

# Calls for \$105 Oil May Have

## *A Joe-Duarte.com Retrospective*

by Doctor Joe Duarte

Joe-Duarte.com & IntelligentForecasts.com

date, 2005

### **Editor's note:**

In early April, Goldman Sachs shocked Wall Street when its oil analysis group predicted that the price of oil would rise to \$105 per barrel.

The events since then have proven the report to be wrong, at least in the short term.

As of April 18, 2005, oil prices, after having risen to \$58 per barrel, were testing the \$50 area, and looked to be heading lower.

No one can predict any price trend with certainty. But such dramatic calls are often reliable signs that a change in the price trend is possible.

Below is a detailed set of excerpts from Doctor Joe Duarte's daily Market IQ column that looks at the oil markets in detail in the context of the Goldman Sachs analysis and its potential repercussions for global markets.

### **April 1, 2005 - Goldman Sachs Analysis Raises Questions**

Goldman Sachs is expecting oil prices to rise to \$105, with gasoline reaching \$4 per gallon, in what it calls a "super spike" scenario. The brokerage report was good enough to keep the U.S. stock market from adding a second day to its rally, and to raise crude oil prices back over \$55, despite the latest supply figures, released one day earlier, noting that U.S. crude oil supplies are at their highest level since July 2002.

According to Reuters, Goldman saw it like this: ["`We believe oil markets may have entered the early stages of what we have referred to as a ``super spike" period -- a multi-year trading band of oil prices high enough to meaningfully reduce energy consumption and recreate a spare capacity cushion only after which will lower energy prices return."]

In other words, Goldman is predicting that something will happen, which in turn will lead to the "super spike," and eventually will lead consumers to ride bicycles long enough for oil prices to fall. Indeed, according to Reuters, "Goldman pointed out thin spare capacity in the energy supply chain, and long response times for bringing on supply additions, as well as robust demand in the United

States and in developing heavyweights China and India, despite the recent rapid increase in energy costs.”

What makes the analysis somewhat questionable, in our opinion, is that the oil markets move more on supply than demand. Second, as we note above in our Starting Points section, the global economy is starting to slow. With OPEC still pumping full tilt, if the global economy slows, then demand will likely slow. To us it sounds as if the potential for an oil glut, not a catastrophic shortage is at least as likely a scenario. To be sure, there is still plenty of demand, especially in China and India. There is also a bottleneck in U.S. refinery capacity. And yes, the world is different after 9/11.

But, you'd think that at \$55 plus dollars per barrel, the market would have priced in a whole lot of stuff, already.

In fact, there are some things in the timing and content of the announcement that have a bit of a nasty ocean breeze smell to them.

According to Reuters: “Goldman Sachs is the biggest trader of energy derivatives, and its Goldman Sachs Commodities Index is a widely-watched barometer of energy and commodities prices.”

In fact, as we pointed out, in this space, on March 2, Wall Street is becoming Oil Street. In that report, we noted that Morgan Stanley was now a leading physical trader of oil, and that the Wall Street Journal had reported that the firm now owns power generation plants, and is a leading provider of electricity.

In that same report, we noted that Goldman Sachs, according to the Wall Street Journal, had “recently bought 30 electricity-generating plants.” We also noted, Morgan Stanley has had huge success in oil, which according to the journal has generated over \$1 billion in revenues and some \$700 in pre-tax profit to the firm in 2004. Indeed, oil, according to the Journal provided as much as 6.5% of Morgan's revenues in 2004.

Others are jumping in the fray as well, including, Goldman, as we noted above, and Merrill Lynch & Co., Credit Suisse First Boston as well as Citigroup.

But, Goldman, may have something of a conflict here, since on 3-21, it bought a privately held wind energy company in Houston. According to a report on newstarget.com, Goldman bought “Zilkha Renewable Energy, a Houston-based wind-energy development company. Zilkha, a privately held company, is currently developing wind power units that will create 4,000 megawatts of power harnessed from the wind. Goldman-Sachs says that it is dedicated to renewable energy and their purchase of Zilkha makes them a big player in the United States' renewable energy market.”

Goldman also has some developing issues, and may possibly be headed for a rough patch, as it is being sued by China Aviation Oil Singapore. According to a 3-18 report by Xinhua “China Aviation Oil Corp (CAO), which is struggling to stave off bankruptcy after losing US \$550 million in derivatives trading, has sued one of its creditors - Goldman Sachs Group Inc. Singapore-listed CAO accused J. Aron & Company, a Goldman Sachs' commodity division, of [“misrepresentation, negligence, breach of statutory duties and/or deceit”] in contracts.”

The report added: ["The company is seeking damages from J. Aron or a rescission of two agreements entered into between the company and J. Aron for the restructuring of the company's options portfolio in January and June 2004."]

More interesting, is the fact that according to Xinhua, traders in Singapore think that CAO should have sued Goldman earlier, suggesting that some close to the situation feel that there is more to the CAO losses than meets the eye.

In Indonesia, Goldman has had an ongoing problem largely ignored by the U.S. media. According to the Hong Kong Standard, on 3-4: "Goldman Sachs Group colluded with Indonesia's state oil company, Pertamina, to ensure Frontline buys two supertankers for as much as US\$56 million (HK\$436.8 million) below the market price in July 2004, the country's anti-monopoly agency said."

Goldman was fined \$15.76 million by Indonesia, a levy that came in close proximity to another fine, in which Goldman was fined \$1 million by the NASD in a case that involved withholding IPO information from the market.

According to the Standard: "Bermuda-based Frontline, the world's biggest oil-tanker owner by capacity, agreed in June to buy two very large crude carriers from Pertamina for US\$184 million. The tankers are being built by Hyundai Heavy Industries of South Korea. The tankers were worth between US\$204 million and US\$240 million in July 2004."

Both Goldman and Pertamina are appealing the decision. But reports in the Asian and European press noted that Indonesia's KPPU, the antitrust agency for the country, "said the tanker sales had caused the state to lose up to \$50 million as the market price of each VLCC (very large crude carrier) was between \$120 million and \$150 million."

## **Conclusion**

Goldman Sachs is a big player in global energy. The company has had a recent run on fines and difficulties with global regulatory agencies.

Goldman is also a big player in derivatives, especially energy. CAO Singapore is alleging that it basically got bad advice from Goldman, and that the \$550 million dollar loss was Goldman's fault.

To be sure, CAO Singapore, and Indonesia's government watchdog for antitrust dealings are not necessarily the poster children for transparency and honest deals. There is plenty of evidence that irregularities go on behind the scenes in all markets around the world. Witness Enron, MCI, and now the proceedings with insurance giant AIG.

There is no proof that Goldman's dramatic oil call is anything but the result of the honest work, and genuine opinion of its energy analyst group. And we are not alleging any wrongdoing on the part of the company.

But, at a time when the company is having energy related issues in Asia, in light of its big role in derivatives, and while it is in the midst of a big push into physical energy, traditional and otherwise, it is a bit unusual for such a call to come out.

One thing is certain, though. It would be interesting to see oil spike up dramatically, and Goldman suddenly start touting its wind energy company.

More interesting is the fact, that when CNBC asked the lead analyst to appear on Squawk Box, the analyst refused.

This may be nothing but a bunch of coincidences. But, in the world of derivatives and really large sums of money, loose threads can sometimes combine to make a nasty and scratchy sweater. When such a sweater gets wet and shrinks, it can become a straight jacket.

If Elliott Spitzer wants to interview Warren Buffet, by gosh, anything is possible on Oil Street.

Just something to keep an eye on, as oil moves.

#### **April 1, 2005 - Oil Market Summary And Outlook: Goldman Rocks Oil Market. IEA To Publish Emergency Manual.**

There is an underlying feeling in the market, largely unsubstantiated at this point, that the global oil supply is in danger, and that a major shortage could develop at any time.

But according to the most recent data from the API and U.S. Energy Information Agency, crude oil supplies are rising. OPEC is pumping full tilt. And the global economy maybe slowing. But, somehow, oil prices are going to \$105 per barrel, according to Goldman Sachs.

The International Energy Agency is also concerned. According to Reuters: "Highlighting anxiety among consuming nations over supply shortages and rocketing prices, the International Energy Agency (IEA) is set to advise importers to adopt emergency oil-saving policies if daily global supplies fall by 1-2 million barrels, the Financial Times said on Friday."

Crude prices remained above \$55 on the Goldman report, and oil and energy stocks recovered recent losses. But there was no huge price spike in the commodities, and there were no new highs on the stocks or energy indexes.

That means that the next few days are going to be crucial, as we look for the emergence of an up trend in energy, in response to the Goldman report, or other developments.

We're not saying that Goldman's report is wrong. But, we wonder what the big investment bank knows, given the fact that it's a big player in oil derivatives, and a rising player in physical energy, as it owns electric companies and has now purchased as wind energy company.

Refineries seem to be more of a problem. Aside from last week's explosion at Texas City, a major Venezuelan refinery was shut down in the last couple of days due to a power failure.

Refineries in the U.S. are operating at near full capacity. Meanwhile gasoline and heating oil supplies are falling.

According to Marketwatch, "Distillate demand is up 4.6 percent from year ago levels, and jet fuel, which is included in the distillate category, is up 10.8 percent from last year at this time, said Phil Flynn, senior market analyst at Alaron.com."

Retail prices for regular unleaded gasoline are now well above \$2 per gallon in the U.S., setting nearly weekly records. A leading gas station in Dallas, that we pass by on a regular basis was selling supreme unleaded for \$2.35 per gallon on 3-31.

One thing is certain, oil is at a major inflection point. And the price volatility likely to continue.

#### **April 5, 2005 Oil Market Summary And Outlook: Analyst Calls For \$28 Oil.**

Market Analyst Tim Evans of IFR Energy Services told the Associated Press that he expects crude oil prices to fall to \$28 per barrel this summer. Evans is obviously at the opposite end of Goldman Sachs, who last week predicted oil to rise to \$105 per barrel, but did not give a specific time frame for the development.

Evans, laughingly describing himself as being on the "lunatic fringe," makes some valid points. According to AP, his rationale is as follows: "today's crude oil prices above \$50 a barrel reflect nothing more than a market bubble fed by speculation and unwarranted fear." And his opinion is fairly well summarized by the following: "the world's oil supply is sufficient to meet demand, that motorists will soon show that they're not willing to pay any price for gasoline, and that the market is unreasonably receptive to worst-case-scenario thinking."

Prices eased slightly overnight, with crude trading below \$57 per barrel in electronic pre-U.S. action. Energy stocks rallied for most of the day on Monday but reversed course at the end, something you don't like to see if you're bullish on the sector.

Supply data is out tomorrow. If the recent trend remains in place, we'll continue to see a buildup in crude supplies, and declines in gasoline, and heating oil, as the refinery bottleneck continues to add to the situation.

We tend to agree, at least in principle with Evans, and have noted so in this space many times. Oil prices will come down at some point, although it is hard to predict when.

At the current time, we are again noticing that crude made new highs last week and that oil stocks did not confirm them, meaning that once again we are seeing that old technical divergence appear. We like to see oil stocks lead the price of crude, or at least confirm new highs in the commodity.

To be sure, this remains a bull market in oil until proven otherwise, given the fact that crude futures recently made new all time highs, and that key support levels, such as the 50 day moving average for the June contract remain intact.

Investors should remain wary of the oil market, and should use extreme caution in any exposure there.

Editor's note: The above reports appeared on [www.joe-duarte.com](http://www.joe-duarte.com) and [www.intelligentforecasts.com](http://www.intelligentforecasts.com).

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