GETTING TECHNICAL

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Oil Can Top $100 a Barrel Soon Enough

By MICHAEL KAHN |

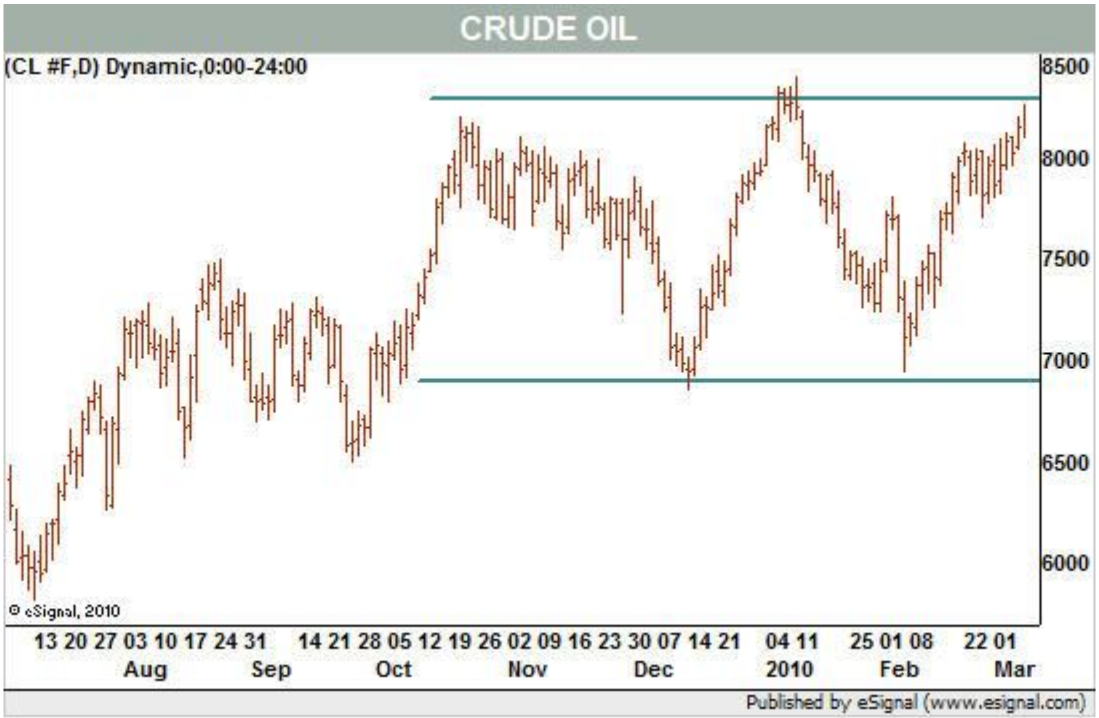
Though still in a trading range, crude oil is showing technical signs that it can easily make a decent run in the next few months.

THE FUNDAMENTALS IN THE crude oil market got a boost in recent weeks with renewed hopes of a swift recovery in the global economy (demand increases) and ethnic violence in oil rich Nigeria (supply disruptions). This pushed crude prices above $82 a barrel.

There's nothing new about this fundament argument for rising oil prices. What is new, however, is that the technicals agree and indeed look rather rosy. A run to the $100 per barrel mark over the next few months is quite possible.

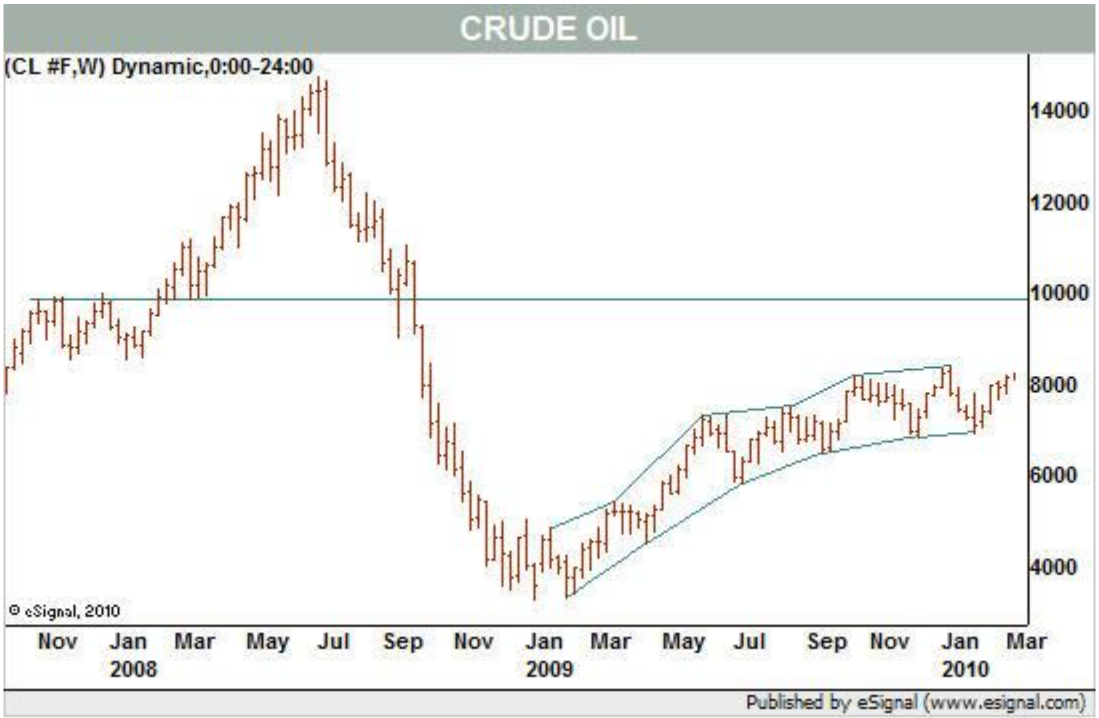
Crude oil has been trading in a range since October between 69 and 83 dollars per barrel, in round numbers but this is not the reason for technical bullishness (see Chart 1). After all, in technical circles, trading range tops, also called resistance, are presumed to hold price advances in check unless proven otherwise.

Chart 1



But let's look at the larger picture. Even though prices have not made much headway for several months, they still have registered higher highs and higher lows since February of last year (see Chart 2). In other words, a bull market is still intact.

Chart 2



If we go back to the trading range and measure its height from lower border to upper border, we can forecast a price target should the market break out to the upside. The 14 dollar height projected up from the presumed breakout point yields a minimum target near 97. This is very close to traditional chart resistance at 100 as can be seen on the left hand side of the chart.

But again, the market has not broken out just yet. It is the weight of the technicals beneath the surface that make the bullish case.

For starters, the seasonal tendency for crude oil to rally from March through May is well documented. John Kosar of Asbury Research says that following the lead of a positive March, April and May are the strongest two months of the year based on data going back 32 years.

Sentiment also plays a role in this market. While certain surveys of trader opinions, such as Jake Bernstein's Daily Sentiment Index (DSI), show a rather neutral mood in the trading pits on the surface, the Commitments of Traders report (COT) shows something more bullish.

The COT breaks down all futures trading activity by types of traders. The theory is that large commercial players, such as oil drillers and refiners, have access to better information and are therefore the "smart money." On the opposite end are the small speculators who are easily swayed by short-term events. Just looking at the track record of the two groups we can see that the commercials are much better market timers.

Veteran trader Larry Williams reported that commercials were large accumulators of crude oil starting the last week of February. Small speculators, on the other hand, were excessively bearish.

Based on the COT, the sentiment environment for crude oil market is bullish.

Kosar offered another reason for strength in crude oil. He monitors the percentage of assets invested in Rydex energy sector mutual funds compared to assets invested in all Rydex sector funds. Right now, that percentage is at a multi-year low and tells him that the public is underinvested in energy stocks. He said that this condition typically coincides with or leads intermediate-term advances in both the energy sector and in crude oil prices.

In other words, it is bullish for oil and for energy stocks.

Energy bears may counter with last week's American Petroleum Institute report that crude oil inventories showed a greater-than-expected rise. Indeed, Phil Flynn, senior market analyst at PFG Best, agreed that the world is awash in spare production and refining capacity.

But Howard Tanney at Cortan Commodity Partners said that oil pricing is not based just on current supply and demand but also on investor perceptions of future supply and demand. Economic factors have become much more of a pricing component lately as more institutions are using oil as a financial tool.

I take all of this to mean that a breakout in the price of crude oil above its recent-trading range would indeed have legs.

Getting Technical Mailbag: Send your questions on technical analysis to us at online.editors@barrons.com. We'll cover as many as we can, but please remember that we cannot give investment advice.

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