Our View: Speculators Abandon Oil

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Commodities trader Pierre Andurand has abandoned oil for copper and cocoa. In his view, oil no longer offers a great risk/reward, while copper and other commodities do. The resulting loss of support from the commodity speculators he influences will put downward pressure on oil prices.

The strategic reserve crude oil release in the spring of 2022 in response to Russia invading Ukraine explains the change in the market's attractiveness and Andurand's decision. Oil refiners and traders learned that governments will augment supplies during a disruption but will not offer financial support to companies whose hedges "blow up" during sharp price increases. This knowledge has eliminated the panic buying once associated with disruptive events that helped make oil speculation by Andurand and others extremely profitable.

OPEC members will meet remotely on Sunday, June 2, with the countries comprising the "plus" group. They will not be celebrating because prices are still below desired levels. No one should be surprised if Saudi oil minister Abdulaziz again criticizes speculators for shorting oil. The recent drop in the net long position of money managers is sure to displease him and others in the oil-exporting alliance.

However, the producers' group is powerless today to move prices without significant output reductions because the IEA and the United States apparently have changed the market's behavior.

By meeting online, the group will miss an opportunity to visit in person with Pierre Andurand. Were such an encounter to occur, Andurand would likely advise them to commit to significant long-term production cuts. He might also explain that commodity investors now have other, far more attractive markets, perhaps pointing to the surge in the money managers' net long position in copper on the CME.

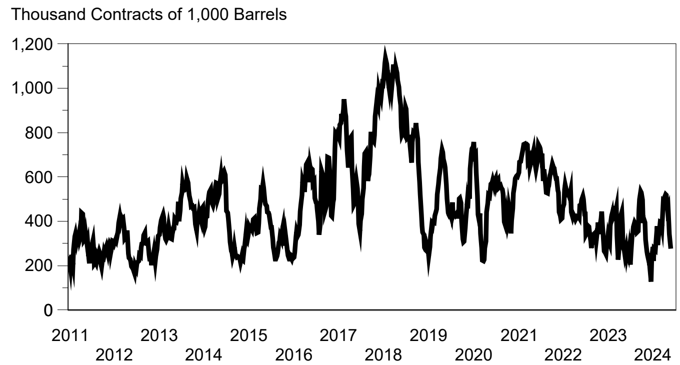
Of course, Andurand will not participate, in person or otherwise. We also doubt that anyone at the meeting will be bold enough to tell the ministers they are losing a competitive battle for speculative money. No one will warn the ministers that they are no longer the only game in town or that, in fact, oil has become one of the commodities least interesting to investors. The decline in the net long position of money managers shown in Figure 1 (page 2) is notable.

Andurand has now turned his attention to commodities such as cocoa and copper. Other speculators are following. In an interview with *Financial Times*, Andurand indicated he expected copper prices to triple. Regarding oil, he was contrite:

> "I think oil traders have learned to be quite cautious about getting excited about potential supply disruptions," he said. "I think we all lost a lot of money, expecting supply disruption that did not happen. You remember that pain."

Andurand has not yet acknowledged how the 2022 strategic stock release influenced his decision. Traders prefer to operate in open markets undisturbed by government intervention. The absence of a market reaction to the Hamas attack on Israel and Yemin attacks on ships in 2023 reflects a change in expectations of market participants. Strategic inventories, once thought to be oil sequestered for some undefined Armageddon and never used in ordinary market circumstances, were now seen as available supplies. Companies seem to have responded by cutting stock holdings.

Figure 1
Net Long Positions of Money Managers in Crude Futures on Three Exchanges, 2011 to 2024



Source: CFTC.

The financial turmoil caused by the huge increases in electricity and natural gas prices in 2022, combined with record margin calls and high interest rates, no doubt further dissuaded private firms from accumulating inventories. Firms discovered that the financial risk from hedging was far higher than expected, making inventories uncertain investments. Companies likely reviewed inventory strategies, looking to operate with even lower stocks, free up working capital, and eliminate unpleasant surprises like hefty margin calls or unanticipated strategic stock sales.

These changes in market behavior alter the supply and demand situation confronting the OPEC+ delegates. A mere extension of the current agreement will likely have little impact on markets. Companies will continue their efforts to reduce inventories, removing support for rising prices. Meanwhile, traders such as Andurand will be allocating increasing amounts of their cash to other commodities at oil's expense.