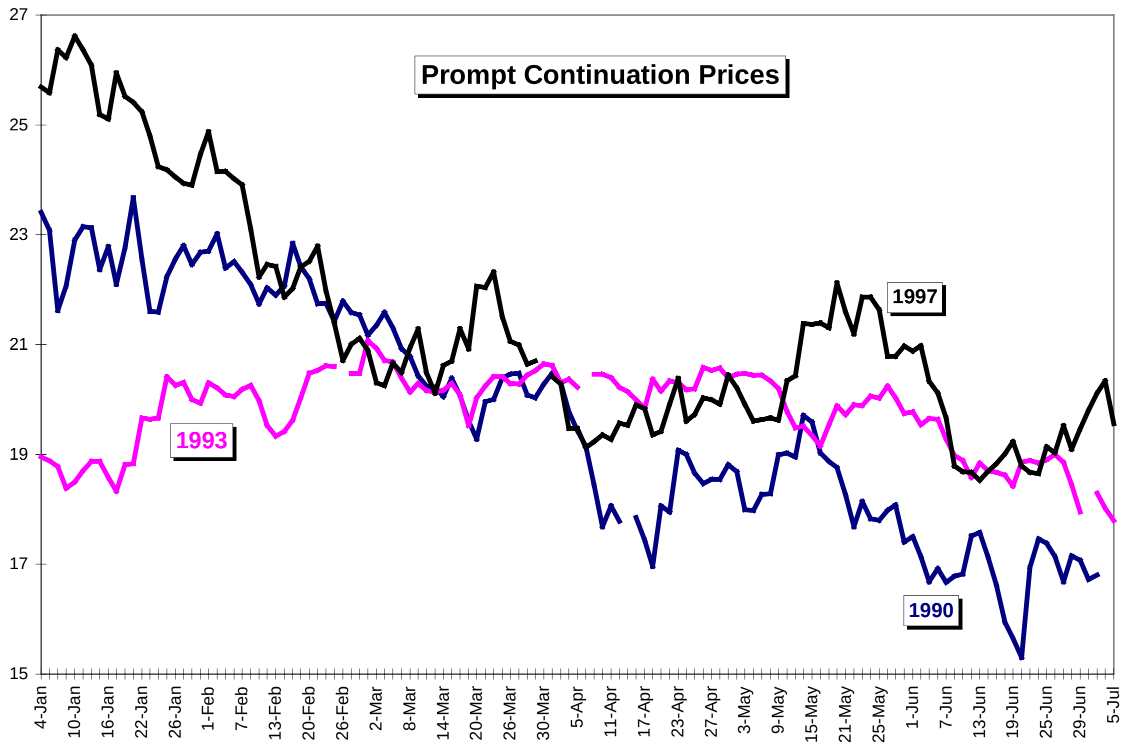
A Crude Comparison

What is like a good analogy? Past performance may not predict future results, but upon what else can we base our decisions? George Santayana had the whole thing pegged: those who do not learn history are condemned to quote him.

Market analogies are actually quite useful from both fundamental and technical perspectives. On the fundamental side, we can analogize from cyclical occurrences such as the El Nino current, or, even more simply, from seasonal patterns of heating oil or natural gas consumption. Technically, we can overlay charts from different periods and study common patterns of human behavior. For example, the bull markets of the 1920s and 1980s tracked each other quite closely through their long ascents, their October crashes, and their subsequent recoveries early into the following years of 1930 and 1988, respectively, after which they diverged.

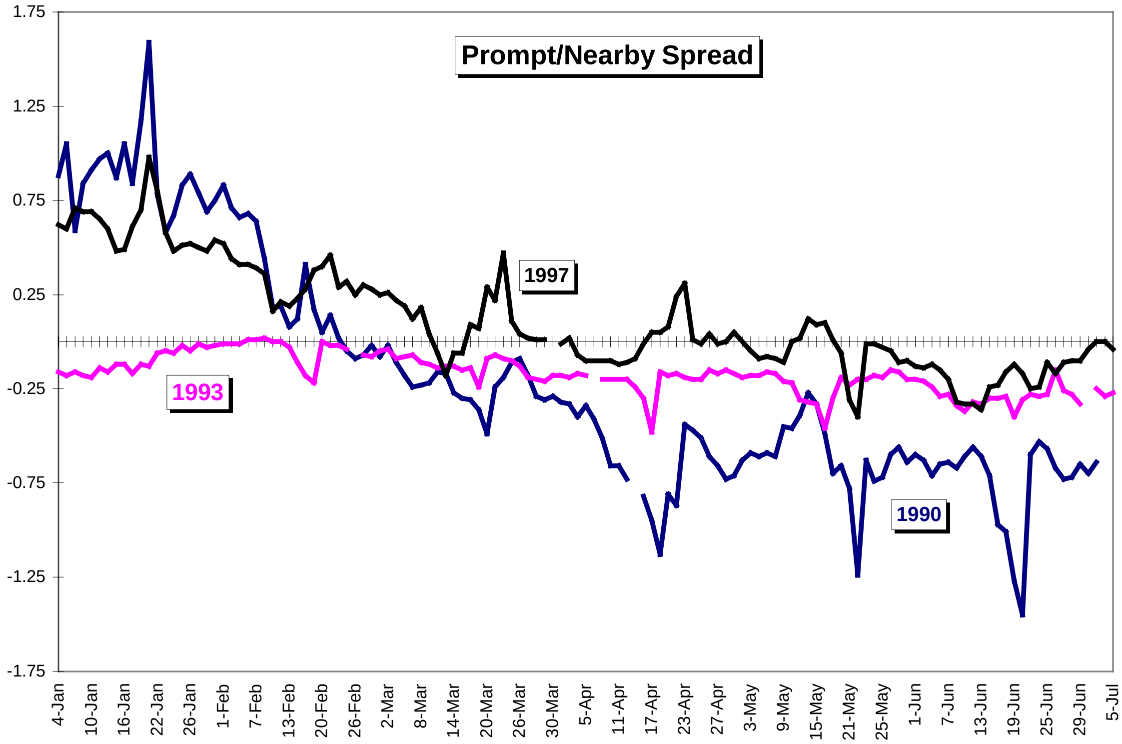
A possible analogy is shaping up in the crude oil market between 1997 and the years 1990 and 1993 (it is hard to remember that prior to the invasion of Kuwait that crude oil was in a bear market in 1990). This can be seen in two dimensions, price and the intermonth spread. The data in the charts below are spot continuation charts for the first half of each year where data are adjusted in time so that days of the week match.



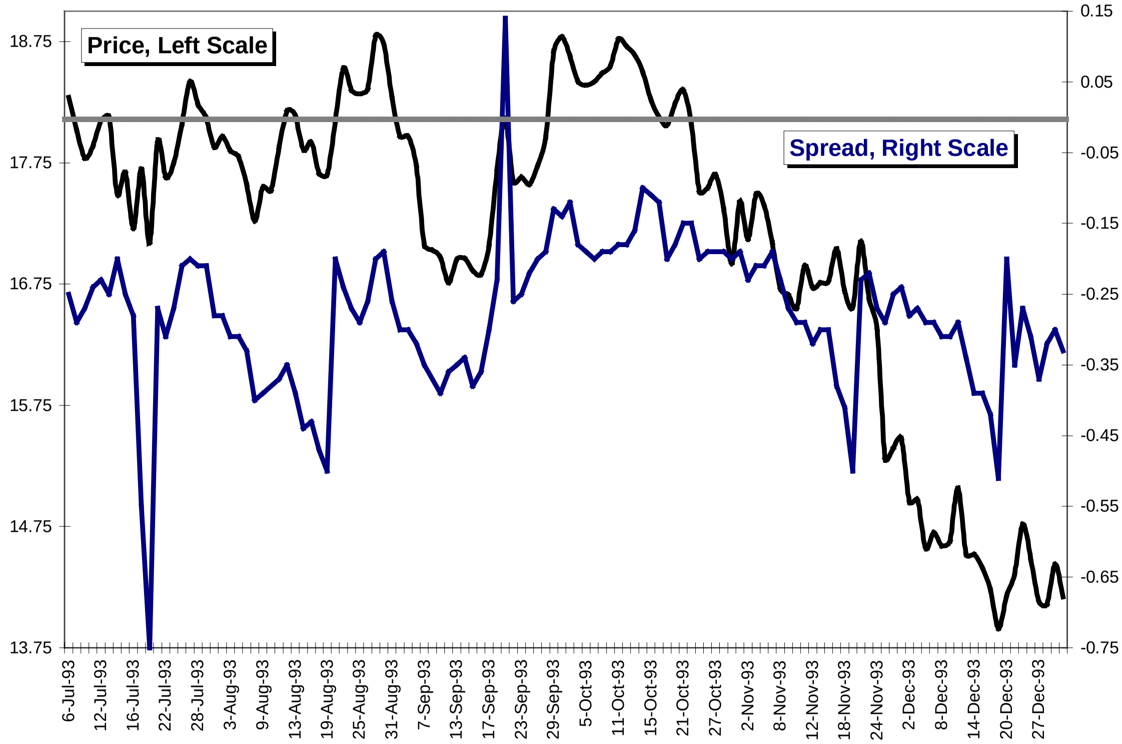
While the price paths for the three years began at markedly different levels, they converged by early March. While the price path for 1990 continued to weaken, 1993 and 1997 continued to track each other closely through early May and in June.

The intermonth spread graph for the three years also shows a strong degree of tracking between the three years. Both 1990 and 1997 collapsed from strong backwardation in the late winter to contango by spring. While the contango in 1990 continued to deepen, the spreads in 1997 continued to oscillate between contango and backwardation, but track the 1993 levels from mid-

May onwards. The firmer spreads in 1997 are probably a result of the refining industry's deliberate decision to operate on minimum inventory levels.



How far will this analogy between 1993 and 1997 extend (let's hope that the second half of 1990 remains a unique market)? At the early July time of this writing, it is impossible to know. However, the second half of 1993 was ugly for the petroleum market. The spread stayed in contango except for a brief period in September, and the price collapsed through $14.00 per barrel by year-end.


Price, Left Scale
Spread, Right Scale
18.75
17.75
16.75
15.75
14.75
13.75
0.15
0.05
-0.05
-0.15
-0.25
-0.35
-0.45
-0.55
-0.65
-0.75
6-Jul-93
12-Jul-93
16-Jul-93
22-Jul-93
28-Jul-93
3-Aug-93
9-Aug-93
13-Aug-93
19-Aug-93
25-Aug-93
31-Aug-93
7-Sep-93
13-Sep-93
17-Sep-93
23-Sep-93
29-Sep-93
5-Oct-93
11-Oct-93
15-Oct-93
21-Oct-93
27-Oct-93
2-Nov-93
8-Nov-93
12-Nov-93
18-Nov-93
24-Nov-93
2-Dec-93
8-Dec-93
14-Dec-93
20-Dec-93
27-Dec-93