

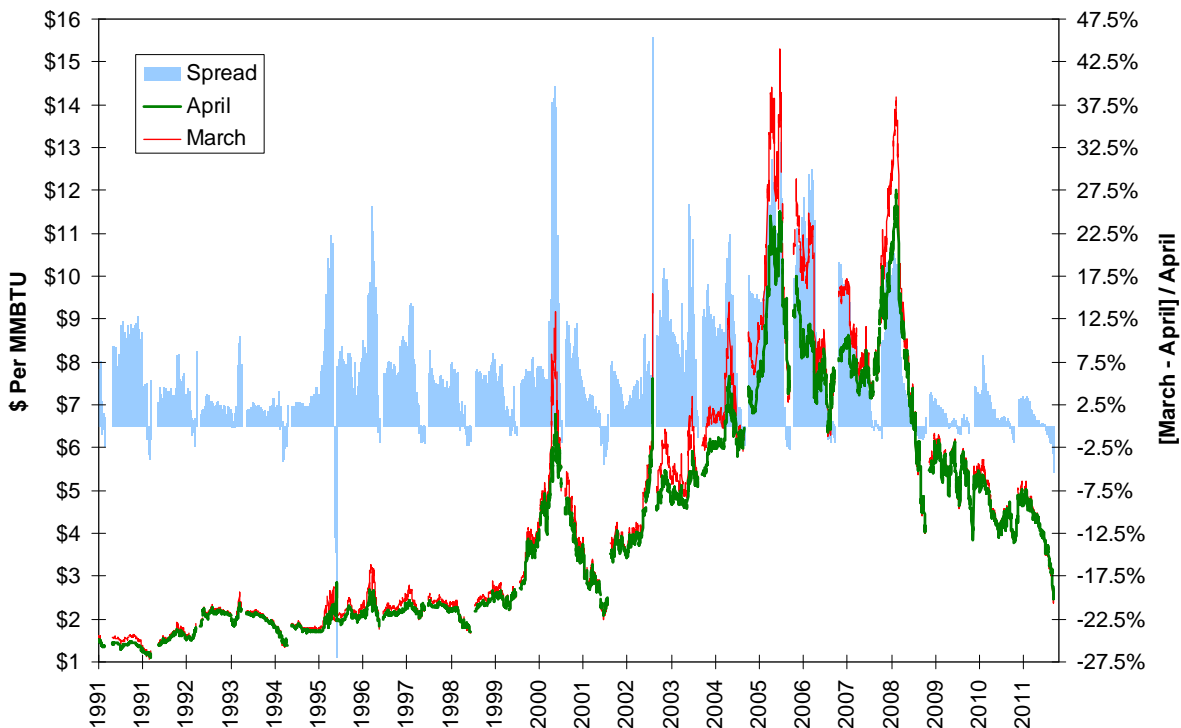
The Natural Gas Widowmaker Should Be Tame In 2012

The March-April Spread Often Blows Out At Winter's End

When something is called "The Widowmaker," it deserves respect. Like "The Black Death" or "Virgin's Sorrow," you just sort of assume the name did not arrive or stick by accident.

The Widowmaker trade in natural gas is the spread between the March and April futures contracts. If the winter was a long and cold one, which has not been the case in 2011-2012, a burst of cold weather in February with more of the same expected in March – please remember the March contract expires at the end of February for delivery in March – will push March to a premium over April. As anyone short March either has to deliver or cover, and being long April is of no use at such time, the premium can get pretty nasty, well over 20% in many instances. I have depicted the entire history of this spread going back to 1991 below.

The March - April "Widowmaker" Trade

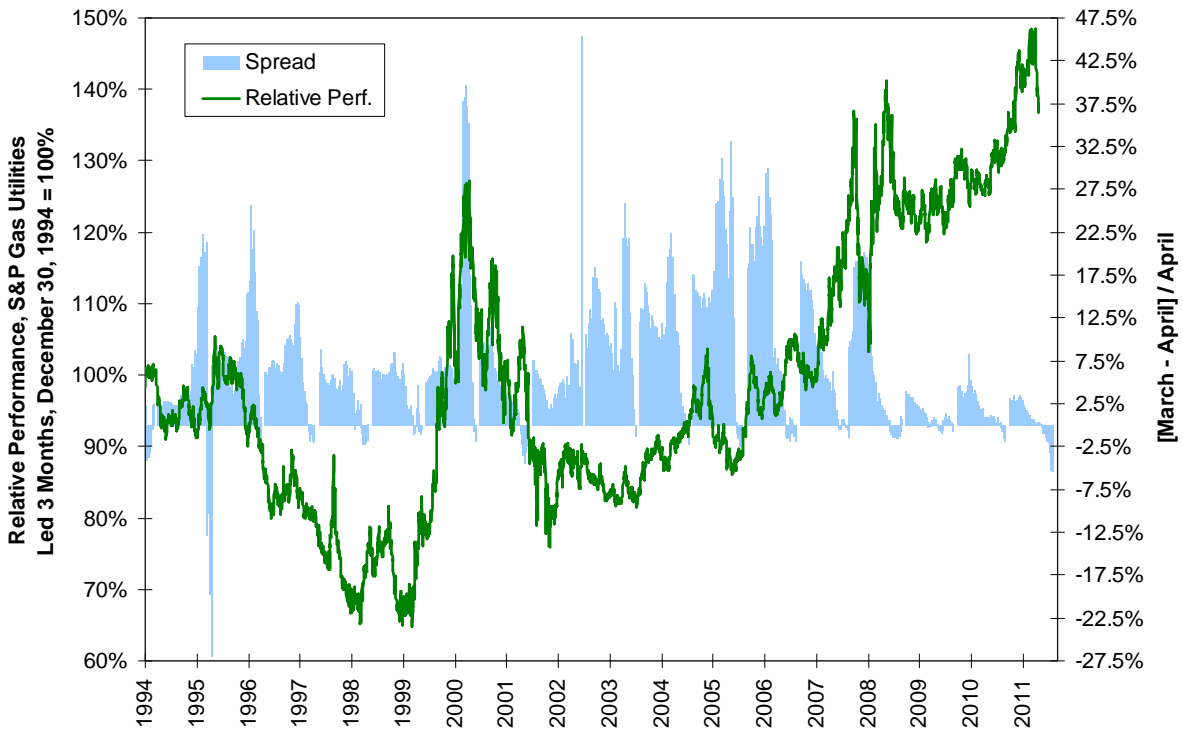


With the notable exception of 1996, we seldom see a normalized discount greater than this year's -5.5% at the time of this writing. Of course, there is a very good reason: The increase in natural gas production and the mild winter have led to a glut of storage. The Department of Energy figures show inventories in the key Eastern Consuming region are running 20.76% ahead of year-ago levels. It would take a freeze of Biblical proportions to lead to a Widowmaker, but preparation for the unexpected makes the trade. Moreover, if you do not get a chance to emplace this trade in 2012, you can use a refrigerator magnet to keep it in mind for 2013.

Stock Market Impact

Now here is a surprise for those of you who believe in market efficiency: The relative performance of the S&P 1500 Gas Utilities index, which includes firms such as Laclede Group (LG), National Fuel Gas (NFG), ONEOK (OKE) and Southwest Gas (SWX) vis-à-vis the S&P 1500 Supercomposite index lags the Widowmaker by three months on average. The gas utilities issues chase the Widowmaker; they do not lead it.

Gas Utilities Arrive Late To The Widowmaker's Party



There is one other surprise about the relative performance of the Gas Utilities index: It underperformed significantly in the late 1990s when Enron was leading the way in trading the newly deregulated power markets. Enron led others down its path and then blew up at the end of 2001. Stare at the chart above and note when the relative performance of Gas Utilities took off to the upside. Razzle-dazzle and financial engineering did not serve the industry well; going back to basics did. There is a lesson here for us all.