THE HIGHTOWER REPORT
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SPECIAL REPORT
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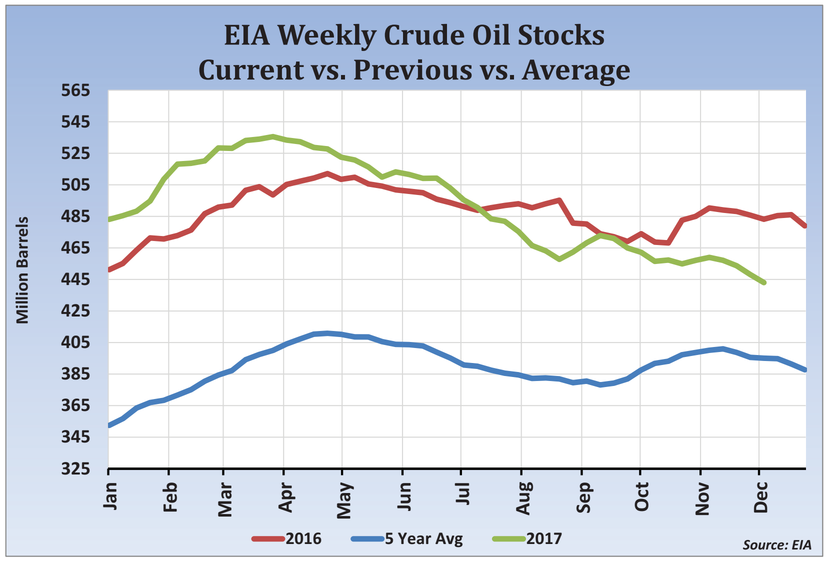
Energy Markets
Shift from "Balancing" to "Tightening"

The world energy markets appear to be capable of holding a very large portion of the gains they have made since June, some $16 per barrel in crude oil, $0.55 per gallon in gasoline (RBOB) and $0.56 per gallon in ultra-low sulfur diesel (ULSD). The world has seen nearly 2 million barrels worth of US oil production come online, and the major oil producers have countervailed that negative by holding back on production, which they are extending to at least June 2018. An amazing example of symmetry of the world oil market is the fact that as the US has seen its daily oil exports approach 1.80 million barrels per day, the OPEC oil production cutbacks are close to US oil production gains of the last two years.



The swing factor that should tighten the world oil market further is the gradual, consistent expansion in global growth. The commensurate increase in global energy demand has been confirmed by evidence of rising imports into China, India and areas that not typically involved in the world markets.

Further evidence of the shift from a "balanced" market towards one which is "tightening" can be seen in the weekly US Energy Information Agency (EIA) inventory statistics. As of the December 13th report, crude oil stocks were at a 40 million-barrel deficit to year- ago levels, gasoline stocks were 3.6 million barrels lower, distillates were 27.8 million barrels lower, and ultra-low sulfur diesel showed a deficit of 20.4 million. Even more surprising is the fact that the distillate deficit has grown as far as it has this heating season despite a pattern of above-normal temperatures. It is possible that expectations of a La Niña-inspired "cold" winter in North America are providing a bullish underpin for prices.

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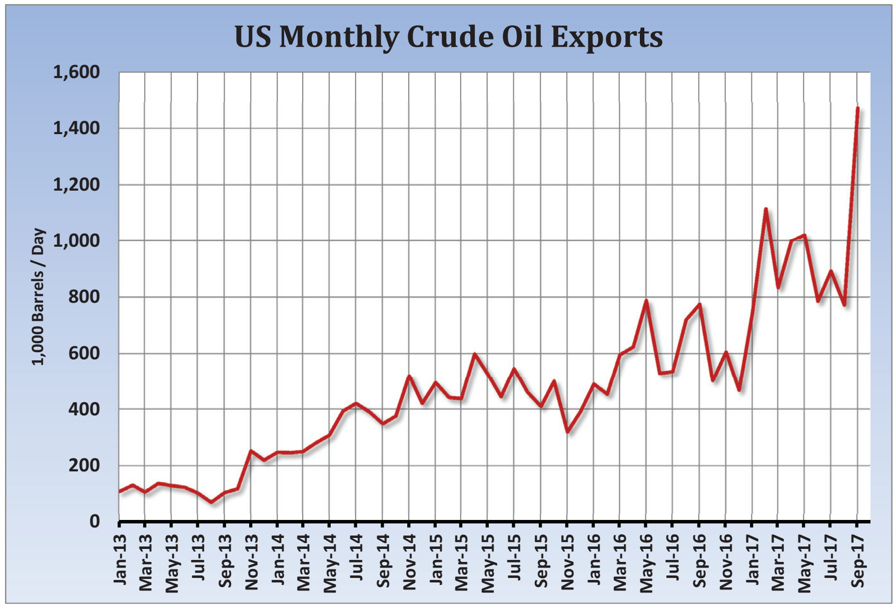
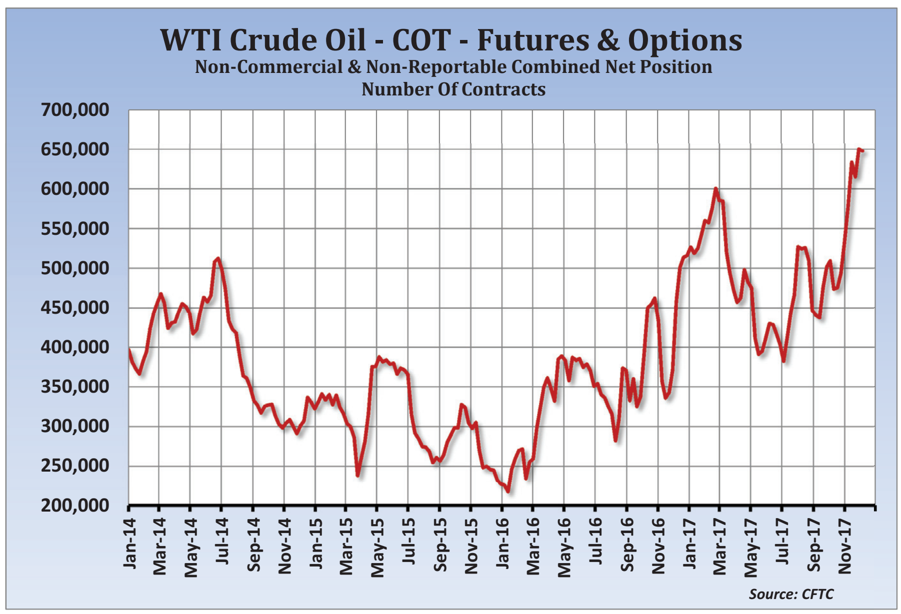
Issues that could spark some profit-taking and fresh selling are the report from the EIA that US production reached a new all-time high at 9.7 barrels per day in November, upward revisions in the growth of US production for 2017, and increases in the production forecasts for US 2018. (The EIA is now looking for US oil production to increase by 780,000 barrels per day in 2018, up from a previous forecast calling for a 720,000 barrel-per-day increase.)

From an intermediate term perspective, crude oil and heating oil are expensive and vulnerable to normal, corrective action into the year end, but the prognosis for the first quarter of 2018 remains upbeat. Oil producers have continued to show strong compliance with their agreed-upon production cuts, and many global oil consumers have clearly shown a newfound preference for US oil. US crude oil exports continue to rise much faster than expected, and for the first time ever US seaborne exports of crude were larger than US seaborne exports of oil products. In many cases the US is clearly stealing market share from OPEC and other global oil producers. Apparently the oil producers are content to give up some market share in exchange for moderately higher pricing.





Short-Term Perspective

Prices have come charging back from the lows in July and are giving off the impression that the world oil market is indeed "tightening" instead of merely balancing. However, in clawing its way above $57.50, crude oil has burned a significant amount of speculative fuel and will probably see a year-end correction due to position-balancing. The most recent Commitments of Traders report showed non-commercial and non-reportable traders combined had a net long position of 639,757 contracts, a new record!

A standard retracement of the fourth-quarter rally would give February Crude Oil a downside target of $55.10 and perhaps $54.51. In a similar fashion, February ULSD could see a normal retracement down to $1.84, and February RBOB could see a normal retracement down to the $1.62.

We suspect energies will finish the year with lower action, which in turn will provide an opportunity for some bargain hunting early in the new year. A well-known investment banking concern has already suggested that energy prices and other commodities will see gains in 2018. A soft finish to the year following the stellar performance in the second half of 2017 could easily result in energies receiving additional fund allocations in the annual rebalancing.

Suggested Trading Strategies

1) BUY February Crude Oil at $54.51. Use an objective of $58.10 on the trade, and risk the position to $52.01.

2) BUY February ULSD at $1.8520. Use an objective of $1.9830, and risk the position to a close below $1.8330.

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