

Our View: Close the Exits

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Money managers, a.k.a., speculators, play a significant role in determining short-run oil price movements. In this week's *Notes at the Margin*, I examined thirty episodes dating from 2011 in which the net position of money managers declined by more than one hundred thousand futures and options equivalent WTI and Brent contracts on the Chicago Mercantile (CME) and InterContinental (ICE) exchanges. I found that, on average, the sale of one thousand contracts resulted in a price decline of \$0.04 per barrel.

This finding should motivate oil-exporting countries to maintain an environment that promotes, rather than discourages, increased speculative participation.

The oil price movements between July 29 and August 2 were astounding. On Monday, prices rose by \$2 per barrel. On Tuesday, they fell by \$1.30. Then prices jumped by \$3, only to drop by \$2.60 on Thursday and another \$2.30 on Friday. When the week ended, WTI had lost almost \$4, while Brent had declined by \$2.

The decline was driven by the exit of speculators anticipating a strong decrease in commodity prices. According to the *Financial Times*,

Commodities from copper to corn have been tumbling as plentiful supplies and flagging Chinese demand prompt fund managers to cut around \$41bn of bullish bets on natural resources.

The sell-off in copper, a bellwether of the global economy because of its wide-ranging uses in building, infrastructure and manufacturing, has been particularly stark—it is down close to 20 per cent from its record high in May above \$11,000 per tonne.¹

The greatest losses occurred in the copper market, where prices had soared earlier this year:

The widespread sell-off marks a sharp reversal from just over two months ago when some commodities, including copper, reached record highs as investors poured in money and bearish traders were forced out of their bets. Many were also drawn to copper as a way of hedging against inflation, after US inflation in March rose faster than expected.

Oil prices dropped along with other commodities. Much of the decline resulted from speculators abandoning oil, as Bloomberg's Julia Fanzeres described:

¹ Susannah Savage, Harry Dempsey, and Wenjie Ding, "Commodity bulls' dash for exit sends prices tumbling," *Financial Times*, August 1, 2024 [<https://tinyurl.com/4c4af4cu>].

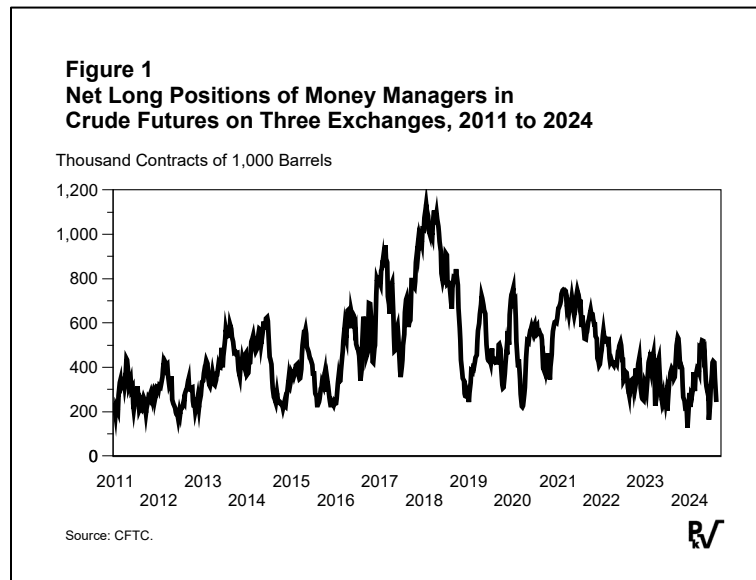
Hedge funds slashed bullish wagers on Brent crude by the most in almost two years amid an algorithmic selloff and increasing concerns about demand.

Money managers reduced their long-only positions on Brent by 55,708 lots to 209,518 lots in the week ended July 30, the biggest absolute decline since March 2022, according to figures from ICE Futures Europe. Meanwhile, funds' net bullish position on West Texas Intermediate slid to a six-week low, Commodities [sic] Futures Trading Commission data.

The drop comes after Brent futures sank below \$80 a barrel amid an algorithmic-propelled selloff. Commodity trading advisers dumped their bullish positions after futures pierced both the 50-day and 100-day moving averages, which had acted as support levels for the commodity.²

Figure 1 tracks the rise and fall in the net long position of money managers (Fanzeres' "hedge funds") in Brent and WTI futures. The rapid liquidation over the last three weeks stands out.

However, the market has seen even greater liquidations. Over the last three weeks, money managers cut their net long positions in crude oil by one hundred seventy-two thousand contracts. In 2018, they reduced them by five hundred seventy-five thousand contracts between October and December after the US declined to increase sanctions on Iran. While WTI prices dropped \$6.65 during the recent selloff, six years ago they decreased by \$30.



Oil prices declined, on average, by \$0.04 per barrel per thousand-contract decrease in traders' net position over the last three years. In 2018, the average was \$0.05 per barrel. The data are remarkably consistent.

Figure 2 below summarizes the declines that occurred in twenty episodes when money managers cut their long positions by more than 100,000 contracts. The graph shows the price change per thousand contracts added or subtracted from the money managers' net position in Brent and WTI futures and option equivalent contracts. (Note that the numbers shown are mostly positive because the calculation is the ratio of the price change to the position change.)

² Julia Fanzeres, "Hedge Funds Cut Bullish Brent Bets Most Since 2022 Amid Selloff," Bloomberg, August 2, 2024 [<https://tinyurl.com/2ktuxbfd>].

The analysis holds when extended back to 2011. The ministers from oil-exporting nations must note this influence of money managers and speculators if they hope to raise prices. Their current efforts are failing.

