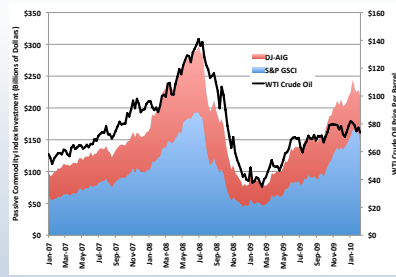
Source: Goldman Sachs, Standard & Poor's, Dow Jones, calculations based upon Commodities Futures Trading Commission (CFTC) Commodity Index Trader (CIT) Supplement. Mid 2008 figure is as of July 1.

## Passive Commodity Index Investment



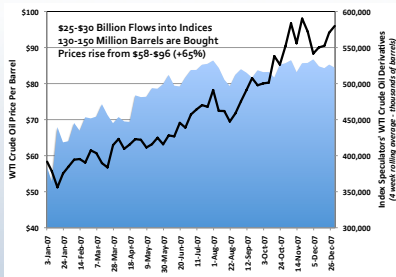
Source: Goldman Sachs, Standard & Poor's, Dow Jones, calculations based upon CFTC CIT report. Mid 2008 figure is as of July 1.

## Passive Commodity Index Investment



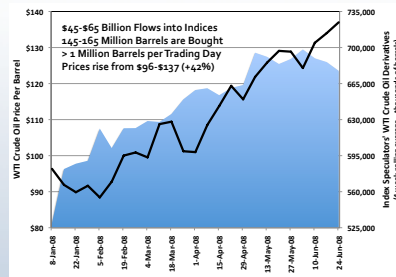
Source: Author calculations based on CFTC CIT report

### 2007



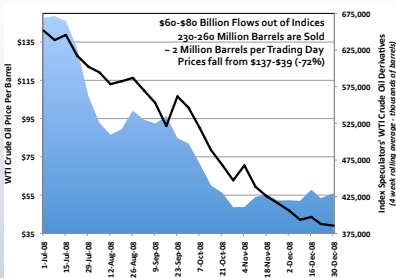
Source: Author calculations based on CFTC CIT report

### 1<sup>st</sup> Half 2008



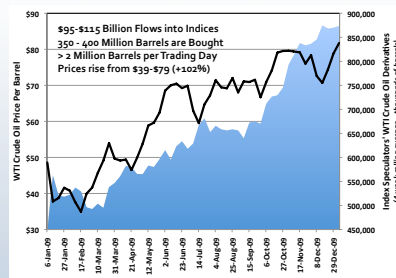
Source: Author calculations based on CFTC CIT report

### 2<sup>nd</sup> Half 2008

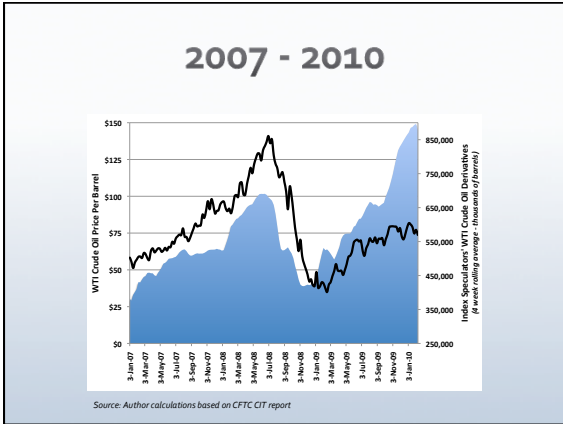


Source: Author calculations based on CFTC CIT report

### 2009

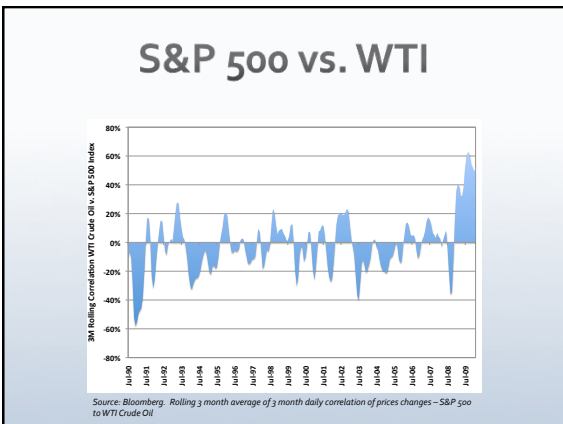
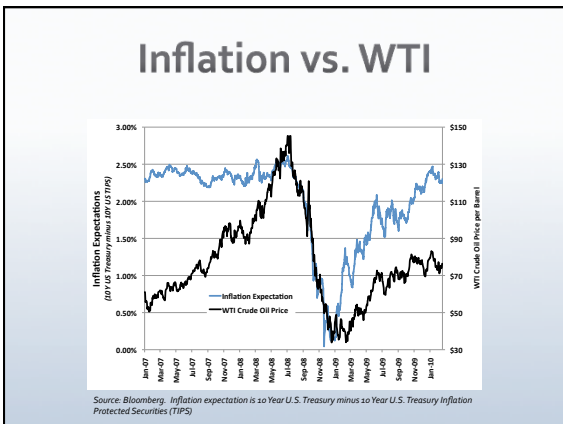
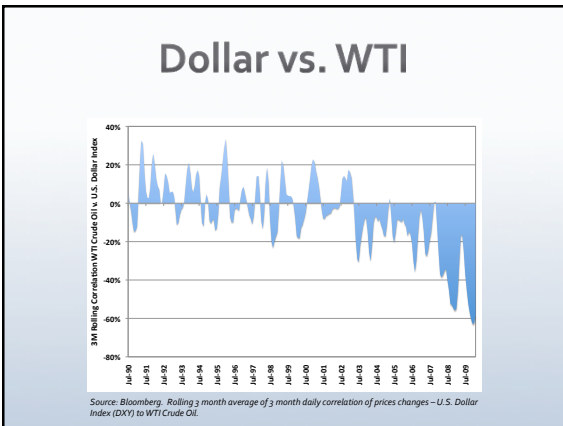
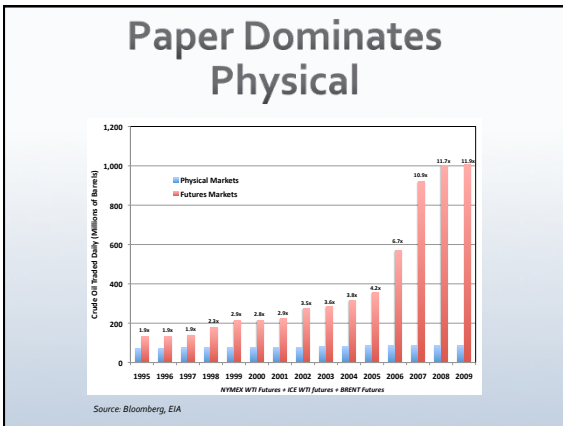


Source: Author calculations based on CFTC CIT report

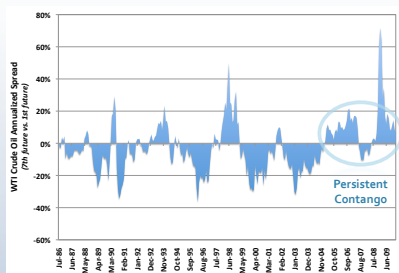


## Effects Of Money Wall

- Derivatives markets are the dog and the spot markets are the tail
- In crude oil markets today, derivatives markets determine spot prices
- Oil has become "financialized" where prices are determined by investors, not producers and consumers
- Oil prices correlate with U.S. Dollar, S&P 500 and inflation expectations
- The rationale for "investing" in oil has been destroyed by the investors themselves

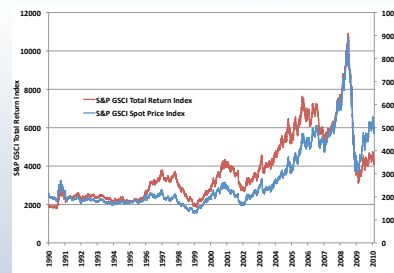


## Persistent Contango



Source: Bloomberg. Monthly averages of annualized spread between 7<sup>th</sup> WTI crude oil future from expiration and 1<sup>st</sup> WTI crude oil future from expiration

## Negative Roll Yield



Source: Bloomberg

## Summary

- Investors have transformed the price discovery function for oil because they now dominate the oil derivatives markets.
- Oil has become a financial "asset" and it now correlates with financial markets
- Because it's "financialized," oil prices are now subject to speculative booms and busts
- Governments must take steps to re-instate speculative position limits in the derivatives markets and severely restrict the phenomenon of passive investment.

## Legislative Update

- House Bill has passed
  - Relatively strong position limits language
  - Loopholes equal 45% of clearing and 100% of trading
- Senate Banking Discussion Draft Introduced
  - Derivatives portion just a placeholder, reportedly not finalized by Senators Reed or Gregg
  - Would be stronger than House if not for the Membership Loophole
- Senate Agriculture Draft Expected Next Week
  - Senator Lincoln's primary challenge and tough general election leave her with less time to devote to this bill
  - She says she wants a bipartisan bill